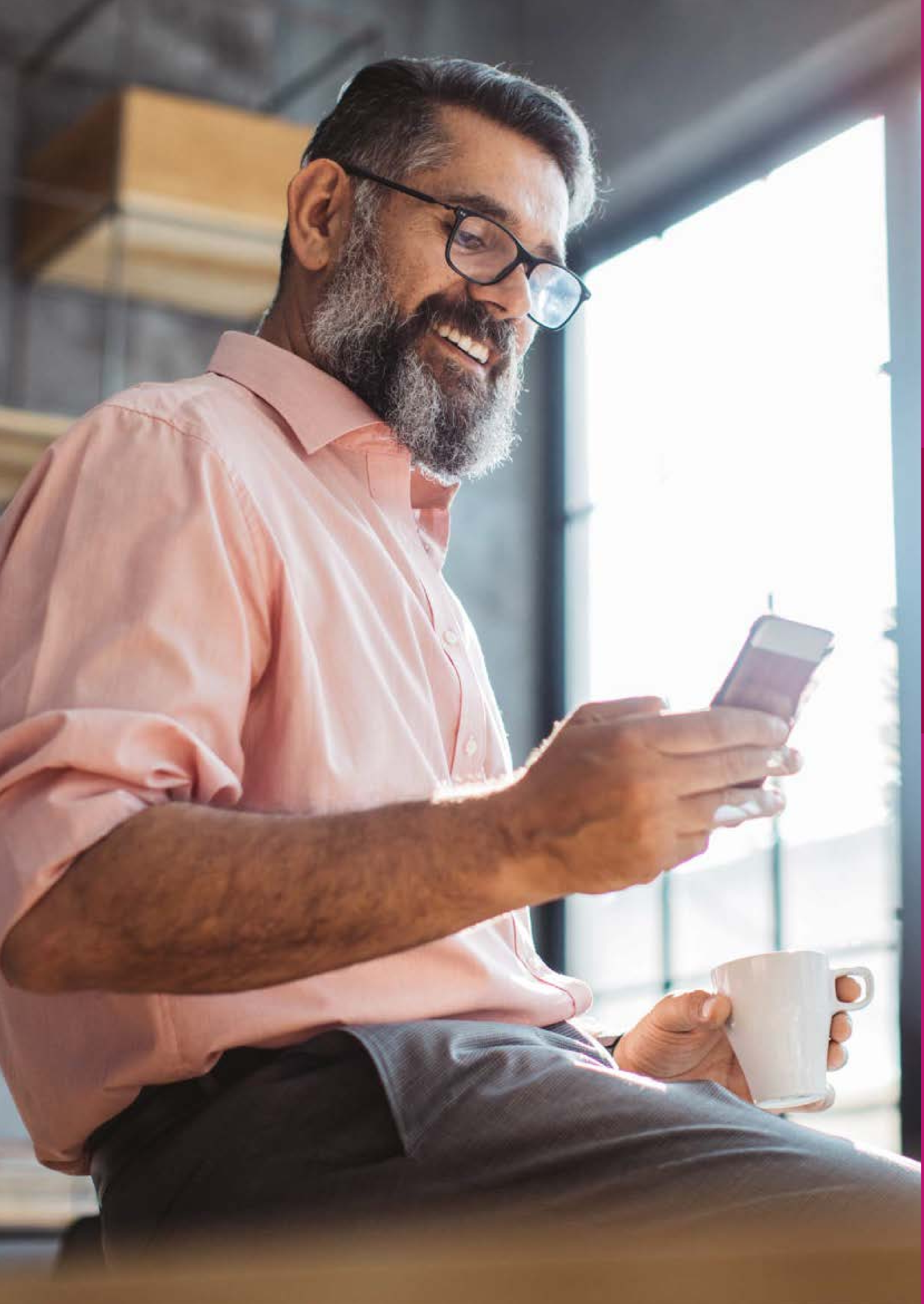
Annual Report & Accounts

2018

SKIPTON BUILDING SOCIETY
Since 1853

Contents



1 Performance and Strategy

2018 Group Highlights

Key performance highlights

1,010,426
Society Membership

Society membership increased by 91,366 (9.9%) to 1,010,426 (2017: by 58,657 (6.8%) to 919,060)

£16.1bn
Savings Balances

Savings balances grew by £1.1bn to £16.1bn, an annual growth rate of 7.7% (2017: 6.2%)

94%
Customer Satisfaction

Society net customer satisfaction was 94% (2017: 92%)

89%
Employee Engagement

Society employee engagement was 89% (2017: 88%)

£188.2m
Group Profit

Total Group profit before tax (PBT) was £188.2m (2017: £200.1m)

£1.6bn
Mortgage Book Growth

The mortgage book grew by £1.6bn to £18.2bn, an annual growth rate of 10.0% (2017: 8.3%)

£186.1m
Underlying Group PBT

Underlying Group PBT (as defined on page 24) increased by 12.3% to £186.1m (2017: £165.7m)

32.9%
Group Common Equity Tier 1 Ratio

The Group Common Equity Tier 1 ratio remained strong at 32.9% (2017: 33.2%)

Awards won

The Sunday Times Top 100 Companies to Work For

UK Customer Experience Gold Awards:
Best customers at the heart of everything
Best new improved product or service
Best financial services – banking and investments

Which? Recommended provider for both mortgages and savings

What Mortgage Award 2018 Best National Building Society

"I am grateful to everyone who works at or with Skipton Building Society, to the communities where we operate, but most importantly to you our members for entrusting us to help you buy your home and save for your life ahead."

Chairman's Statement

I am pleased to report another successful year for our Society. As the Society is owned by you and not shareholders, we were able to continue to deliver real value to you, maintain our financial strength and invest in new services for the future. We helped more people to buy their homes and to save for their life ahead than ever before, with membership increasing to an all-time high of one million. This achievement is due to the hard work of all those who work for the Society and I am very grateful to them for everything they did this year.

In my last report to you, I talked about how since 1853 our purpose has been to help more members have homes, save for their life ahead and support their long term financial well-being. David Cutter's report covers in detail how our Society has continued to fulfil its purpose in 2018. During the year we have been pleased to welcome almost 7,000 new members from Holmesdale Building Society following our merger with them on 1 October 2018.

In particular, you will see from David's report how our Society has enhanced its mortgage product range to enable more people to buy their first homes, increased the number of Lifetime ISA (LISA) members to 129,707, enabling younger people to save for their first home or retirement with support from the Government, and invested in its financial advice and digital services which are increasingly valued by members. Importantly, we delivered to our savers 0.59% better interest rates than the market average for banks and building societies (based on the CACI Current Account & Savings Database). These are amongst many tangible examples of how we have delivered value for our members leading to membership reaching record levels.

Competition in the mortgage market intensified in 2018 as a result of new lenders entering the market and others seeking to increase market share. This has been coupled with a lower number of housing transactions, house price growth moderating, particularly in London and the South East, as prices are not affordable for many, and buy-to-let property investment becoming less attractive as a result of stamp duty and other tax changes. The increased competition has resulted in mortgage interest margins declining during 2018. Our response has been to continue to invest in areas which will make us more efficient and improve the services offered to members such that we stand out from the competition. We were delighted to see the UK's largest independent consumer body recognise our efforts by listing Skipton as a Which? 'Recommended Provider' for both mortgages and savings accounts.

Connells, our estate agency subsidiary, produced another good result despite a tough UK housing market. The reduced number of housing transactions in the market as a whole did have an impact on Connells' profits but its diversified business which includes, alongside the estate agency, the provision of surveys and valuations, financial advice, property lettings management and services to new homes developers, continued to perform well and deliver good returns. In addition, Skipton International, our business based in the Channel Islands, delivered a strong performance through its focus of providing competitive savings products, helping people to buy homes in the Channel Islands and also a growing business of helping expatriates buy or remortgage residential investment property in the UK.

During 2018, a revised Corporate Governance Code was published placing more focus on relationships with employees and other stakeholders, culture, succession and diversity, and remuneration. At its simplest, the Code is about helping guide long term business success. We regard our clear sense of purpose about how we make a positive difference to society and our cultural values that ensure we do the right thing for our members and our employees as being fundamental to this. These values are at the foundation of our business along with ensuring that we maintain a strong financial position and resilient business so that we can help more members both now and in the future and provide a safe home for our members' savings. This seems particularly relevant in the context of the current complex Brexit negotiations, which makes defining an exact vision of the future UK economy more challenging than normal, as well as the current global political issues and trends. It is difficult to anticipate the outcome of the Brexit withdrawal discussions and the nature of the future trading relationship with the European Union and, whilst we are well prepared for all eventualities, the potential impact on economic growth, employment and the housing market will be carefully monitored so that we can respond appropriately.

As a mutual owned by members, with a focus of delivering to current and future members, and without the presence of shareholders with their greater focus on maximising profit, we can, and do, make different judgements in the way we seek to balance the interests of all our stakeholders. These judgements, including, for example, the interest rates we offer to members on their savings, the way we reward and invest in our people, the way we invest and grow, and how we support the communities we operate in, are all informed by regular feedback and measurement, and consideration of economic and political trends and what feels right in the context of our purpose and member ownership.

Not having shareholders also shapes our culture. Our people are focused on what you need to help you own a home or save for your life ahead and not on selling you a service. Our values of one team, taking ownership and trust underpin how we do business. We want our people to enjoy coming to work and to be engaged, involved and able to contribute to business decisions and to feel a sense of ownership for the services that are delivered to you. This culture is demonstrated by our peoples' focus on supporting the communities where we operate and the charities we partner with. In 2018 we continued to support Alzheimer's Society and Alzheimer Scotland which we supported with our *Miles for Memories* national fundraising campaign, raising over £79,000. Our Sustainability Report shares with you more of our activities and how we are aligning our future commitments to the UN's Sustainable Development Goals which are a blueprint to achieve a better and more sustainable future for us all or, in our words, build a better Society.

During 2018, we have continued to work on building a more diverse organisation, which represents the communities we operate in and our members, with the objective of enabling all of our people to achieve their potential. Whilst our mean gender pay gap for the whole organisation of 29.8% (as per our latest gender pay reporting published in March 2018) is lower than the banking industry average, we have more to do to achieve the right balance and fairness, and we are taking a number of steps to create better outcomes.

We recognise the high level of trust you place in us to do the right thing for you, our members. We welcome feedback from all of our members whether it is via our branches, by telephone, email, social media or through your AGM votes and letters. This feedback is important as we make the judgements and trade-offs that influence our Society in the future. Your board is very focused on ensuring that it has insight to, and challenges effectively, all aspect of our business in compliance with the highest standards of governance and reflecting the interests of all its stakeholders. In this context, thank you to Marisa Cassoni who retires from the Board after six years, during which time she has chaired our Audit Committee with great distinction, and we extend a warm welcome to Heather Jackson who has recently joined the Board as a Non-Executive Director.

I am grateful to everyone who works at or with Skipton Building Society, to the communities where we operate, but most importantly to you our members for entrusting us to help you buy your home and save for your life ahead.

Robert East
Chairman

26 February 2019

> “These are another set of strong results for Skipton Building Society, and I’m really proud that we now serve over one million members.”

Group Chief Executive’s Report

The political scene in 2018 was dominated by Brexit, in particular the UK’s negotiations over the withdrawal agreement with the EU, and the reactions to it within Parliament. Britain’s high streets went through a continued period of change, with big name closures and the UK Bank Base Rate saw its second rise in the last 10 years. Job growth however has remained strong thus far, with employment at record levels and wage growth rising above inflation.

It is against this backdrop that it is pleasing to report a very strong performance by Skipton Building Society when measured against a multitude of metrics. 2018 was another year of pleasing performance in many ways. Underlying Group profits before tax increased by 12.3% to £186.1m, with statutory profits reducing by 5.9% to £188.2m, whilst we maintained a strong Common Equity Tier 1 ratio of 32.9% and grew our membership to over one million members.

The growth in members was driven by the success of the Society’s Cash Lifetime ISA, the first such product launched by any provider in response to the Government’s savings initiative, which attracted 85,948 new members during the year. We also welcomed almost 7,000 new members through the Society merging with Holmesdale Building Society on 1 October 2018.

Performance highlights in 2018 include:

- The Society continued to grow with a 91,366 (9.9%) increase in members to 1,010,426;
- Total balances held by Cash LISA customers were £602.4m at the end of 2018 (2017: £74.9m), and these customers benefitted from £116.1m of government bonuses paid during the year;
- Group profit before tax (PBT) was £188.2m, 5.9% below 2017 (£200.1m);
- However underlying Group PBT increased by 12.3% to £186.1m (2017: £165.7m);
- Mortgage balances grew by £1.6bn to £18.2bn, a growth rate of 10.0% (2017: by £1.3bn, a growth rate of 8.3%), including £139m of balances arising on the merger with Holmesdale Building Society;
- Savings balances grew by £1.1bn to £16.1bn, a growth rate of 7.7% (2017: by £0.9bn to £15.0bn, a growth rate of 6.2%), including £122m of balances arising on the merger with Holmesdale Building Society;
- The Group net interest margin remained relatively stable at 1.09% (2017: 1.10%), whilst net interest income increased to £241.2m (2017: £220.6m), an increase of £20.6m (or 9.3%);
- The Common Equity Tier 1 (CET 1) ratio at 31 December 2018 was 32.9% on a transitional basis (2017: 33.2%);
- The leverage ratio was 6.2% (2017: 6.1%) on an end-point basis, comfortably ahead of the regulator’s expected minimum of 3%; and
- The Liquidity Coverage Ratio was 203% (2017: 179%); well above both the regulatory limit of 100% and the Board’s internal limit.

Unwavering focus on our members

We are continually working hard to ensure our customers have the best experience during any interaction with the Society to ensure they achieve their dream of having their own home or saving for their future. Our colleagues are committed to putting the customer first and providing excellent service. As a result we have continued to invest in our member offering and, through Skipton Link, we are now one of the few high street financial services providers to offer full mortgage and financial advice video appointments via branch, head office or home.

For savers, the Society paid an average savings rate of 1.29% during the year (2017: 1.21%), which was on average 0.59% higher than the market average for banks and building societies during 2018 (2017: 0.52% higher) (source: CACI Current Account & Savings Database for the 12 months to 31 December 2018).

We have also continued to refurbish our branches and continued to invest in developing the skills of our colleagues, with every branch colleague now fully competent in identifying financial advice needs. In 2018, the Society achieved a net customer satisfaction rating of 94% (2017: 92%).

One of the achievements that we are most proud of over the past 12 months is Skipton’s success at the prestigious UK Customer Experience Awards 2018, winning gold in three categories, which included the ‘Best customers at the heart of everything’ award. This category showcases organisations in all sectors who ensure that, at every step of the way, customers are at the forefront of their thinking.

Delivering through our people

A key factor in the Society’s strong performance seen during the period and the ongoing high satisfaction of our customers is our people. The Society is focused on ensuring its people are highly engaged and motivated to deliver a great experience for our customers both now and in the future. In June 2018, the Society achieved an employee engagement score of 89% (2017: 88%), well above financial services industry norms.

The Society retained its Investors in People Platinum standard which is the highest level of the accreditation, with only 2% of accredited organisations in the UK achieving this as at 1 February 2019.

Also, for the fifth year in a row, the Society was included in *The Sunday Times* Top 100 Companies to Work For.

Enabling our members to achieve home ownership and save for their life ahead aspirations

In 2018 we continued to enable more people to save for their future and finance their own home. And we are proud of our award-winning achievements in 2018 that demonstrate our commitment to this; we became a Which? ‘Recommended’ provider for both savings and mortgages (one of only two firms to do so) and we were named ‘Best National Building Society’ by What Mortgage? for the fifth year running, a tremendous achievement.

The Society helped 26,734 homeowners (2017: 25,979) to purchase or remortgage their properties, including 5,516 first time buyers (2017: 4,540) and 1,036 (2017: 1,498) through participation in the Government’s Help to Buy equity loan scheme. The Group’s net residential UK mortgage lending accounted for 4.0% of the growth in the UK residential mortgage market (2017: 3.0%), compared to our 1.2% share of UK residential mortgage balances (source: Bank of England statistics, December 2018).

The Society entered the shared ownership market during the year, whilst in July 2018 it re-entered the 95% loan-to-value market, giving more people, including first time buyers, the opportunity to step onto the housing ladder

Group Chief Executive's Report *(continued)*

sooner than they may have expected. £949.8m, or 21.9%, of the Group's gross lending during the year was on buy-to-let mortgages (2017: £824.1m or 18.4%).

The growth in the Society's savings balances in the year accounted for 2.5% of the growth in the UK deposit savings market (2017: 1.9%), compared to our market share of savings balances of 1.1% (source: Bank of England statistics, December 2018).

Strong performance in the Mortgages and Savings division

The division produced a PBT of £114.3m, compared to £89.1m in 2017, an increase of £25.2m (or 28.3%), predominantly as a result of the £15.0m loss on disposal of non-performing or recently non-performing loans recorded in 2017. The division reported an underlying PBT of £112.7m, up from £105.3m in 2017, an increase of 7.0%.

When expressed as a percentage of mean assets, the Group net interest margin (which is almost entirely generated from the Mortgages and Savings division) remained relatively stable at 1.09% (2017: 1.10%), whilst net interest income for the division increased by £19.2m, which is a key driver in the increase in PBT in the division. We do however expect margins to come under pressure in 2019 as competition within the mortgage market remains intense. The cost income ratio of the division was 56.3% (2017: 57.1%), whilst the management expense ratio of the division was 0.68% (2017: 0.72%).

Further information on the performance of the Mortgages and Savings division can be found in the Strategic Report on page 28.

Good performance from estate agency in a difficult market

Connells, our Estate Agency division, reported profits of £56.9m (2017: £65.7m excluding a gain on the disposal of shares in ZPG Plc). Underlying PBT was £59.7m (2017: £64.9m), reflecting a robust performance in a continuing difficult UK housing market.

The volume of housing transactions in the UK fell again in 2018 and consequently the number of house sales arranged by Connells fell by 7% during the year (2017: fall of 4%). However, lettings income increased by 5% (2017: 9%), financial services income by 10% (2017: 13%) and survey and valuation income by 2% (2017: 5%), reflecting the diverse revenue generating activities carried out by the Connells group. At 31 December 2018, Connells operated 586 branches (2017: 591).

Further information on the performance of the Estate Agency division can be found in the Strategic Report on pages 28 and 29.

Other subsidiaries

Skipton Business Finance, a provider of debt factoring and invoice discounting to small and medium-sized enterprises, recorded a PBT of £3.8m (2017: £3.5m); and Jade Software Corporation, the provider of the Society's core database and software development language, and provider of digital solutions and large enterprise IT solutions to a number of other clients, recorded a PBT of £3.8m (2017: £1.2m).

Further information on the performance of these subsidiaries can be found in the Strategic Report on page 29.

Conclusion and outlook

These are another set of strong results for Skipton Building Society, and I'm really proud that we now serve over one million members. We also saw continued good growth in our mortgage and savings balances whilst maintaining a strong capital base.

Looking after people's savings and enabling home ownership is at the very heart of what the Society does as a mutual building society. I firmly believe that our long term focus of being there to help people plan for their life ahead is resonating with our members.

2019 is going to be an interesting time not only across the political landscape as the Brexit deadline looms but with the effect that it may have on the UK economy and house prices. The ongoing political uncertainty is clearly causing some buyers and sellers to take a wait-and-see approach when it comes to the property market. Should there be a no-deal Brexit there would be no immediate significant impact on the Society but we would be cautious regarding the potential medium to longer term implications arising from possible movements in house prices, unemployment or bank base rates.

We currently anticipate that profits in 2019 will be lower than 2018 due to a combination of ongoing pressures on mortgage and savings margins, and the continuation of a subdued housing market. However, the political and economic uncertainty highlighted above makes forecasting difficult and creates a need for caution.

We remain vigilant regarding potential economic headwinds, but with the strong capital and liquidity position we have continued to build during 2018, we are well placed to manage the risks that we may face and to capitalise upon any opportunities that may arise for the benefit of our members.

David Cutter

David Cutter
Group Chief Executive

26 February 2019

Strategic Report

Skipton Building Society is the UK's fourth largest building society, with £23bn of assets and over one million members.

The provision of mortgages, savings and financial advice is core to the delivery of our purpose, which is to help more people into homes, help people save for their life ahead and support long term financial well-being.

*This in turn supports our core vision of **"Building a better Society"**, delivered through our core values of 'Trust', 'Ownership' and 'One Team'.*

The business model

As a mutual organisation, the Society is owned by its members. The Society's business model centres on providing a secure place for our members' savings and the provision of loans to our borrowers to enable people to buy their own homes. We also source funding from the wholesale markets, which diversifies our funding base and improves our financial stability. In addition, we support a growing rented housing sector by providing buy-to-let mortgages to landlords. Our business model is strengthened by the provision of high quality financial advice, enabling us to offer guidance to our customers on their journey to and through retirement.

The difference between the interest received from our borrowers and on liquid assets and the interest payable to our savers and on wholesale funding forms our net interest income. This income, together with other income mainly from the provision of financial advice, covers any impairment losses, provisions, tax expenses and operating costs including paying our people. Our mutual status means we do not pay dividends, since we do not have any external shareholders. Therefore, our remaining profits are reinvested into the Society for the long term benefit of our members; to support growth, help us to maintain a sustainable business model and preserve a strong capital position to protect members in the event of an economic downturn.

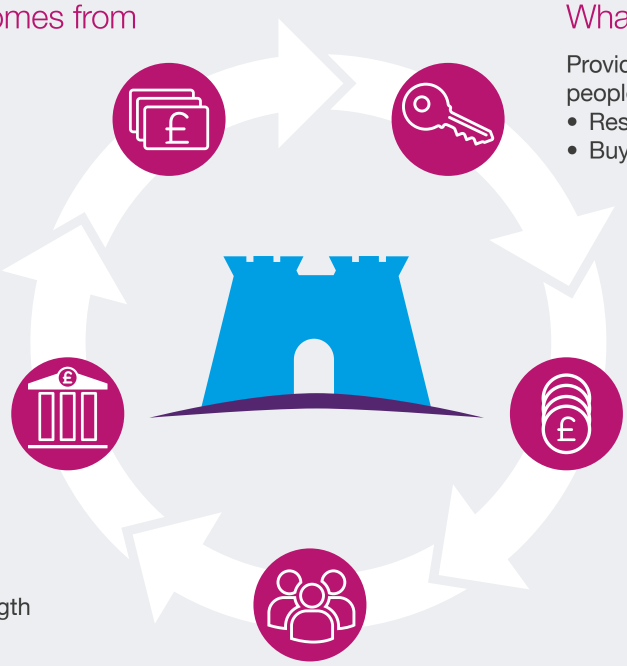
The Society's business model can be demonstrated as follows:

Where the money comes from

- Members' deposits (82%)
- Wholesale markets (18%)
- Retained earnings from previous profits in the Society and dividends from our subsidiaries

What we do with it

Provide mortgages to help people into homes:
- Residential mortgages (80%)
- Buy-to-let mortgages (20%)



How we generate income

- Net interest income
  - the difference between the interest received from our borrowers and on our liquid assets, and the interest payable to our savers and on wholesale funding
- Other income
  - provision of financial advice and other financial products and services

What we use our profits for

- Enhancing the customer experience
- Investing in the future of the Society
- Maintaining capital strength

What we incur costs on

- Paying our people
- Property and operating costs
- Mortgage and other impairment losses
- Paying taxes

Strategic Report *(continued)*

The Society is at the head of the Skipton Group, which comprises the following divisions:

Mortgages and Savings division

The Mortgages and Savings division is the core of the Group's business model, predominantly comprising the Society. On 1 October 2018 the Society merged with Holmesdale Building Society, which presented us with a great opportunity to welcome almost 7,000 new members and add a new branch in Reigate to our network.

The division also includes Skipton International Limited (SIL), which carries out mortgage lending in the Channel Islands and the UK and accepts deposits in Guernsey. Our specialist lending businesses, Amber Homeloans Limited (Amber) and North Yorkshire Mortgages Limited (NYM), which both ceased lending in 2008, are included in the division along with the Group's special purpose vehicles, formed to acquire funds from the wholesale markets, and the intermediate holding company Skipton Group Holdings Limited (SGHL).

Estate Agency division

The Society holds a significant presence in the estate agency sector through the Connells group (99.9% holding), which includes property sales, surveys and valuations, conveyancing, lettings, asset management and mortgage and insurance broking. The Society's capital position is reinforced by dividends from the Connells group, which are invested back into the Society for the benefit of our members.

Investment Portfolio

The Group holds interests in a small number of companies comprising the Investment Portfolio, including Skipton Business Finance (a provider of debt factoring and invoice discounting to small and medium-sized enterprises) and Jade Software Corporation (a software solutions provider based in New Zealand that specialises in digital solutions and large enterprise IT solutions, and assists in the development of the Society's core technology).

Strategy and objectives

Our strategy is to differentiate on service and to provide long term value to our members through the products we offer. We aim to develop deep mutually beneficial relationships, delivered in an efficient manner by our people and our processes, in order to deliver a great customer experience. Our intention is that our members select and stay with us not only because of the products and service they receive but also for our values, quality of service, the provision of easily understood products and services, depth of relationship and the ease by which they can interact with us through all channels.

Our people are critical to delivering our strategy and we will ensure that the Society has skilled, engaged and high performing people who deliver the human touch, and we will optimise the balance between risk and reward in order to build a sustainable future.

We remain committed to mutuality because we believe it is in the best interests of our current and future members. This means we are not required to pay dividends to shareholders. Instead we have developed objectives to support the above strategy and to ensure we are generating sufficient profits to maintain a strong capital position. This allows us to take long term decisions to invest in the development of the business for the benefit of our current and future members, whilst keeping our purpose at the heart of everything we do.

The Society's approach to delivering our purpose and vision is through respect for our people and customers, our environment and the communities in which we operate.

Employee matters

The Society places the well-being of its people in the highest regard and has a number of policies in place to ensure that their working environment is one of respect and where they are valued. These policies include, but are not limited to, a flexible working policy, a career break policy, a carer's leave policy, a diversity policy, a family friendly policy and a health and safety policy. The Society also has a modern slavery policy which fully supports the objectives of the Modern Slavery Act 2015, further details of which can be found at skipton.co.uk/about-us/governance. In 2018 the Society has introduced mental health first aiders across the business as an area of support for our colleagues and their well-being.

These policies are drafted by appropriately qualified experts and monitored on an ongoing basis to ensure they remain fit for purpose. For further details of the recently introduced framework on diversity and inclusion and our diversity policy, see page 21 of this report and page 53 of the Corporate Governance Report. We continue to focus on diversity and inclusion throughout the Society, which includes the use of gender balanced interview panels and we are reviewing balance within our shortlists.

The Society is committed to ensuring that there are no instances of bribery or corruption across any area of our business. We have an anti-corruption and anti-bribery policy in place, drafted in line with government guidelines, which prohibits the offering, giving, solicitation or the acceptance of any bribe to or from any person or company by any individual employee, agent or other person or body acting on behalf of the Society. The policy is readily available for all employees to view on our internal intranet and we require our employees to receive annual refresher training regarding the policy to ensure they can recognise and prevent the use of bribery by themselves and others. The Society has focused senior leaders in the business on this topic which coupled with our strong culture across the business and our geographical locations means that we focus on doing the right thing for our customers.

Social matters

We are committed to encouraging and enabling our people to participate in activities, and to help them learn vital skills, to help the Society deliver benefits to the communities in which we operate and contribute to Building a better Society.

We have a vulnerable customer policy in place to ensure that we treat all our customers fairly throughout the whole customer lifecycle, regardless of their personal circumstances or characteristics. We recognise that customer vulnerability can happen at any time and in some cases cannot be predicted. It is therefore essential that we have the appropriate policies, procedures and trained people to help identify and support our customers in a sensitive and empathetic manner through any periods of vulnerability.

The Society's charity partnership is with Alzheimer's Society and Alzheimer Scotland and the Society-wide drive to support our charity partners has resulted in many of our colleagues becoming 'dementia friends', attending sessions to improve their understanding of dementia and, as a result, they are better equipped to support people who are affected. Our association with these charities clearly links to our culture and supports the Society's purpose. This year Miles for Memories was an internally led fundraising activity which involved our people in Head Office and every branch across the Society and led to over £79,000 being raised for Alzheimer's Society and Alzheimer Scotland.

The Society also has a volunteering policy in place to encourage our people to take two days per year to participate in volunteering activities to benefit the community.

For more information, including activities we have undertaken during the year to demonstrate our commitment to making a positive change to our society, which includes our commitment to four specific goals as part of the United Nations' Sustainable Development Goals, see our Sustainability Report on pages 34 to 38.

Environmental matters

We realise that as a responsible business we have an obligation to operate in a manner that minimises our impact on the environment. We have a high regard to how we impact our environment and follow all relevant environmental legislation in carrying out our business. Further information on how we are performing against our commitment to environmental matters can be found on page 37 in the Sustainability Report.

Our business relationships

We closely monitor all our business relationships that allow us to provide our customers with excellent service across the range of products and services we offer. We assess, on an ongoing basis, any risk of an adverse impact on our customers, our people and the environment in which we operate as a result of these relationships, or as a result of our policies. This includes detailed due diligence processes with all our business suppliers to ensure the values of the Society in respect of the above matters will not be impeded by any business relationships we enter into.

The Society has regard to the above matters as part of our risk assessment processes; a full description of our principal risks and how we manage these is found in the Risk Management Report on pages 62 to 69.

The Society's medium term objectives are built around the following four pillars: Our Customers, Our People, Our Proposition and Our Financial Strength.

Our Customers

Our customer strategy is to put the customer at the heart of our business, providing a compelling and differentiated proposition that resonates with our customers and makes them want to become and remain Skipton customers. Key to our strategy is the sustainable growth of the Society's membership, bringing the benefits of membership to an increasing number of people. In 2018 we hit the significant milestone of increasing our membership to over one million members.

Our strategy is based upon a deep understanding of the needs of our customers gained through research, customer feedback and analysis. We use the insight this provides us to continuously refine, develop and improve the products and services we offer.

Our core target savings and investment customers are those saving for a new home (including our Lifetime ISA (LISA) customers) or planning for and moving through retirement. We are focused on ensuring we have a compelling proposition to meet the needs of these customers which includes offering a broad and attractive range of savings products, together with access to financial advice to support investment and pension planning. This year, we have undertaken a review of our financial advice strategy to identify opportunities to enhance our services and make them accessible to a wider range of customers. This includes developing a more competitive proposition and ongoing service which can be tailored to individual needs, which is due to be rolled out in 2019.

2018 has seen continued success in attracting LISA customers to the Society. We were the first provider to launch a cash LISA in 2017 and at the end of 2018 had over 129,000 LISA customers and over £600m of LISA savings balances. LISA fits perfectly with our purpose as a building society – helping customers aged 18 to 39 to save to own their own home or for their future needs in retirement. Our LISA customers benefitted from £116m of government bonuses in 2018, helping to boost their savings and help them towards achieving their ambitions. We know from research that almost 90% of our LISA customers are saving with the objective of

Our Customers *(continued)*

buying their first home and we are well placed to help them on this journey through the provision of help, advice and suitable mortgage products.

We continue to provide good value mortgages together with excellent personal service, to both our direct mortgage customers and intermediary partners, as well as providing buy-to-let mortgages to landlords to support the rented housing sector. In 2018 we have sought to increase the attractiveness of our mortgage offer to first time buyers with the re-introduction of lending up to 95% loan-to-value and the launch of shared ownership mortgages following a rigorous assessment by our Credit Risk team. We see these enhancements as being particularly important in supporting the home ownership aspirations of our growing LISA customer base.

Following the merger with Holmesdale Building Society in October, we have been able to expand the range of products and services available to former Holmesdale members.

A review of performance in the year against our customer strategy is set out on pages 19 and 20.

Our People

Our people strategy is to ensure we have knowledgeable, highly skilled and engaged colleagues, who work collaboratively across channels, to deliver a great experience for our customers both now and in the future.

We continue to invest in our people and our culture, ensuring alignment to the delivery of our purpose and our vision of ‘Building a better Society’. Our culture is defined as one that is customer-focused and based on our mutual values of One Team, Trust and Ownership. We embed these values into all aspects of people management including recruitment, induction, development, performance management and remuneration. We know through our employee opinion surveys that our people understand what is expected of them, believe in our values, are able to contribute to our success and enjoy working for the Society.

One of the aspects setting our service apart for our members is our human touch and we ensure that a focus on members, people and relationships is at the heart of our culture. We create a learning culture and develop our people to deliver our customer propositions, building deep and lasting relationships with our customers and colleagues. We enable our colleagues to demonstrate the knowledge and expertise needed to provide support and advice for our customers now and in the future. We seek to attract, develop and retain a diverse range of talented colleagues, reflecting the communities in which we operate.

We develop leadership capability, to allow current and future leaders to grow and adapt their leadership skills and create the right culture for now and the future. We offer a number of leadership programmes to give them the tools they need to deliver our strategy and lead change effectively across the business. We invest in developing the skills needed in the future in a variety of ways such as apprenticeships, career development programmes and succession planning.

Our reward strategy is an important part of retaining the right skills and experience and reinforcing our culture. Ensuring we always deliver a fair outcome for our customers will remain at the forefront of our minds and so we ensure that any remuneration package relating to performance encourages the right behaviours and customer outcomes. We are committed to ensuring our rewards are future focused and relevant to all demographics and life stages of our colleagues.

We seek to design an organisation that is fit for the future. This includes developing the roles, skills and organisational flexibility for a changing world, ensuring that our work is rewarding for our people and creating a great experience for our customers. We have a keen eye on the capabilities we require to continue to deliver for our customers.

A review of performance in the year against our people strategy is set out on pages 20 and 21.

Our Proposition

Our proposition seeks to provide good value products and consistently excellent service to our customers however they choose to interact with us.

Our savings, mortgage and financial advice propositions are all based on continually striving to understand what is important to our customers; listening to their feedback and ensuring that the products and services we offer are aligned with their needs. Our savings and financial advice proposition focuses on helping our customers save for life ahead and supporting their long term financial well-being, whilst our mortgage proposition focuses on building strong relationships with our mortgage customers and intermediary partners in order to help more people into homes.

A key strategic objective is to provide customers with choice as to how they engage with us: face-to-face (branch or home-based advice), through Skipton Direct by telephone, video, social media and web-chat, or online, in order that they experience a high quality, empathetic and personalised service. We continually look for better ways to make every customer interaction value-adding, easy and efficient to ensure we delight our customers however they choose to engage with us. We have recently set up a 24/7 fraud telephone helpline to ensure our customers have access to support at all times.

Investment in enhanced digital capability continues to be a particular area of focus to support and drive improvements to the customer experience. Key initiatives underway include the development of a customer app, the roll out of digital customer signatures and new mortgage affordability and decision in principle calculators, all of which are due for launch in 2019.

To ensure our branch network is evolving with the changing needs of our customers, we have continued to refurbish our branches and invested in increasing the skills of our colleagues so that they can deliver the services our customers value. For example, we are currently testing a new branch format in a number of branches and every branch colleague is now fully competent in identifying financial advice needs.

A review of performance in the year against our proposition strategy is set out on page 22.

Our Financial Strength

Our financial strength objective is to maintain our strong capital position in order to be here for our members over the long term. We do this by sustainably growing our mortgage and savings balances, supplemented by dividends principally from our estate agency business, whilst applying strong cost control and a prudent approach to risk management.

We continue to grow our mortgage and savings balances, with mortgage balances mostly funded by retail deposits in line with our mutual ethos. We continue to see less appetite amongst our savings members for longer term savings products, whereas longer term mortgage products are currently proving attractive to customers. We have therefore continued to respond proactively to our members’ needs, whilst also making greater use of longer term funding from the wholesale markets. This helps us to align the duration of our funding with the longer term mortgages our members are seeking, but also allows us to broaden our wholesale funding base and continue to offer competitive savings rates to our members. It is however also important to ensure that our funding costs are sustainable, allowing us to generate sufficient profits to maintain our capital strength for our current and future members.

The Group maintains sufficient levels of high quality liquid assets in order to support growth plans and recognise market uncertainty. Stress testing scenarios are regularly run to help ensure we remain within our liquidity risk appetite and meet all regulatory requirements. Extreme economic scenarios are also run to ensure our contingency plans remain robust.

Close management of our cost base is a key component of our financial strategy, and we will focus on driving efficiencies across all areas of our business in order to

Our Financial Strength *(continued)*

create capacity to invest in our people, processes and systems. This includes the use of robotics and other automated processes to increase the efficiency of our operations.

Proactively managing losses in our mortgage portfolios is also an important part of our objectives. We closely monitor and manage mortgages that have fallen into arrears and, where necessary, always aim to seek solutions that are appropriate for our borrowers and minimise the risk of the Society incurring financial loss.

The Group's investment in its subsidiaries, primarily Connells, remains a key part of our financial strategy, creating additional financial strength for the Society through the regular receipt of dividend payments.

A review of our financial strength is set out on pages 23 to 33.

Economic and market background

The current economic and political climate remains somewhat uncertain, with the nature of the EU exit deal and the future trade relationship of the UK with the rest of Europe and the world still unknown. This level of uncertainty has grown throughout 2018 and a range of possible outcomes exist, which may negatively impact the UK economy. In particular, business investment growth has slowed and inflation has impacted the price of exports. Job growth has however remained strong thus far, with employment at record levels, and wage growth has risen above inflation.

Whilst the Group's UK focus means it is not necessarily directly impacted by Brexit, wider economic changes could impact the Society and its subsidiaries. In particular, the Monetary Policy Committee may remain cautious about the pace of future interest rate rises, which may make it difficult for lenders to maintain sustainable margins, and any adverse impact on house prices and housing transaction volumes could impact the performance of the Group's mortgage portfolio and also the performance of Connells' business, which has experienced a difficult housing market over the last year. We continue to lend prudently and in a controlled fashion, managing impairment losses closely, whilst the diversified nature of Connells' business has meant that it has continued to perform well despite these pressures.

Depending on the outcome of the Brexit negotiations there could be an impact on the valuation of a number of the Group's assets and liabilities as a result of the wider economic changes. For example, the valuation of expected credit losses on our loans and advances could be impacted as it incorporates forward-looking economic indicators such as expected future house price movements and unemployment levels; the fair value of our equity release portfolio and the associated swaps are also sensitive to expected future house price movements and the rate of inflation amongst other factors; and the valuation of our pension deficit is impacted by asset values, discount rates and inflation rates. Sensitivity disclosures for each of these and other assets and liabilities are included in note 1t).

The potential impact of Brexit is discussed in the 'Conclusion and outlook' section of the Group Chief Executive's Report on page 12, and also in the Risk Management Report on page 64.

Elsewhere within the UK residential mortgage market, competition remains high and intensified further during 2018, with the availability of cheaper wholesale funding through the Government's Term Funding Scheme supporting low mortgage rates throughout the market. There is however a risk that reduced economic confidence or a fall in either house prices or rental yields could result in a reduced demand for mortgages, which may, in turn, trigger further mortgage margin compression as lenders respond to fewer opportunities to lend.

The Society does however remain in a strong position, with strong capital and liquidity ratios, healthy and sustainable growth seen in mortgage and savings balances and strong underlying profitability and is therefore well placed to serve both current and future members. Performance over 2018 is discussed in more detail on the following pages.

Performance in the year

We monitor our progress against our vision and strategic goals using a number of key performance indicators (KPIs), aligned to each of our strategic pillars. These indicators are reported to the Board and senior management on an ongoing basis and are key to the Board's management of the business and to its decision making process.

Changes to key performance indicators

During the year the Group has made two changes to the key performance indicators as reported within the Report and Accounts. The first such change is the addition of total member numbers to the metrics used to measure our performance against our customer strategy (see below). This reflects the Board's focus on this measure and links to the Society's purpose and vision.

The second change is that the Group now reports as a key performance indicator the Liquidity Coverage Ratio (LCR), rather than the liquidity ratio as a percentage of shares and deposit liabilities as in previous years. This reflects the increased prominence of this measure over recent years and the increased focus that management have given to this measure internally. In the opinion of the Directors this change better reflects the way in which the Group internally monitors and reports its liquidity.

Our Customers

Key Performance Indicator	Strategic Goal	Year	Value
Our Customers			
Total member numbers (Society only)	To ensure we are attracting and retaining members	2018	1,010,426
		2017	919,060
		2016	860,403
Growth in membership numbers (Society only)*	To ensure we are attracting and retaining members	2018	91,366
		2017	58,657
		2016	22,316
Increase in member savings balances (Society only)	To help more members save for their future	2018	£1,154m
		2017	£881m
		2016	£1,285m
Group gross mortgage advances	To help us to meet our goal of helping more people into homes through prudent and controlled lending	2018	£4,329m
		2017	£4,476m
		2016	£3,968m
Group net mortgage growth (note 1)	To help us to meet our goal of helping more people into homes through prudent and controlled lending	2018	£1,648m
		2017	£1,290m
		2016	£1,298m

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 70 to 87.

Note

1. With effect from 1 January 2018 this is measured excluding movements in the Group's equity release portfolio which, following the implementation of IFRS 9, is held at fair value (previously amortised cost; see note 1b) to the Accounts for further details). The comparative amounts for 2016 and 2017 have not been restated; if the comparative amounts were restated to exclude movements in the equity release portfolio, Group net mortgage growth would be £1,285m for the year ended 31 December 2017 and £1,296m for the year ended 31 December 2016.

Membership numbers

A key part of our strategy is to grow the Society's membership in a sustainable manner, bringing the benefits of membership to an increasing number of people going forward.

In 2018, Society membership numbers grew by 91,366 to take our total membership base to a record 1,010,426. The cash Lifetime ISA (LISA) has been a key driver in the growth in new customers to the Society. Over 85,000 LISA accounts were opened in 2018, bringing the total number of LISA customers to 129,707 at the end of 2018 and helping us to achieve the milestone of one million customers.

Mortgage and savings balances

We remain committed to our purpose to help more people into homes and to help them save for their life ahead by offering competitive rates and attractive products, whilst maintaining high levels of customer service.

We grew Group mortgage balances by 10.0% (2017: 8.3%) whilst maintaining our prudent credit risk appetite. Despite the highly competitive mortgage market, our mortgage growth in the year was significantly ahead of the UK residential mortgage market where net mortgage growth was 3.0% (source: Bank of England statistics, December 2018), which demonstrated our success in delivering mortgage products and services that are valued by both new and existing Skipton members.

Gross mortgage advances totalled £4,329m (2017: £4,476m) across the Group during 2018, with the small reduction in gross lending due to the intensity of competition within the mortgage market together with the impact of more stringent customer affordability criteria the Society introduced towards the end of 2017. During the year we helped a broad spectrum of homeowners, by offering loans requiring only a 5% deposit for first and next-time buyers, a targeted range of new-build mortgages including 'Help to Buy' equity loans and a suite of buy-to-let loans alongside our core mortgage range.

Strategic Report *(continued)*

In 2018 our savings balances grew by 7.7% (2017: 6.2%) compared to the UK savings market where net savings growth was 3.2% (source: Bank of England statistics, December 2018). We paid on average 0.59% higher interest than the market average for banks and building societies during 2018 (2017: 0.52%) (source: CACI Current Account & Savings Database).

We were pleased to be able to pass on in full to all our on-sale savings products the 25 basis points increase in Bank Base Rate announced in August 2018 by the Bank of England.

Our People

Key Performance Indicator	Strategic Goal		
Our People			
Employee engagement (Society only)* (note 1)	To ensure our people are passionate, loyal and committed	2018	89%
		2017	88%
		2016	90%

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 70 to 87.

Note
1. As measured by Willis Towers Watson, an independent company who provide benchmarking on employee surveys in both the UK and globally.

Employee engagement

Our people are fundamental to our success, and we are committed to providing a great environment for our people to work in, where their development and well-being is a focus of our employee ethos.

The delivery of the Society's people strategy is primarily measured by employee engagement which was at 89% when measured in June 2018. Sustaining high engagement is achieved through a range of activities reflecting all aspects of our people strategy including learning and development, recruitment and reward. We were also proud to achieve a place in *The Sunday Times* 100 Best Companies to Work For, for the fifth year running.

After 20 years of being an Investor in People, in 2017 the Society achieved the Investors in People Platinum accreditation and we again achieved Platinum status in 2018 following our annual reassessment. Only 2% of organisations with the Investors in People accreditation at 1 February 2019 have achieved this level, so we are delighted to have achieved this accreditation.

Training and recruitment

The majority of our branch and head office colleagues attended 'Building a better Society' and 'For Your Life Ahead Live' sessions in the year, enabling them to gain an even greater insight into our strategic priorities, values and culture and strengthen the connection to the customer across the Society. Our Networked Leadership Programme, launched in 2017, aims to develop strategic thinking and complements continued investment in leadership development programmes such as Modern Leaders and Skipton Leadership and Culture.

To support the delivery of our strategy we have invested in attracting the right people with the right skills into the Society. We have paid particular focus to the level of short term turnover seen within our branch network and within the contact centre, Skipton Direct. We have invested in our new-starter employee journey process with a new format being rolled out in 2018 along with further embedding flexible working arrangements in these areas to manage levels of employee turnover.

Diversity and inclusion

The Society believes that a diverse and inclusive culture is an integral part of its core values and is key to ensuring the Society delivers a great service to its members. This inclusive culture creates an environment where everyone is encouraged and able to fulfil their capability and potential, irrespective of their gender, ethnicity, any disability or sexual orientation. In order to focus on the underlying themes we have run 'unconscious bias' workshops across our Board and leadership population along with the Executive Committee continuing to lead areas of focus, together with involving a wide range of colleagues with a focus on gender, ethnicity, LGBTQ, flexibility and disability, which includes a focus on mental health. We aim to make further progress to ensure our people feel valued, respected and able to perform to their potential. We aim to provide a work environment that is safe and accessible, free from unfair treatment, discrimination and harassment and gives fair access to learning, development, reward and promotion opportunities. We have a range of policies and practices which support these aims and monitor their application. In relation to gender specifically, the Society would like to see a higher representation of women amongst its Senior Leadership Team, which is 35% at present. Initiatives to improve the Society's gender mix, and progress reports thereon, will be included in our Gender Pay Report, published annually.

At Skipton we believe that a balanced workforce is good for business. We are committed to the view that the more diverse, integrated and equal our senior leadership teams are, the fairer the working environment is, which in turn boosts creativity and productivity that better serves our customers.

In December therefore, we decided that the time is now right for us to join the Women in Finance Charter and that signing the charter would provide further focus and ensure that gender diversity and inclusion is a key objective measured alongside our strategic commercial objectives.

The number of employees of each gender employed in the Society and the Group as at 31 December 2018 is outlined below:

Society	Male	Female	Total	Percentage female
Executive Directors	4	-	4	**-**
Other members of the Society's Senior Leadership team	38	23	61	**37.7%**
Senior leadership team	**42**	**23**	**65**	**35.4%**
Non-Executive Directors	4	5	9	**55.6%**
Other employees	871	1,292	2,163	**59.7%**
	917	**1,320**	**2,237**	**59.0%**

Group	Male	Female	Total	Percentage female
Executive Directors (note 1)	4	-	4	**-**
Senior managers (note 2)	48	24	72	**33.3%**
	52	**24**	**76**	**31.6%**
Non-Executive Directors (note 1)	4	5	9	**55.6%**
Other employees (note 3)	4,079	5,361	9,440	**56.8%**
	4,135	**5,390**	**9,525**	**56.6%**

Notes
1. Society Board Directors only.
2. Consists of the Society's Senior Leadership team (other than Executive Directors) and the Executive Directors of the subsidiaries.
3. Including senior managers of the subsidiaries.

Enhanced reporting on diversity and pay by gender within the Society is available on our website, skipton.co.uk.

Strategic Report *(continued)*

Our Proposition

Key Performance Indicator	Strategic Goal	Year	Value
Our Proposition			
Society net customer satisfaction score* (note 1)	To ensure we are putting the customer at the heart of our business	2018	94%
		2017	92%
		2016	90%
Society Financial Ombudsman Service (FOS) complaints - change in outcome rate (note 2)	To ensure we are treating customers fairly	2018	22%
		2017	15%
		2016	21%

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 70 to 87.

Notes
1. As measured from an independent third party survey of 2,400 Society members. The net customer satisfaction score is calculated by subtracting the percentage of customers who are dissatisfied (those scoring satisfaction with the Society as 1-3 on a scale of 1-7) from the percentage of customers who are satisfied (those scoring satisfaction as 5-7 on the same scale).
2. For the six months ended 30 June 2018, being the latest available comparable market data.

Customer experience

Central to our strategy is to ensure a truly customer centric proposition, focusing on providing an excellent customer experience across all the ways our customers interact with us.

One of the ways in which we monitor the success of this is by measuring net customer satisfaction. We do this quarterly, using an independent third party to ask our customers about their levels of satisfaction with the service and products they have received. In 2018 net customer satisfaction was 94% (2017: 92%), demonstrating the continued delivery of high quality products and services to our customers.

Proof of our commitment to providing outstanding customer service came at the UK Customer Experience Awards 2018, which recognise 'inspiring organisations who deliver an outstanding customer experience'. We were delighted to receive three gold awards for *'Best New Improved Product or Service'* for the launch of our Lifetime ISA, *'Best Customers at the Heart of Everything'* for the introduction of our video appointment service, and *'Best Financial Services - Banking and Investments'*.

Whilst we strive to get things right for our customers first time, every time, we recognise that on occasion things can go wrong and our customers may have cause for complaint. We aim to deal with these complaints efficiently and with empathy, putting right what has gone wrong. A measure of our success in doing this is the proportion of the Society's complaints going to the FOS that have their outcomes changed. The Society's change in outcome rate for the first six months of 2018 was 22% (full year 2017: 15%). This compared favourably with the financial services industry average of 30% for the first six months of 2018, being the latest available comparable market data (source: FOS complaints data (resolved cases)).

Products and services recognition

Independent third party recognition of our products and services is a key demonstration of the value we are delivering to our members. We received a number of awards for the quality of both our products and service offered, including being one of only two organisations to receive *Which?* 'recommended' provider status for both savings and mortgages in 2018. We were also 'commended' as 'High Street Savings Provider of the Year' in the 2018 *Moneyfacts Consumer Awards*.

Our Financial Strength

The financial performance of the Society was strong during 2018 as we grew both mortgage and savings balances above the rates of growth of the UK markets and invested further in the future of the Society, all while reducing our management expense ratio and maintaining strong capital ratios and healthy levels of liquidity.

Key Performance Indicator	Strategic Goal	Year	Value	Discussed further
Our Financial Strength				
Total Group profit before tax	To ensure we generate the necessary capital to grow the business	2018	£188.2m	Page 27
		2017	£200.1m	
		2016	£168.9m	
Underlying Group profit before tax*	To ensure we generate the necessary capital to grow the business regardless of any costs or benefits not arising from the Group's ongoing trading operations	2018	£186.1m	Pages 27 and 28
		2017	£165.7m	
		2016	£151.5m	
Group net interest margin (% of mean assets)	To manage the earnings of our core Mortgages and Savings division	2018	1.09%	Page 25
		2017	1.10%	
		2016	1.18%	
Mortgages and Savings division cost income ratio* (note 1)	To maintain a manageable cost base to ensure the business remains efficient	2018	56.3%	Page 28
		2017	57.1%	
		2016	57.3%	
Mortgages and Savings division management expense ratio	To maintain a manageable cost base to ensure the business remains efficient	2018	0.68%	Page 26
		2017	0.72%	
		2016	0.75%	
Group residential mortgages in arrears by three months or more	To manage and monitor our arrears and credit risk management	2018	0.29%	Page 31
		2017	0.36%	
		2016	0.73%	
Liquidity Coverage Ratio	To ensure we hold sufficient levels and quality of liquidity	2018	203%	Page 30
		2017	179%	
		2016	170%	
Group retail funding as a % of total funding	To ensure we fund the majority of our mortgages through retail savings, in line with our customer proposition	2018	81.6%	Page 31
		2017	84.6%	
		2016	89.6%	
Group Common Equity Tier 1 ratio (note 2)	To ensure the Group remains financially strong by having a strong (risk weighted) capital base	2018	32.9%	Page 32
		2017	33.2%	
		2016	23.9%	
Group Leverage ratio (note 3)	To ensure the Group remains financially strong by having a strong (non-risk weighted) capital base	2018	6.2%	Page 32
		2017	6.1%	
		2016	5.9%	

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 70 to 87.

Notes
1. For the purposes of this ratio, costs and income exclude items that are not included in arriving at underlying Group profit before tax, as defined on page 24.
2. This ratio is calculated under the Internal Ratings Based (IRB) approach on a transitional basis; see page 32 for further details.
3. This ratio is calculated on an end-point basis; see page 32 for further details.

Strategic Report *(continued)*

Alternative performance measures

The Board monitors and reports profits at both a statutory level, governed by accounting standards and practices, and at an 'underlying' level. The Board uses underlying profit to measure the progress of the Group against its strategic objectives and uses this measure to aid in strategic decision making in relation to the operation of the Group's business activities. As per the Group's policy on alternative performance measures as agreed by the Board Audit Committee, the following items are excluded from statutory profit to arrive at underlying profit: gains or losses on disposal of Group undertakings, impairment of Group undertakings, gains or losses on disposal of mortgage assets, fair value movements in relation to the equity release portfolio, fair value movements in equity share investments and the Financial Services Compensation Scheme (FSCS) levy.

This reflects the Group's current strategy and business model and the majority of these items are generated from the Group's investments in other entities not considered to be part of the Group's core strategy, and are excluded from underlying profit on that basis. The other items listed above are excluded from underlying profit on the following basis:

- Fair value movements in relation to the equity release portfolio. The implementation of IFRS 9 with effect from 1 January 2018 has resulted in a significant change in accounting for this portfolio. Prior to IFRS 9, the equity release loans were held at amortised cost and the no negative equity guarantee (presented within loan impairment) was held at fair value. Where the Group uses derivatives to manage the risks associated with the portfolio, the use of hedge accounting was previously available to manage income statement volatility. Under IFRS 9, the Group's equity release portfolio is held entirely at fair value with resulting gains / losses taken to the Income Statement; the use of hedge accounting is no longer available for the equity release portfolio and, as a result, the Group is exposed to significant income statement volatility. Such gains / losses are therefore excluded from underlying PBT on the grounds that they are not reflective of the underlying trading performance of the business. This represents a new item excluded from underlying profit this year.
- The introduction of IFRS 9 from 1 January 2018 has also meant that fair value gains or losses on our equity share investments are now recognised through the Income Statement, whereas previously these were recognised through Other Comprehensive Income and only recycled to the Income Statement on sale or part sale of the investment. Our existing policy, as above, is to exclude any gains or losses from the disposal of Group undertakings and therefore fair value gains / losses on equity share investments are also excluded from underlying PBT. This represents a new item excluded from underlying profit this year.
- The FSCS levy in relation to the 2008/2009 banking failures (most notably Bradford and Bingley and the Icelandic banks) is added back to arrive at underlying profit as it is a significant cost borne by the Group as a result of the failure of a number of financial institutions and is not viewed as a long term ongoing cost to the Group. The payment made in 2018 represents the final payment to be made under the scheme for these particular failures and thus this levy is not expected to be a cost to the Group in future years.

Underlying profit therefore provides greater transparency of the performance of the Group's ongoing trading activities and improves the comparability of information between reporting periods.

The Group also reports a cost income ratio at a Mortgages and Savings division level, as shown in the table on page 23. Any items that are excluded from underlying profit are also excluded from the calculation of this ratio in order that this measure too provides greater transparency of the performance of the Group's ongoing trading activities and improves the comparability of information between reporting periods.

Financial performance

Underlying Group profit before tax for the year, as described above, increased by 12.3% to £186.1m (2017: £165.7m) as show below. Underlying PBT by division is shown on page 27.

	2018 £m	2017 £m
Total Group profit before tax	188.2	200.1
Less profit on disposal of subsidiary undertakings	(3.3)	(11.3)
Less profit on disposal of other Group undertakings	-	(39.4)
Less fair value gains in relation to the equity release portfolio (note 1)	(1.0)	-
Add back loss on disposal of mortgage assets	-	15.0
Add back fair value losses on equity share investments	0.3	-
Add back impairment of goodwill and equity share investments	2.5	0.1
Less / add back FSCS levy	(0.6)	1.2
Underlying Group profit before tax	186.1	165.7

Note

1. This is comprised of fair value losses of £17.1m as shown in the 'Fair value losses on equity release portfolio' line in the Income Statement, and fair value gains of £18.1m on the associated derivatives held to economically hedge these fair value movements, as shown in the 'Fair value gains on other derivatives' line in the Income Statement.

For further details of the profit on disposal of subsidiary undertakings see page 26.

A summary Group Income Statement is set out below:

	2018 £m	2017 £m
Net interest income	241.2	220.6
Net non-interest income	477.0	472.5
Fair value gains on financial instruments mandatorily held at FVTPL	1.2	1.5
Fair value movements in relation to the equity release portfolio	1.0	-
Profit on disposal of treasury assets held as available for sale	-	2.7
Loss on disposal of mortgage assets held at amortised cost	-	(15.0)
Profit on disposal of subsidiary undertakings	3.3	11.3
Profit on disposal of joint ventures	-	0.9
Profit on disposal of equity share investments	-	38.5
Dividend income from equity share investments	-	0.6
Share of profits from joint ventures	0.8	2.0
Total income	724.5	735.6
Administrative expenses	(521.0)	(523.1)
Operating profit before impairment losses and provisions	203.5	212.5
Impairment on loans and advances to customers	(2.5)	4.0
Impairment losses on debt securities	(0.1)	-
Impairment losses on equity share investments	-	(0.1)
Realised losses on the equity release portfolio	(0.7)	-
Provisions for liabilities	(12.0)	(16.3)
Total Group profit before tax	188.2	200.1
Tax expense	(40.6)	(41.9)
Profit after tax	147.6	158.2

The movements in the Income Statement during the year are attributable to the following key Income Statement items.

Net interest income

Our net interest income, the main source of income for the Mortgages and Savings division, increased to £241.2m (2017: £220.6m), which represents an increase of 9.3% from 2017. The Group net interest margin, a key profitability and performance indicator that measures net interest income as a percentage of mean total assets, remained relatively stable at 1.09% (2017: 1.10%). This highlights that, despite pressures on interest margins within the market, we were able to ensure that our net interest income increased at a similar rate to our mean assets during 2018.

The increase in net interest income was a result of recent rises in the Bank Base Rate, as well as higher mortgage balances held throughout the year. During 2018, we released a number of 95% loan-to-value (LTV) mortgage products, including an exclusive product to complement our lifetime ISA offering and help more first time buyers into homes. Since higher LTV mortgages carry more risk, we typically charge higher interest rates, contributing to the increase in Group net interest income. We have however seen continued pressures on mortgage margins within the industry and we expect this to continue.

In the market, we continue to see customers seeking shorter term savings and longer term mortgages. To offset to a degree the impact of this, we have made greater use of longer term funding from the wholesale markets, including through a covered bond programme, further details of which can be seen on page 31.

Net non-interest income

The Group's net non-interest income (or 'other income') by division is set out below:

	2018 £m	2017 £m
Mortgages and Savings	31.9	33.0
Estate Agency	428.5	417.4
Investment Portfolio	30.3	30.6
Inter-divisional adjustments^	(13.7)	(8.5)
	477.0	472.5

^ Inter-divisional adjustments relate primarily to the elimination of inter-divisional trading.

The majority of the Group's other income is generated by the Estate Agency division, which remained broadly in line with 2017, despite the increasingly difficult UK housing market. Details of Connells' performance can be found on pages 28 and 29.

The Mortgages and Savings division's net non-interest income, which is predominantly made up of financial advice activities, remained relatively constant at £31.9m (2017: £33.0m).

The Investment Portfolio's net non-interest income was also relatively stable at £30.3m (2017: £30.6m). The inter-divisional adjustments of £(13.7)m (2017: £(8.5)m) relate predominantly to income recognised in Connells in relation to fees paid by the Society to Connells for introducing mortgage customers and for surveys and valuations carried out by Connells for the Society and SIL. The corresponding cost to the Society and SIL is spread over the expected life of the mortgage product through net interest income.

Strategic Report *(continued)*

Fair value movements in relation to the equity release portfolio

Following the adoption of IFRS 9 with effect from 1 January 2018, the equity release portfolio is now held at fair value, with any fair value gains or losses taken to the Income Statement. The Group holds derivatives to economically hedge these fair value movements, which are also held at fair value. As these derivatives are not designated as being in a hedge relationship for accounting purposes under IFRS 9, fair value movements in the derivatives do not exactly offset the fair value movements in the portfolio, thus income statement volatility arises. For the year there was a fair value loss of £17.1m on the portfolio and an £18.1m gain on the associated derivatives. The net fair value gain of £1.0m is excluded from underlying profit, as shown in the table on page 24.

Profit on disposal of subsidiary undertakings

The profit on disposal of subsidiary undertakings during the year was £3.3m (2017: £11.3m).

The sale of HML to Computershare in 2014 included contingent consideration dependent on HML's performance over a period following the disposal. In May 2018 the contingent consideration receivable by the Group was finalised with the purchaser at £32.5m, which is £2.3m higher (undiscounted and before costs) than the amount estimated by the Group as at 31 December 2017. This is reflected in the profit recognised in the year of £3.3m (2017: £15.9m), which also includes the unwind of the discounted cash flows. The first instalment of £6.9m (before costs) was received by the Group in May 2018 and the discounted contingent consideration asset stands at £23.0m at 31 December 2018 (2017: £25.1m).

Administrative expenses

The Group's administrative expenses by division are set out below:

	2018	2017
	£m	£m
Mortgages and Savings	**148.7**	141.9
Estate Agency	**359.3**	345.5
Investment Portfolio	**24.6**	27.2
Sundry incl. inter-divisional adjustments^	**(11.6)**	8.5
	521.0	523.1

^ Sundry including inter-divisional adjustments relates to the elimination of inter-divisional trading and also includes the cost of the long term management incentive scheme for the senior managers at Connells Limited.

Administrative expenses across the Group reduced by £2.1m (0.4%) to £521.0m (2017: £523.1m).

During 2018, the Mortgages and Savings division maintained its focus on careful control of the cost base, which is reflected in an improved management expense ratio of 0.68% (2017: 0.72%). We achieved this improvement while continuing to invest in the future of the Society and enhance our member offering, with Skipton now one of the few financial services providers on the UK high street to offer full mortgage and financial advice video appointments via branch, head office or home. The Society also incurred one-off costs on the merger with Holmesdale Building Society, investing in a smooth transition for our new members.

Connells' administrative expenses of £359.3m increased by 4.0% compared with 2017 (£345.5m), which was in line with the movement in income year-on-year in a subdued housing market.

The movement in sundry / inter-divisional adjustments predominantly relates to the long term management incentive scheme in place for Connells' senior management; this was a credit of £4.2m compared to a £9.7m charge in 2017. The management incentive scheme cost is based on a number of assumptions relating to the performance of the Estate Agency division and is in place to retain the high performing management team at Connells in order to safeguard the financial contribution this business makes to the Group. The movement in the year is a result of an update to the assumptions in relation to the scheme, the details of which can be found in note 26 to the Accounts. The remaining movement in the year is mainly in respect of the intra-Group adjustment between the Mortgages and Savings and Estate Agency divisions, as described on page 29, whereby an enhancement was made during 2018 to spread certain costs incurred by Connells over the life of the mortgage products in question. This resulted in a credit to administrative expenses in the year of £6.0m (2017: £nil).

Impairment on loans and advances to customers

Impairment on loans and advances to customers for the Group was a charge of £2.5m during the year (2017: £4.0m credit) and is broken down as follows:

	2018	2017
	£m	£m
Residential mortgages	**1.3**	(1.3)
Commercial mortgages*	**1.0**	(1.1)
Other loans	**0.2**	0.2
Equity release portfolio	**-**	(1.8)
	2.5	(4.0)

* Also known as loans fully secured on land.

Ongoing management of our credit risk exposure is a key strategic focus for the Group in order to keep losses to the Group to a minimum and help our customers through financial difficulties wherever possible.

During 2018 the Group adopted the new accounting standard IFRS 9, which has changed the way in which impairment losses are measured. Impairment is now measured on an 'expected loss' basis rather than an 'incurred loss' basis, and this has contributed towards there being a £2.5m charge for loan impairment in 2018 compared to a £4.0m credit in 2017. Further details can be found in note 1b) to the Accounts.

A further change under IFRS 9 is that the equity release portfolio is now fair valued in its entirety and as such impairment losses in relation to the fair value movement on the embedded derivative within the portfolio are no longer recognised separately in the Income Statement.

The loan impairment charge on residential mortgages was £1.3m (2017: £1.3m credit). Interest rates increased slightly in 2018, whilst house price growth moderated, however arrears levels remain low. Similarly, in the commercial mortgage portfolio, arrears also remain low and continue to be managed proactively and the impairment charge for the year was low at £1.0m (2017: £1.1m credit).

Provisions for liabilities

The Group's provisions for liabilities charge was £12.0m for the year (2017: £16.3m). The main component of this was commission clawbacks in the Connells group, which resulted in provisions charges of £12.7m (2017: £11.4m) and which arise in the ordinary course of business.

There was a £0.6m credit (2017: £1.2m charge), reflecting a reduction in the provision required in respect of the Group's share of the 2018 FSCS levy. The levy is charged to the Society and other regulated deposit takers to cover interest on the outstanding loan from HM Treasury used to bail out the failed banks during the financial crisis of 2008. The loan made by HM Treasury to the FSCS has now been repaid in full.

Movements in the Group's other provisions resulted in a credit of £0.1m (2017: £3.7m charge) including movements in provisions for potential claims on payment protection insurance, as well as survey and valuation claims in the Connells group.

Taxation

The Group's effective tax rate is 21.7% (2017: 21.2%) compared with the standard rate of UK Corporation tax of 19.00% (2017: 19.25%). The effective rate is higher than the standard rate due to the impact of the 8% surcharge on bank profits introduced by the Finance (No.2) Act 2015, which is charged on the Society's taxable profits above £25m. The rate for the year is also increased by expenditure disallowable for tax purposes and reduced by the lower tax rate in Guernsey which applies to the taxable profits of Skipton International Limited.

The effective tax rate for the Society is 13.5% (2017: 11.4%). The major impact on the effective rate of tax is the non-taxable dividend income received of £82.9m (2017: £60.5m). This is partially offset by the £5.2m (2017: £4.5m) impact of the 8% surcharge on taxable profits above £25m, resulting in a tax charge of £22.6m (2017: £15.2m).

The table below shows the total UK tax contribution borne by the Group in the year:

UK taxes borne in the year	**2018**	2017
	£m	£m
Corporation tax	**36.4**	38.6
Taxes on property	**8.0**	7.9
Employment taxes	**29.5**	26.1
Irrecoverable VAT	**7.6**	6.1
	81.5	78.7

More detailed tax disclosures are provided in notes 9 and 28 to the Accounts and in the Country by Country Reporting section on pages 220 and 221. Further details of the Group's taxation strategy can be found at skipton.co.uk/about-us/governance.

Other comprehensive income

During the year the Group recorded a net expense of £4.5m through other comprehensive income (net of tax) (2017: net expense of £24.2m). The prior year figure consisted predominantly of a reversal of gains of £38.7m previously recognised through other comprehensive income following the disposal of shares in ZPG Plc; on disposal these gains were recycled to the Income Statement.

The 2018 figure included a £3.1m loss (before tax) (2017: £10.2m gain) from the re-measurement of retirement benefit obligations, with further details provided in note 29. Various other movements in the Group's fair value and cash flow hedging reserves account for the remainder of the overall movement.

Performance by division

The Group's total profit before tax by division was as follows:

	2018	2017
	£m	£m
Mortgages and Savings	**114.3**	89.1
Estate Agency	**56.9**	104.2
Investment Portfolio	**7.6**	0.1
Sundry incl. inter-divisional adjustments^	**9.4**	6.7
Profit before tax	**188.2**	200.1

^ Sundry including inter-divisional adjustments relate primarily to the elimination of inter-divisional trading, the impact of the Connells long term management incentive scheme (£4.2m credit; 2017: £9.7m charge), and additional profit on disposal recognised in relation to the sale of HML in 2014 (£3.3m; 2017: £15.9m).

The Group's underlying profit before tax by division, determined in the same way as underlying Group PBT (as defined on page 24), was as follows:

	2018	2017
	£m	£m
Mortgages and Savings	**112.7**	105.3
Estate Agency	**59.7**	64.9
Investment Portfolio	**7.6**	5.0
Sundry incl. inter-divisional adjustments^	**6.1**	(9.5)
Underlying Group profit before tax	**186.1**	165.7

^ Sundry including inter-divisional adjustments relate primarily to the elimination of inter-divisional trading and the cost of the Connells long term management incentive scheme.

The Group's underlying profit increased in the year to £186.1m from £165.7m. The Mortgages and Savings division saw a 7.0% increase in underlying profits during

Strategic Report *(continued)*

the year to £112.7m from £105.3m, and Group mortgage and savings balances have seen good growth, of 10.0% and 7.7% respectively (2017: 8.3% and 6.2% respectively).

The fall in the Estate Agency division's underlying profit can be attributed to the sluggish UK housing market; the fall in market confidence in this time of political and economic uncertainty has resulted in lower levels of activity within the housing market.

The Investment Portfolio delivered underlying profits of £7.6m (2017: £5.0m) following continued strong performance by Skipton Business Finance generating a profit of £3.8m (2017: £3.5m) whilst Jade Software Corporation also delivered an encouraging underlying profit of £3.8m (2017: £1.5m).

The movement in sundry / inter-divisional adjustments during the year, which is the main driver for the increase in underlying Group PBT, is predominantly as a result of a credit with respect to the Connells long term management incentive scheme of £4.2m (2017: £9.7m charge). For further details, refer to the administrative expenses section on page 26 of this report, and for details of the calculation and the assumptions used see note 26 to the Accounts.

We anticipate that Group profits in 2019 will be lower due to a combination of ongoing pressures on mortgage and savings margins, and the continuation of a subdued housing market.

Mortgages and Savings

We saw a robust performance from the Mortgages and Savings division during the year, despite continuing margin pressures as a result of increased competition in the mortgage market. Profit for the year was £114.3m (2017: £89.1m), although 2017's profits include the loss of £15.0m on the disposal of the £220m portfolio of non-performing mortgage assets.

As a result of our broad range of competitive mortgage products and our strong intermediary partnerships, we have continued to meaningfully grow our mortgage book during 2018. Our above-market-average interest rates have also helped us to grow our retail savings balances, by £1.1bn up to £16.1bn (2017: £15.0bn).

We continue to invest in the Society's financial advice offering, which is integral to our purpose, to provide guidance to our customers on their journey to and through retirement. Financial advice generated £29.0m of income, which is broadly in line with the previous year (2017: £29.3m) and during the year, £313m of new money was invested (2017: £245m). Funds under management fell to £3.2bn (2017: £3.4bn) as a result of natural attrition and negative market movements of £267m (2017: return of £185m) due to challenging market conditions and a global slowdown in stock markets.

The division saw an overall increase in costs during the year of £6.8m to £148.7m as outlined on page 26, yet the division's cost income ratio improved slightly from the previous year to 56.3% (2017: 57.1%).

The charge for mortgage impairment losses was £2.3m (2017: credit of £4.2m) as discussed on pages 26 and 27, and the provisions for liabilities charges for the division was a £1.2m credit (2017: £6.8m charge), the majority of the 2017 charge relating to customer compensation provisions.

The division's Channel Islands operation, SIL, had another strong year, achieving profits of £20.1m (2017: £18.0m) as it grew its mortgage and savings balances to £1.2bn and £1.5bn respectively (2017: £1.1bn and £1.4bn respectively). SIL's mortgage book is of a high quality and continues to perform well, with just one account in arrears by more than three months at the end of the year.

Our specialist lending businesses, Amber and NYM, reported an aggregate profit before tax of £10.3m (2017: loss of £11.6m which included a £15.0m loss on disposal of a mortgage portfolio of non-performing loans). Due to the specialist nature of these mortgage portfolios, loan impairment provisions and arrears are generally higher than those reported in the Society, and the aim of these businesses is to manage the mortgage portfolios carefully with a view to running down these closed books. During the year the number of mortgages in arrears by three months or more reduced to 1.6% (2017: 1.9%), and the aggregate mortgage balances in these businesses decreased in the year to £0.7bn from £0.8bn.

Estate Agency

The Group's estate agency operations are carried out through the Connells group. Performance highlights are outlined below:

	2018	2017
Total income (note 1)	**£429.3m**	£459.3m
Profit before tax	**£56.9m**	£104.2m
Movement in:		
Estate agency – house exchanges	**-7%**	-4%
Residential lettings properties under management	**+3%**	+5%
Number of mortgages arranged	**+9%**	+11%
Surveys and valuations completed	**-2%**	+1%
Number of conveyancing transactions handled	**-5%**	+3%

Note
1. Total income is as defined in note 38 to the Accounts 'Group segmental reporting'.

Total profit before tax of £56.9m compares with £104.2m in 2017, however the prior year included a gain of £38.5m from the disposal of Connells' shareholding in ZPG Plc.

The ongoing political and Brexit related uncertainty weakened the UK housing market during 2018, and the number of housing transactions within the UK fell further. Consequently, the number of properties that Connells exchanged contracts on was 7% lower than in 2017. The Connells group remains committed to its high street presence and operated from 586 branches at 31 December 2018 (2017: 591).

Connells continues to invest in its residential lettings business and despite the impact of the tax changes announced in recent years, the private rented sector remains a key part of the UK's housing market. Market conditions in the rental market were broadly stable throughout the year, with a modest increase in average rents and an adequate level of demand from tenants. During 2018 the number of properties managed by the group increased by a further 3% and the group implemented a range of revenue enhancing initiatives which will mitigate some of the lost revenue in 2019 when the prohibition on charging fees to tenants comes into force.

Connells' financial services proposition continues to prosper and during 2018 Connells increased the number of mortgages it arranged by 9%, despite lower property sales in the branches, generating £10.6bn worth of lending for UK mortgage providers. The Connells group remains focused on helping more customers to buy homes or reduce their mortgage outgoings by providing them with a good experience and outcome.

Connells Survey & Valuation continues to invest heavily in new technology and process improvements, to support clients' risk management and improved customer outcomes. It continues to focus on delivering great customer service, has secured a number of new long term client contracts during 2018 and also renewed contracts with many existing clients. The number of cases carried out during 2018 was 2% lower than in 2017.

The Connells group continues to invest wisely in all parts of its business, aiming towards delivering an efficient, customer focused proposition, with its diverse business model being well positioned to manage the fluctuations in the housing market. Current and planned system enhancements are focused on improving customer interactions, increasing operational efficiencies or reducing costs and supporting new business developments. With Connells' strong focus on people, it sees digital technology as an enabler that supports and enhances rather than replaces the bond built between its customers and people.

Within its estate agency operations Connells continues to focus on the service provided to customers through its high street presence. Despite the group exiting the pure online/hybrid market during 2018, when it closed hatched.co.uk, it continues to invest in digital products and solutions, including the continued enhancement of its customer communications and online portal to support its branch operations in winning and retaining business and achieving successful transaction outcomes for customers.

Building upon the successes achieved through coordinated national campaigns, the Connells group has expanded its use of digital and social media advertising. These activities are centrally managed and fully tracked via its lead management platform. This approach provides flexibility, allowing the business to adapt quickly during changing market conditions.

Connells continues to innovate, invest and partner within the industry where it sees opportunities to enhance customer outcomes. In partnership with TM Group, the Move It On (MIO) application, designed to shorten the property purchase process, has been implemented in a trial region. Further refinements are planned in advance of a national launch to the remainder of the Connells group and the wider market during 2019.

Despite the subdued market conditions, Connells made four small business acquisitions during the year, each of which will complement and add to the group's proposition.

Investment Portfolio

The Investment Portfolio reported a profit of £7.6m during the year (2017: £0.1m). Skipton Business Finance Limited (a provider of debt factoring and invoice discounting to small and medium-sized enterprises) again performed well, producing a pre-tax profit of £3.8m (2017: £3.5m). Jade Software Corporation (a software solutions provider specialising in digital solutions and large enterprise IT solutions, and the provider of the Society's core database and software development language) continues to deliver improved performance, recording a pre-tax profit of £3.8m (2017: £1.2m). The division's result for 2017 also included a loss on disposal of £4.9m (£0.3m of which was included in the above reported profit of Jade) following the disposal of Jade Logistics Holding Company and its subsidiary undertakings which were previously part of the Jade group.

Sundry, including inter-divisional adjustments

Sundry, including inter-divisional adjustments, of £9.4m (2017: £6.7m) mainly comprises a £4.2m credit (2017: £9.7m charge) in respect of the Connells long term management incentive scheme and profit in relation to contingent consideration on the 2014 disposal of HML of £3.3m (2017: £15.9m), as described on page 26 of this report. For further details on the credit / charge for the management incentive scheme refer to the administrative expenses section on page 26 of this report, and for details of the calculation of the Connells long term management incentive scheme and the assumptions used see note 26 to the Accounts.

Other inter-divisional adjustments during the period of £1.9m income (2017: £0.5m income) relate to the elimination of inter-divisional trading, which is primarily in respect of introducer and valuation fees paid by the Society and SIL to Connells, as well as certain costs incurred by Connells in relation to this. The income and costs are recognised up-front by Connells but on consolidation are spread over the expected life of the mortgage product through net interest income.

Financial position

A summary Statement of Financial Position is set out below:

	2018 £m	2017 £m
Assets		
Liquid assets	4,201.5	3,533.3
Loans and advances to customers held at amortised cost	18,127.0	16,972.7
Loans and advances to customers held at FVTPL	1.9	-
Equity release portfolio held at FVTPL (note 1)	410.9	-
Derivatives	72.3	94.2
Fixed and other assets	390.8	423.4
Total assets	23,204.4	21,023.6
Liabilities		
Shares	16,113.5	14,985.8
Borrowings	4,988.7	3,954.7
Derivatives	279.4	318.5
Other liabilities	256.4	318.2
Subscribed capital	41.6	41.6
Reserves	1,524.8	1,404.8
Total liabilities and equity	23,204.4	21,023.6

Note

1. Following the introduction of new accounting standard IFRS 9 with effect from 1 January 2018, the equity release portfolio is now fair valued, whereas previously it was held at amortised cost and included in 'Loans and advances to customers held at amortised cost' above.

Our financial position is analysed below by our key balance sheet areas – liquidity, loans and advances to customers, and retail and wholesale funding.

Liquidity

The Group continues to hold healthy levels of liquid assets to ensure it can meet its liabilities as they fall due and to help mitigate economic uncertainty, with the Liquidity Coverage Ratio (LCR), a measure designed to ensure that financial institutions have sufficient high quality assets available to meet their liquidity needs for a 30 day liquidity stress scenario, at 203% at 31 December 2018 (2017: 179%), well above both the regulatory limit of 100% and the internal limit set by the Board throughout the period.

The Group's liquidity levels are closely managed by senior management and have remained above internal and regulatory limits throughout the period. Liquid assets in the year increased to £4.2bn from £3.5bn at 31 December 2017, providing the Group flexibility in what may be an unpredictable market.

At 31 December 2018, the Society held £3.1bn (2017: £2.9bn) of High Quality Liquid Assets (HQLA) as analysed below:

	2018 £m	2017 £m
Balances with the Bank of England	2,342.1	2,367.0
Gilts	105.0	59.5
Treasury Bills	26.9	-
Fixed rate bonds	210.8	146.0
Floating rate notes	20.0	-
Residential mortgage backed securities	207.1	197.8
Covered bonds	208.6	87.4
	3,120.5	2,857.7

The Society also holds a portfolio of other liquid assets, which are not categorised as HQLA, as shown below:

	2018 £m	2017 £m
Cash with other institutions	50.1	-
Certificates of deposit	301.5	20.0
Fixed rate bonds	31.5	32.1
Residential mortgage backed securities	0.3	1.0
	383.4	53.1

The above tables showing HQLA and non-HQLA are different to the total amount of liquid assets held within the Society's Statement of Financial Position (£4.1bn) due to certain items that are excluded from the above tables, such as liquid assets used as collateral and those used in repurchase, or 'repo', transactions.

The Group's treasury investments are held to provide liquidity and 95.7% (2017: 98.7%) of the Group's treasury investments are rated A3 or better. The Group's policy is that initial investments in treasury assets are typically A3 or better (with the exception of some unrated building societies where separate credit analysis is undertaken).

The Net Stable Funding Ratio (NSFR) is a longer term stable funding metric, which measures the stability of our funding sources relative to the assets (mortgage balances) we are required to fund. The Group's NSFR (143.3% at 31 December 2018) is well in excess of the regulatory requirement of 100%, which was introduced on 1 January 2018, confirming that the Group holds sufficient stable funding to meet the new requirement.

When measured as a percentage of shares, deposits and borrowings, the liquidity ratio increased from 18.7% to 19.9%. The Group regularly conducts an Internal Liquidity Adequacy Assessment Process (ILAAP) in accordance with the Prudential Regulation Authority's (PRA) liquidity guidelines and the Board remains satisfied that the Group has sufficient liquid assets at its disposal in order to meet its obligations as they fall due.

Loans and advances to customers

Lending to our members is at the core of the Society's purpose. The majority of the Society's mortgage lending is secured on residential property, including owner-occupied and buy-to-let mortgages. The Group also holds the Amber and NYM specialist lending portfolios and a legacy commercial mortgage portfolio, both of which ceased lending in 2008.

During the year, the Group achieved strong net mortgage growth of 10.0%, with net mortgage lending totalling £1.6bn (excluding impairment and fair value adjustments for hedged risk) (2017: £1.3bn). The Group's new lending, delivered through both mortgage intermediaries and our own distribution channels, amounted to £4.3bn (2017: £4.5bn).

The Society's average residential loan-to-value (LTV) ratio (valuation-weighted) on new lending has fallen slightly to 57.1% (2017: 59.5%). The average LTV on the Group residential mortgage book remained low at 46.1% (2017: 47.2%).

Our well-managed spread of risk ensures that the quality of the Group's lending remains high. This is evidenced by our low proportion of residential mortgage accounts in arrears by three months or more reducing to 0.29% (2017: 0.36%) or 0.30% (2017: 0.37%) excluding non-UK lending, which compares with the industry average of 0.79% of UK mortgages in arrears by more than three months (source: UK Finance).

The mortgage balances of Amber and NYM continued to run off during the period, with the average LTV reducing to 55.4% from 57.0%. Close monitoring of the Group's exposure to potential losses on these outstanding loans remains a key part of our credit risk strategy.

The Group's commercial mortgage portfolio reduced in the year by 8.9% to £267.6m as we continue to actively manage down these balances. The average LTV of this portfolio reduced to 50.0% from 52.5% and the proportion of accounts in arrears by three months or more in this portfolio remains low at 0.84% (2017: 0.68%).

We support our customers who find themselves in financial difficulty and where appropriate we will apply a policy of forbearance which could include arrears capitalisation, a reduction in the monthly payment, a conversion to interest only or a mortgage term extension, based on the customer's individual circumstances and needs. Ensuring a fair outcome for our customers is central to our strategy of forbearance, and further details on this can be found in note 36 to the Accounts.

Funding

The Society continues to manage the mix of retail and wholesale funding in the best interests of our members, but remains primarily funded by retail savings. Optimising our mix of retail and wholesale funding is essential to the Group achieving both its retail savings and lending growth objectives. We maintain a diverse funding portfolio to prevent over-reliance on one source, and, taking into consideration the term profile of our lending, closely manage the term of our funding in order to manage the risks of duration mis-match.

During the year, we took the opportunity to raise wholesale funding both to diversify our portfolio and take advantage of favourable funding schemes. This reduced the proportion of funding from retail savings to 81.6% (2017: 84.6%), which is in line with our balance sheet strategy.

Retail funding

As a mutual building society we remain committed to providing savers with competitive returns along with offering excellent customer service, which is reflected in the increase in retail savings balances of 7.7% during the year, as detailed on page 20.

In addition to our UK retail funding, the Group also accepts deposits through our Channel Islands based subsidiary, SIL. SIL has increased its funding base in the year, to £1.5bn (2017: £1.4bn). These balances are included in 'Amounts owed to other customers' within the Group Statement of Financial Position.

Wholesale funding

At 31 December 2018, £3.5bn (2017: £2.6bn) of our funding came from the wholesale markets, as analysed below:

	2018 £m	2017 £m
Repo and other secured agreements	1,853.7	1,401.8
Deposits	190.4	498.9
Certificates of deposit	4.0	15.7
Senior unsecured funding	348.8	348.5
Covered bonds	846.3	-
Securitisation	219.6	306.4
Fair value adjustments	1.6	(4.2)
	3,464.4	2,567.1

The Group's wholesale funding balances in the above table exclude offshore funding in our Channel Islands based subsidiary, SIL, as shown below:

	2018 £m	2017 £m
Amounts owed to credit institutions	1,878.0	1,483.2
Amounts owed to other customers	1,690.4	1,805.1
Debt securities in issue	1,420.3	666.4
Less: SIL funding	(1,524.3)	(1,387.6)
	3,464.4	2,567.1

In April 2018, the Society issued a Sterling covered bond transaction, raising £400m of funding over a five year term and further diversifying our wholesale funding base. We then returned to the market in October with our first Euro denominated covered bond transaction, which raised €500m of five year funding.

Strategic Report *(continued)*

The Society has made use of the Government's Term Funding Scheme (TFS), which is included in 'Repo and other secured agreements' in the table above. During the year, the Society has drawn down £1,000m (2017: £1,100m) under the scheme and repaid £550m. As at 31 December 2018, the Society had outstanding TFS drawings of £1,850m (2017: £1,400m).

The credit ratings of the Society are assigned by two major credit rating agencies, Fitch and Moody's. Our long and short term ratings did not change from 2017 however in August 2018 Moody's changed our outlook from 'stable' to 'positive'. Our credit ratings are summarised in the table below:

	Long term	Short term	Outlook	Date of last change of rating
Fitch	A-	F1	Stable	26 May 2016
Moody's	Baa1	P-2	Positive	10 April 2017

The Class A Notes of our rated securitisation transactions (Darrowby No. 3 plc and Darrowby No. 4 plc) remain Aaa rated by both agencies.

Capital

Capital comprises principally the general reserve and subscribed capital provided through Permanent Interest Bearing Shares (PIBS). Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses.

Under the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), together referred to as CRD IV, the main level at which we monitor our capital is at a prudential consolidation group level. The prudential group comprises the entire Group except Connells and a small number of other entities whose activities are not closely aligned with the core business.

Total regulatory capital has increased by £124.7m during 2018 to £1,448.4m (2017: £1,323.7m). This is mainly due to retained profits, including dividend income from Connells, accumulated during the year, which are added to the general reserve and partly offset by the impact of adopting IFRS 9 from 1 January 2018. See note 1b) for further details regarding the impact of IFRS 9 on regulatory capital.

Risk weighted assets (RWAs) have increased by £414.6m during 2018 to £4,279.3m (31 December 2017: £3,864.7m) due to the increase in mortgage balances held in the year as well as higher liquid asset balances held to support the growth of the business.

As a result of these movements, the CET 1 ratio, calculated on a transitional basis, has reduced slightly to 32.9% from 33.2% at 31 December 2017.

The leverage ratio, a non-risk based capital measure, has remained stable at 6.2% at 31 December 2018 (2017: 6.1%) showing that the growth in mortgage lending has been offset by the profits and dividend income accumulated during the year.

The following table shows the composition of the prudential group's regulatory capital as at 31 December 2018. More detailed disclosures can be found in the Pillar 3 document available on our website. The capital ratios are reported on a CRD IV transitional basis. On a transitional basis £40m of PIBS are being phased out of Additional Tier 1 capital over the period to 2022. Under CRD IV end-point rules the PIBS are fully transitioned into Tier 2 capital. On an end-point basis our CET 1 ratio would remain the same at 32.9%, the Tier 1 ratio would be 32.9% and the total capital ratio would remain the same at 33.8%. The leverage ratio is reported on an end-point basis.

	2018 £m	2017 £m
Capital resources:		
Common Equity Tier 1 capital	**1,408.4**	1,283.7
Total Tier 1 capital	**1,444.4**	1,323.7
Total Tier 2 capital	**4.0**	-
Total regulatory capital	**1,448.4**	1,323.7
Risk weighted assets	**4,279.3**	3,864.7
Capital and leverage ratios (note 1)		
Common Equity Tier 1 ratio (CET 1)	**32.9%**	33.2%
Tier 1 ratio	**33.8%**	34.3%
Total capital ratio	**33.8%**	34.3%
Leverage ratio	**6.2%**	6.1%
UK leverage ratio (note 2)	**6.9%**	6.8%

Notes

1. The capital ratios are calculated as relevant capital divided by risk weighted assets and the leverage ratio is calculated as Tier 1 capital divided by total exposure, i.e. total assets per the prudential group consolidated position (subject to some regulatory adjustments). The leverage ratio is reported on a CRD IV end-point basis; under CRD IV end-point rules all existing Additional Tier 1 instruments that become ineligible as capital under CRD IV are excluded in full.
2. The UK leverage ratio represents the UK regulatory regime which excludes deposits with central banks from the leverage exposure measure.

IFRS 9 transitional relief has been applied in the figures above. The end-point position excluding IFRS 9 transitional relief results in the same capital ratios as those reported above as the impact of the transitional relief is not material for the Society.

Capital management

The Group is regulated by the PRA and the Financial Conduct Authority (FCA) and is required to manage its capital in accordance with the rules and guidance issued by the PRA under CRD IV. The capital requirements of the Group are monitored on an ongoing basis to ensure the minimum regulatory requirement is always met and that the Group has sufficient levels of capital for current and projected future activities.

Pillar 1

The Group holds capital to meet Pillar 1 requirements for credit risk, operational risk and market risk. The IRB approach to capital modelling is applied to residential mortgages in the Society, Amber and NYM and to equity and non-credit obligation exposures. The standardised approach is applied to all other exposures, operational risk, market risk and credit valuation adjustments.

Pillar 2A

The PRA requires the Group to hold additional Pillar 2A capital for the risks not covered under Pillar 1. At 31 December 2018 the regulatory requirement was 3.4% of risk weighted assets, a point in time estimate set by the PRA during 2018.

Capital buffers

CRD IV requires the holding of capital buffers that can be used to absorb the impact of a stress scenario. For the Society the buffer framework comprises a sector-wide Capital Conservation Buffer, introduced in 2016 at 0.625% of RWAs and set at 1.875% in 2018 rising to 2.5% by 1 January 2019 and a macro-prudential Countercyclical Capital Buffer currently set at 1% of RWAs for exposures to the UK. In addition, the Internal Capital Adequacy Assessment Process (ICAAP) considers whether any additional capital is required over and above the regulatory buffers, to satisfy our risk appetite over the planning horizon, and to absorb the impact of a severe stress scenario. The ICAAP is reviewed by the PRA when setting the Group's Total Capital Requirement (Pillar 1 and Pillar 2A).

The Group has performed regular stress tests on its capital base and these tests have consistently demonstrated a capital surplus above requirements after applying management actions.

Further information is provided in the Risk Management Report on pages 62 to 69.

The Group publishes further information about its exposures and risk management processes and policies within the Pillar 3 disclosures on the Society's website skipton.co.uk.

Minimum Requirement for Own Funds and Eligible Liabilities

The Minimum Requirement for Own Funds and Eligible Liabilities (MREL) is being phased in over a transitional period to 1 January 2022. The transitional period MREL set for the Society, by the Bank of England, is equal to the minimum regulatory capital requirements for the period to 31 December 2019, then changes to the higher rate of 18% of risk weighted assets by 1 January 2020 for the period to 31 December 2021. MREL at the end of the transitional period is subject to review by the Bank of England and may change. Compliance with MREL is reflected in the Society's latest corporate plan.

Pension funds

The Group manages two funded defined benefit schemes and a hybrid scheme as described in note 29 to the Accounts. The aggregate valuation of the two defined benefit schemes and the hybrid scheme at 31 December 2018 resulted in a combined deficit of £99.5m (2017: £100.2m) using the methodology set out in IAS 19. The hybrid scheme is a legacy scheme acquired on the merger with Holmesdale Building Society and is not material to the Group.

We continue to take steps to manage the deficit and all three schemes are closed to new members and to future accrual of benefit. The actuarial valuation deficits, as described in note 29 to the Accounts, are used to judge the level of contributions that should be made and contributions totalling £28.9m have been paid into the schemes in the last five years. We have also undertaken a number of other initiatives aimed at managing the funding deficit of the above-mentioned defined benefit schemes and associated long-tail risk including early retirement exercises and pension transfer exercises.

We will continue to monitor the deficit on the schemes to manage the funds in a responsible manner with the aim of ultimately eliminating the actuarial funding deficit.

We also operate defined contribution schemes into which eligible employees are automatically enrolled.

Principal risks and uncertainties

As a result of its normal business activities, the Group is exposed to a variety of risks. The Group has established a number of committees and policies to successfully manage these risks. These principal risks and uncertainties are set out in the Risk Management Report on pages 62 to 69 and in notes 34 to 36 to the Accounts.

This Strategic Report was approved by the Board of Directors on 26 February 2019 and signed on behalf of the Board by:

Bobby Ndawula

Bobby Ndawula
Group Finance Director

Colleagues took part in the London Moonwalk organised by Walk the Walk to raise money and awareness for breast cancer

Skipton Building Society mental health first aiders

Sustainability Report

Our purpose has remained broadly the same since we were founded in 1853 and as a mutual we work hard to help our members build better futures for themselves and their families. We are proud of the way we work together, building a better Society for our members, colleagues and the communities in which we serve.

Our People

Delivering a customer-centric culture is important if we are to continue to deliver the exceptional customer service we are so very proud of. It is our people who deliver this and make our Society special.

We are proud that we have continued to maintain high levels of colleague engagement at above 85% as measured by our independent colleague engagement survey. The survey gives our people a voice to let us know the things we are doing well and anything that could be improved. This valuable feedback allows us to focus our attention on making improvements that are important to the well-being of our people and that make the Society a great place to work.

Diversity & Inclusion

We strive for a culture which is diverse, inclusive and representative of the world in which we live.

As an inclusive society, we embrace the diversity of everyone in the workplace, ensuring all colleagues are able to make a full contribution.

As part of our focus on diversity and inclusion we played an active part in National Inclusion Week in September. This provided a fantastic opportunity to raise understanding and awareness of inclusion in the workplace, through a variety of events, communications and conversations under the theme of 'Everyday Inclusion'.

Well-being

Healthy people are happier, more engaged and more productive, so it is important that we support the well-being of our colleagues. Stress, anxiety and depression are the biggest cause of sickness absence in the UK. That's why in 2018 we trained over 70 mental health first aiders to support colleagues across the Society.

Our benefits package includes access to Lifeworks, our employee assistance programme provided by Unum, which offers comprehensive online resources to support colleagues in the ups and downs of everyday life, such as guidance on moving house, minor legal issues and budgeting tools. In 2018, we introduced Lifeworks Perks, which provides our colleagues with savings on a range of local and national retailers including cinema tickets, restaurant deals, gym memberships, supermarkets, fashion and beauty and days out.

Flexible Working

The Society recognises that in today's society, individuals sometimes require more flexibility to manage the many commitments in both their work and personal lives. We aim to be attractive to a diverse and talented workforce and we recognise that offering flexibility in both how and when we work is key to achieving this.

Reward & Recognition

We recognise the added value our colleagues bring and are committed to supporting them to build better futures and reach their full potential.

Our annual STAR ('Special Thanks and Recognition') awards provide an opportunity to celebrate the achievements of our people through ten awards which are structured around our values and behaviours. Colleagues nominate teams and individuals who they think have gone above and beyond and deserve recognition for their hard work.

We invest in a range of benefits to support the changing needs of our colleagues, helping our people to develop themselves, achieve their career aspirations and maintain a good work-life balance.

Pension scheme

We have continued to invest in the pension contributions of our people as well as offering practical support through pension planning workshops and a visit from the JLT pension decision service tour bus at our head office to raise awareness of the importance of pension planning.

In 2018, we invested £5.2m in colleagues' pension contributions, with colleagues contributing an additional £4.7m. 38% of colleagues made additional contributions to their pensions of 8% or more ensuring they benefitted from the maximum contribution from the Society.

Salary

The Society invests year-on-year to ensure all salaries are at least the level of the living wage.

Leadership & Talent

We continue to develop our people and provide opportunities for younger people within the Society. In 2018 we took on a further eight apprentices on our Connecting our Future Programme, bringing the total to 35 over the past four years.

We deliver a number of different in-house programmes for colleagues at different stages in their career journey, including Connecting our Future, Aspiring Leaders and the Modern Leaders Programme. We also worked with the Building Societies Association to enable seven of our senior leaders to study for a Masters Degree in Leadership and Management at Loughborough University, with our first two leaders graduating in December. Developing leaders with values and behaviours that are aligned to the Skipton culture is important for us to deliver for our customers both now and into the future.

It's not just our colleagues who tell us that Skipton is a great place to work as we are recognised externally too:

- ***The Sunday Times* 100 Best Companies to Work For – 83rd**
- **IIP Platinum Accreditation**
- **Yorkshire Post Business Excellence for Diversity Award**

Taunton branch took to the skies with a tandem skydive

Three colleagues ran 35 miles between Solihull and Worcester branches

In 2018, we continued to recycle 95% of our waste

Colleagues used human power to mix fruit smoothies and milkshakes on static bikes

Skipton colleagues supporting Nell Bank Outdoor Education Centre

We have worked with AccessAble to develop online guides that contain information about the accessibility of all our branches, available on skipton.co.uk/branchfinder

Our Communities

Being active in the community creates a foundation for who we are. Whether it's fundraising, volunteering or building relationships across diverse communities, we are really proud of the way our colleagues put communities at the very heart of what we do.

As a mutual, and one of the UK's largest building societies, it's important that we continue to support a wide range of community activity, providing support to community groups and charities that are important to our colleagues and customers.

Charity Partnership

In December 2016, Skipton colleagues voted overwhelmingly to support the Alzheimer's Society and Alzheimer Scotland, which became our charity partners until the end of 2019.

Having a charity partner is about much more than raising money. It's about partnering with a cause that our people, our members and our wider communities believe in. It's about understanding how we can add value and how we can work together to take action on dementia. Our colleagues have undergone training to become dementia friends and improve their understanding of dementia so that they're better equipped to support people who are affected, and we are pleased to report that 100% of our branches are now dementia friendly.

Miles for Memories

In 2018 we embarked on our most ambitious fundraising event yet with colleagues from across Head Office and across the branch network challenged to cover 2,296 miles by human power alone. The mileage was set by Branch Distribution Director Paul Fenn and Specialist Lending Director Ian Moore, who visited all of our branches by motorbike over the nine days of the challenge.

Colleagues really got behind the challenge with walks, runs, skydives, static bikes and even kayaking to raise an incredible £79,194 for Alzheimer's Society and Alzheimer Scotland.

Volunteering

All colleagues are given up to two days additional paid leave to volunteer in their local communities. This can be taken as a team to deliver a one-off project or broken down into smaller chunks to allow them to volunteer over a longer period of time.

We have continued to see an increase in the number of teams using a volunteering day to build relationships, as well as using volunteering to improve professional skills. This has included supporting Nell Bank Outdoor Education Centre, Children's Literacy Trust and Young Enterprise.

In 2018 we donated or provided financial support to almost 300 charities and community groups:

- **Skipton Building Society Charitable Foundation gave £152,801 to 81 charities**
- **165 community groups shared a total of £82,500 from our Grassroots Giving scheme**
- **We raised £94,451 for Alzheimer's Society and Alzheimer Scotland including £79,194 as part of our Miles for Memories Festival of Fundraising**
- **We donated a further £63,989 to other community groups and charities**

Charitable Foundation

Established in 2000 the Skipton Building Society Charitable Foundation has given over £2m to charities, providing vital funding for them to continue the fantastic work they already do in our local communities.

Grants are awarded by a board of seven trustees, five of whom are independent to the Society. In 2018 the average grant was £1,886.

Grassroots Giving

Since it was established in 2013 to celebrate our 160th birthday Grassroots Giving has given £487,500 to 975 local community groups. The scheme gave donations of £500 to groups who often struggle to get funding elsewhere because they do not have registered charity status.

Rachel's Rainbows

In memory of our colleague, Rachel, a team of 30 colleagues took on the London Moonwalk in May 2018. This is a 26 mile night-walk through London, organised by Walk the Walk to raise money and awareness for breast cancer. Through sponsorship, bake sales and charity fun days the team raised over £16,000.

AccessAble

We believe that around 50% of our customers have some form of disability, impairment or long term condition which can mean that they need tailored ways for us to help them to access our products, services and communications.

Recognising that, for some, leaving the house can be a challenge where the accessibility of the destination is unknown, we have worked with an external organisation, AccessAble, to develop online guides that contain information about the accessibility of all our branches, from how easy it is to park, to how wide the entry doors are.

Our branch accessibility guides are available on skipton.co.uk/branchfinder.

Our Environment

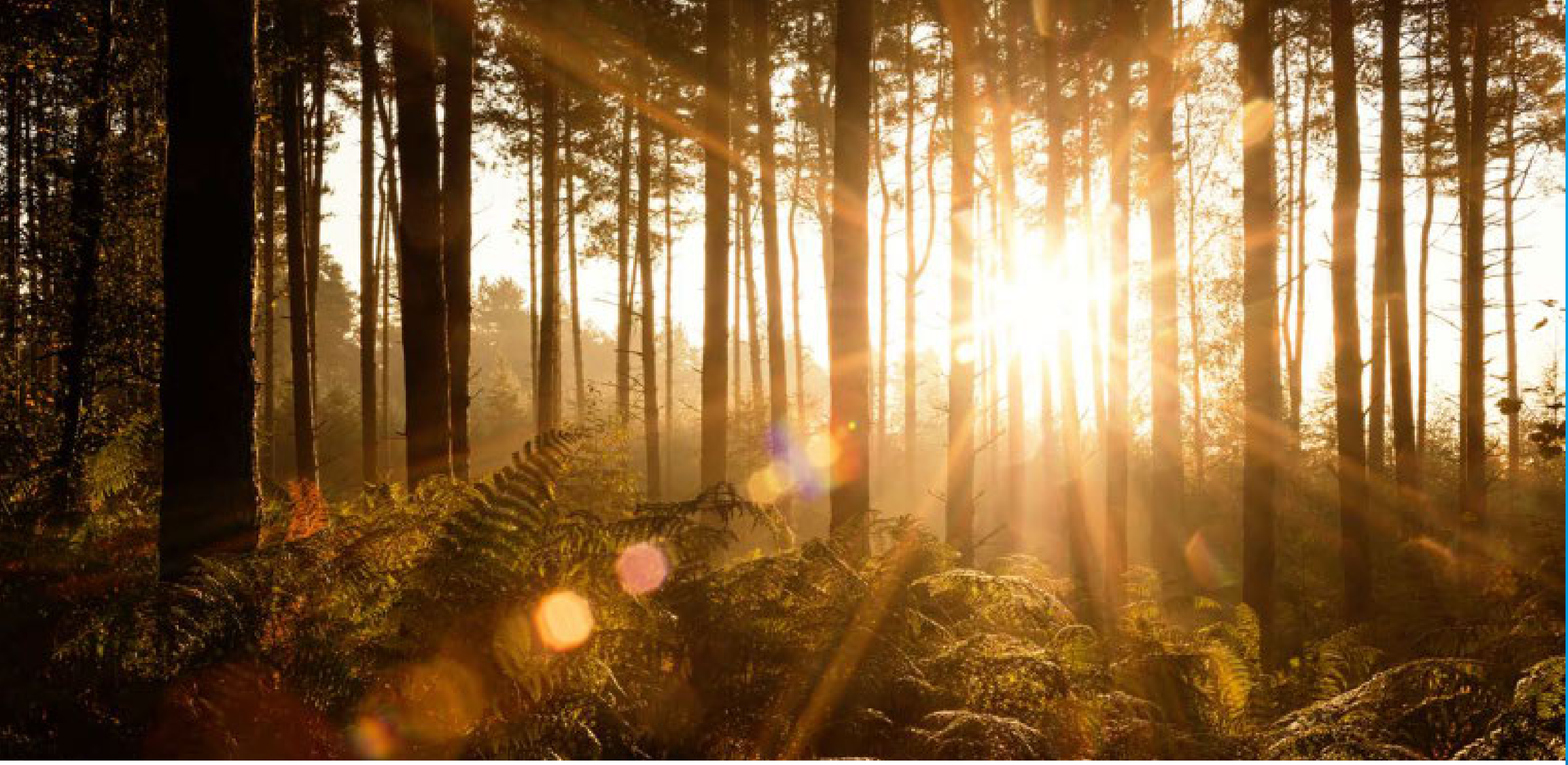
Over the last 12 months we have been reviewing our environmental policy and looking at ways in which we will give more to the planet than we take. This, along with some exciting initiatives we have planned for 2019 and beyond, will enable us to build a sustainable Society.

We encourage colleagues to consider the environment and go plastic free. We do this by supporting a discount for hot drinks in our head office with 'bring your own cup' and we have installed filtered water taps to encourage less use of single use plastic.

We're also helping to keep our communities clean and litter free with colleagues taking part in litter picks and donating money to a local community group in Bedale so they can buy litter pickers and hi-vis jackets to help keep their community clean.

In 2018, we continued to recycle over 95% of our waste and we reduced the amount of CO_2 we used across the branch network and head office from 2,703 tonnes to 2,321 tonnes. In 2019, we will start to include colleague travel in our carbon footprint calculation, which will lead to an initial increase in our carbon footprint, however will allow us to really understand what impact we are having on our environment.

In 2017 we joined the national Liftshare scheme encouraging colleagues to join like-minded people to save money and the planet by sharing their commute to work. In 2018 this reduced carbon emissions by 34 tonnes.



SUSTAINABLE DEVELOPMENT GOALS

Skipton Building Society
Support the Goals Rating

The future

In September 2015, the leaders of all 193 member states of the United Nations introduced 17 Global Goals for Sustainable Development that aim to end poverty, fight inequality and stop climate change by 2030. We have shaped our sustainability strategy around these goals; focussing on the four we feel are most relevant to Skipton and which we can most positively contribute towards.

Skipton is the first Building Society to be recognised by Support the Goals, a not-for-profit initiative that celebrates the businesses supporting the Sustainable Development Goals and we were awarded the maximum four-star rating.

We have made specific commitments to the four goals that are particularly relevant to our business, as below, and we will review our performance against these targets on a quarterly basis.

8 DECENT WORK AND ECONOMIC GROWTH

OUR COMMITMENT:

We will be one of the best places to work.

11 SUSTAINABLE CITIES AND COMMUNITIES

OUR COMMITMENT:

We will help more people into homes and support our local communities.

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

OUR COMMITMENT:

We will give more back to the planet than we take.

16 PEACE, JUSTICE AND STRONG INSTITUTIONS

OUR COMMITMENT:

We will always be owned by, and responsible to, our members, not shareholders.

Please refer to our full sustainability report at skipton.co.uk for more information on our sustainability strategy, including specific targets we have set ourselves in relation to the UN's global goals for sustainable development, and to understand how it links into the Global Sustainable Development Goals.

2 Governance

The Board of Directors

Robert East

Chairman of the Board, Nominations and Non-Executive Remuneration Committees.

Robert joined the Board in 2011, bringing more than 40 years' experience in, and understanding of, retail and commercial banking in the UK and internationally. During his 32 years at Barclays Bank he was Chief Risk Officer of Absa South Africa amongst other roles. He's also had other leadership roles in retail and commercial banking, and took leadership of Cattles Limited's restructuring from 2009 and became its Chief Executive in 2010 until completion of its wind down in 2016. Other directorships are Welcome Financial Services Limited and Non-Executive Director of Hampshire Trust Bank plc.

"In 1976, I joined a branch of Barclays in South East London, first as the office junior and then as a cashier. Since then, I have worked in many varied roles in financial services, seeing some of the best and some of the worst practices. This time has taught me that well-led and motivated people will give great service to and do the right thing for their customers. I really believe in this. I joined Skipton because I saw a business with the same ambition and one where I could use my experience to help it deliver that ambition both now and in the future.

I feel proud to chair Skipton Building Society because of its history, values, the importance it has for our members and the dedication of our people. Our focus for the changing times ahead will be to help more people secure homes, save for their life ahead and support their long term financial well-being."

David Cutter

Group Chief Executive, Chairman of the Executive and Retail Credit Committees and member of the Asset & Liability and Non-Executive Remuneration Committees.

David has had extensive experience working in many areas of our business, including periods as Operations Director, Group Corporate Development Director and Head of Internal Audit. He joined the Board in 2000. He is a qualified chartered accountant, Trustee of The Craven Educational Trust and a former Chairman of the Building Societies Association.

"I've been with Skipton for 25 years and I still enjoy learning something new every day and seeing the culture of continual improvement we've developed over the years. Skipton is a trusted business that aspires to consistently provide excellent service and build strong relationships with its customers. It's important to me that I can lead a team to build a trusted, values-driven Society, which inspires its people. My ambition for the business is for Skipton to thrive and be a beacon for our customers in a confusing financial world."

Andrew Bottomley

Distribution and Financial Services Director and a member of the Executive Committee and the Non-Executive Remuneration Committee.

Andrew has more than 30 years' experience in building societies and banking. He has previously served as Mortgage and Bancassurance Director at Lloyds Bank, held various senior roles at the Halifax, encompassing branches, mortgages and head office positions, and was Chairman of Halifax Sharedealing. He joined the Board in 2016.

"I have worked in financial services for many years and it is important to me to work for an organisation that cares for both its customers and colleagues. I thrive on a challenge and an action-orientated environment where the team has strong values that won't be compromised. I've dealt with many cultures and segments of the financial services industry and I'm keen to help people develop and grow. I also have wide experience in conduct risk and change management and ensure there's a rigorous customer focus. I'm pragmatic and bring energy and a clear set of values to work every day."

Amanda Burton

A member of the Nominations and Remuneration Committees and a Non-Executive Director of Connells Limited.

Amanda joined the Board in 2016, bringing more than 15 years' Non-Executive Director experience. Until 2014 she held the role of Global Chief Operating Officer of Clifford Chance LLP and was previously General Counsel at Meyer International and Ratners Group. Her other directorships are Senior Independent Director and Chair of Remuneration Committee of HSS Hire Group plc and Non-Executive Director and Chair of Remuneration Committee (Countryside Properties plc). She's also Chair of Battersea Dogs' and Cats' Home. She was previously Senior Independent Director and Chair of Remuneration Committee of Monitise plc and Galliford Try plc.

"I'm a strong believer in continuous improvement and making sure everything starts with the customer's perception of value. I was attracted to Skipton because it has a strong culture in customer focus and uses continuous improvement methodology to ensure that the customer proposition is delivered effectively and efficiently. I have a strong operational and legal background in a number of diverse industries and enjoy learning about new sectors and the challenges they face."

The Board of Directors *(continued)*

Richard Coates

A member of the Audit, Nominations and Risk Committees.

A chartered accountant, Richard was a senior partner at KPMG before joining the Skipton Group in 2003 as Managing Director of Baseline Capital Limited, which he retired from in 2008. Since then, Richard has held Non-Executive Director roles at Northern Rock (until 2010) and The Co-operative Bank (until 2016), where he chaired the Audit Committees and was also a member of their Risk Committees. He is also a Non-Executive Director of TPT Retirement Solutions.

"Living in the Skipton area and having previously been part of the Group, I welcomed the opportunity to join the Board. The Society stays true to its mutual ethos and has its members at the centre of its thinking. I aim to bring my experience of strong corporate governance to the Board to support the Society's ongoing financial strength and growth strategy."

Denise Cockrem

A member of the Audit and Nominations Committees.

Denise joined the Board in 2015, bringing more than 20 years' experience in financial services from roles at Barclays, RBS, Direct Line and RSA Insurance. She's currently also the Group Chief Financial Officer at Ecclesiastical Insurance Group, which is wholly owned by a charitable trust. Denise is also an independent Trustee of MacIntyre Academies Trust, which supports children with learning disabilities. She has a passion for delivering excellent customer service and developing people.

"Customer service is really important to me. Skipton's reputation for this and its investment in the people who deliver it were strong drivers in attracting me to join. I enjoy being part of an organisation that really makes a difference to its customers and colleagues. I have experience in financial services in a variety of finance roles as well as being part of customer-centric and growing businesses."

Ian Cornelius

Commercial Director, member of the Executive, Retail Credit, Asset & Liability and Non-Executive Remuneration Committees and Chairman of the Skipton International Limited Board.

Ian has been a member of the Board since 2012. He has extensive experience of working in financial services, previously holding senior positions at Homeloan Management Limited, Virgin Money, Bradford & Bingley, Capital One and Boots. He is also a Non-Executive Director of Incommunities Group Ltd and Governor and Trustee of Giggleswick School.

"I am proud to be a director of an organisation that has a strong set of values and genuinely seeks to put customers at the heart of everything we do. Skipton Building Society has successfully focused on helping people to save for life ahead and have a home of their own since 1853. My role is to support and enable colleagues to build on this great legacy by constantly seeking to improve the products and services we offer to ensure that we meet the needs of both current and future members."

Denis Hall

Chairman of the Risk Committee and a member of the Remuneration and Nominations Committees.

Denis started his career with Barclays Bank in 1974. He worked for Citibank for 16 years, mainly in Germany and Belgium, where he held various positions including Head of Risk. From 2001 to 2007 he was Chief Risk Officer at Deutsche Bank in their retail bank in Europe, and from 2007 was Global Head of Risk for GE Capital Consumer Bank until December 2016. Denis is also a Director and sits on the Audit and Risk Committee of Switzerland's Cembra Money Bank, and is a Director and member of the Risk Committee and the Audit Committee of Moneta Bank in the Czech Republic, and is on the Supervisory Board of Hyundai Capital Bank Europe based in Germany.

"I love Skipton's principle that puts members first and services their needs without pressure. What excites me is being a part of a team that makes things happen and delivers with excellence. I also have the unique opportunity to serve on the boards of three other financial institutions in different geographies, which keeps me up to date with current issues, so I'm hoping to be able to contribute to the Society by being able to weigh up different approaches to common challenges."

The Board of Directors *(continued)*

Heather Jackson

A member of the Nominations Committee.

Heather is currently a Non-Executive Director of Ikano Bank AB, JD Sports Fashion plc and Ditto AI Ltd and also the Managing Director of her own consultancy business. Until recently she was a Non-Executive Director of Tandem Bank. Heather also has 25 years' experience in senior roles at HBOS/Lloyds plc, Capital One, Boots the Chemist, Asda and Burton Group plc.

“I have huge respect for Skipton, which plays such a large part in helping people shape better financial futures for themselves. I think organisations that really focus on their customers' needs both short term and future are the ones that succeed in the long term. I have worked in large corporations and small start-ups and a common thread for making a positive difference is that they all focus on doing the right thing for their customers. Even though technology and large change projects help drive innovation, the key ingredients are always customers and people – ensuring customers, colleagues and members are at the centre of everything.”

Mark Lund

Deputy Chairman of the Board and a member of the Risk and Nominations Committees.

Mark has more than 30 years' experience in commercial and financial services. His previous roles include CEO of St James's Place plc, CEO of Virgin Direct and Director of Henderson Investors plc. In 2012, he was appointed by the Cabinet Office to Chair the Employee Benefit Trust of the mutual company MyCSP Ltd, where he also sits on the Board as acting Chairman. Mark is also Vice Chairman at British Ski and Snowboard Limited, a Non-Executive Director of Coutts & Co and Chairman of Equiniti Financial Services Limited.

“I joined the Society's Board in 2016 following a number of years as a Non-Executive Director with Skipton's financial advice business. I've got to know the broader business of the Society well and, importantly, what it stands for – especially in terms of putting customers at the heart of everything we do. My personal goal remains to play my part in ensuring that we really understand our customers' needs and provide them with the most appropriate solutions from a business that continues to be in robust financial health.”

Bobby Ndawula

Group Finance Director, Chairman of the Asset & Liability Committee, member of the Executive, Retail Credit, Model Governance and Non-Executive Remuneration Committees.

A chartered accountant, Bobby previously held a number of senior positions in Group Finance and Financial Risk. With over 20 years of experience in IT, finance and risk, he has a desire to continue to ensure the Society's customers' financial and service interests are safeguarded. Bobby has been a member of the Board since 2015. He is also a Trustee of Yorkshire Cancer Research.

“Being part of a values-led organisation that has its members at the heart of everything it does is important to me and keeps me highly motivated. I enjoy leading teams that look to embrace change and continuously improve the financial strength of the Society for the long term benefit of our members. My ambition for the business is for it to grow sustainably, so we can continue to help more people achieve their financial goals.”

Helen Stevenson

Chairman of the Remuneration Committee and a member of the Risk and Nominations Committees.

Helen joined the Board in 2013. She spent 19 years with Mars Inc, was Group Marketing Director of Lloyds TSB from 2003-6 and Chief Marketing Officer of Yell Group 2006-11. Helen is now Senior Independent Director on the Boards of Reach plc and Kin & Carta plc and is a member of Henley Business School Advisory Board and a Governor at Wellington College. Helen brings a strong customer focus to the Board as well as being an experienced Non-Executive Director.

“I believe the mutual model serves financial services particularly well. Skipton is well placed to continue to strengthen both its excellent customer service and financial stability and I am delighted to serve on its Board. I am interested in encouraging the Board to maintain a powerful connection between members and our business and to evolve our strategy so that it continues to thrive in a changing marketplace.”

Marisa Cassoni

Chairman of the Audit Committee and member of the Nominations Committee.

A chartered accountant with more than 40 years' experience as a financial professional, Marisa's previous roles include Group Finance Director of John Lewis Partnership, Royal Mail Group, Britannic Assurance Group and Prudential UK Group. She has over 20 years' experience as an executive board member, including financial services organisations, and was a member of the Accounting Standards Board 2005-11 and the CBI Economics Committee 2001-12. She is a Non-Executive Director of AO World plc and Enterprise Inns plc and Non-Executive Director and Chair of Remuneration Committee of Galliford Try plc. She joined the Board in 2012.

Marisa will be retiring from the Board at the conclusion of the Annual General Meeting on 29 April 2019.

Directors' Report

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2018.

The financial information given in this Directors' Report is taken from the statutory Accounts on pages 96 to 218 prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). Further unaudited information which allows comparison between 2018 and 2017 is set out on pages 18 to 33 of the Strategic Report.

Business objectives

The business objectives of the Group are set out on pages 14 to 18 of the Strategic Report.

Business review and future developments

The Chairman's Statement set out on pages 8 and 9, the Group Chief Executive's Report set out on pages 10 to 12 and the Strategic Report set out on pages 13 to 33 report on the performance of the business and its future objectives.

Profits and capital

Group profit before tax was £188.2m (2017: £200.1m). Total profit after tax transferred to the general reserve was £147.6m (2017: £158.2m).

Total Group reserves at 31 December 2018 were £1,524.8m (2017: £1,404.8m) including the fair value reserve of £1.6m (2017: available-for-sale reserve of £3.1m) and the cash flow hedging reserve of £(0.2)m (2017: £0.1m).

Gross capital at 31 December 2018 was £1,566.4m (2017: £1,446.4m) including £41.6m (2017: £41.6m) of subscribed capital. The ratio of gross capital as a percentage of shares, deposits and borrowings at 31 December 2018 was 7.42% (2017: 7.64%) and the free capital ratio was 6.23% (2017: 6.44%). The Annual Business Statement on pages 222 to 224 gives an explanation of these ratios.

Mortgage arrears

Group mortgage balances at 31 December 2018 included 72 cases (2017: 84) either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £9.9m (2017: £12.5m). The total amount of arrears on these loans was £0.6m (2017: £0.9m).

Charitable donations

During the year the Group made charitable donations of £0.3m (2017: £0.3m), primarily to the Skipton Building Society Charitable Foundation. No contributions were made for political purposes (2017: £nil).

Creditor payment policy

The Group's policy concerning the payment of suppliers is to negotiate and agree terms and conditions with all suppliers and upon complete provision of goods and services, unless there is an express provision for stage payments, undertake to pay suppliers within the agreed payment period, usually 30 days. The number of trade creditor days as at 31 December 2018 for the Group was 15 days (2017: 11 days).

Principal risks and uncertainties

The principal risks and uncertainties are set out on pages 64 to 69 of the Risk Management Report and in notes 34 to 36 to the Accounts.

Financial risk management objectives and policies

Details of the key risks to which the Group is exposed in relation to its financial instruments, and how these risks are managed, are set out on pages 64 to 69 of the Risk Management Report and in notes 34 to 36 of the Accounts.

Employees

The Group remains committed to its policy of treating all employees and job applicants equally at all times. Our policy is that no employee, or potential employee, is treated less favourably on the grounds of age, race, colour, religion, nationality, ethnic origin, gender, marital status or sexual orientation. We also give all applications from disabled people full consideration in relation to the vacancy concerned and their own aptitudes and abilities. In the event of an existing employee becoming disabled, we make every effort to maintain their present position or to employ them in alternative suitable work.

We also aim to provide high quality relevant training and development opportunities to all employees, which enables them to achieve their full potential and helps the Group meet its corporate objectives.

The Board meets 10 times a year and is briefed regularly on key employee matters as they arise. There is a comprehensive internal communications structure to cascade relevant business information to employees throughout the organisation in an appropriate and timely way. The Society's subsidiary companies have similar arrangements in place to ensure that their employees are effectively managed.

The Society recognises an independent employee trade union (Aegis) with which management meets regularly to consult and negotiate on a wide variety of matters and to which employees may make their views known on issues affecting their interests.

Property, plant and equipment

The Directors consider that the overall market value of the freehold and leasehold properties occupied by the Group, excluding the principal office of the Society, is in excess of the book value. In arriving at this view, the Directors have taken account of internal and external valuations of the Group's property portfolio. It is difficult to ascertain a reliable market value for the principal office of the Society, which is a special purpose facility, however the Board considers that its value in use to the Group is greater than its book value.

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

This statement, which should be read in conjunction with the Independent Auditor's Report on pages 90 to 95, is made by the Directors to explain their responsibilities in relation to the preparation of the Annual Report and Accounts.

The Directors are responsible for preparing the Annual Report, Annual Business Statement, Directors' Report and the Annual Accounts in accordance with applicable laws and regulations.

The Building Societies Act 1986 (the Act) requires the Directors to prepare Group and Society Annual Accounts for each financial year. Under that law they are required to prepare the Group Annual Accounts in accordance with IFRS as adopted by the EU and applicable law and have elected to prepare the Society Annual Accounts on the same basis.

The Group and Society Annual Accounts are required by law and IFRS as adopted by the EU to present fairly the financial position and the performance of the Group and the Society. The Building Societies Act 1986 provides in relation to such annual accounts that references in the relevant part of that Act to annual accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the Group and Society Annual Accounts, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU;
- assess the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

In addition to the Annual Accounts, the Act requires the Directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Group. The Annual Business Statement can be found on pages 222 to 224.

The Directors are also required by the Disclosure and Transparency Rules of the Financial Conduct Authority to include a management report containing a fair review of the business, which is set out on pages 18 to 33 of the Strategic Report, and a description of the principal risks and uncertainties facing the Group which is set out on pages 64 to 69 of the Risk Management Report.

The Directors have decided to prepare voluntarily a Report on Corporate Governance as if the Society were required to comply with the Listing Rules and the Disclosure and Transparency Rules of the Financial Conduct Authority in relation to those matters.

A copy of these Annual Report and Accounts are placed on the Society's website. Information in respect of the Capital Requirements (Country-by-Country Reporting) Regulations 2014 is included as an annex to these Annual Accounts on pages 220 and 221.

Directors' responsibilities for accounting records and internal controls

The Directors are responsible for ensuring that the Group:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act; and
- takes 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 Financial Conduct Authority and Prudential Regulation Authority under the Financial Services and Markets Act 2000.

The Directors are responsible for such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the UK governing the preparation and dissemination of annual accounts may differ from legislation in other jurisdictions.

Directors' responsibilities in respect of going concern

The Group's business activities together with its financial position, capital resources and the factors likely to affect its future development and performance are set out on pages 13 to 33 of the Strategic Report and on pages 62 to 69 of the Risk Management Report. In addition, notes 34 to 36 of the Annual Accounts include the Group's objectives, policies and processes for managing its liquidity risk, details of financial instruments and hedging activities, and its exposure to credit risk, liquidity risk and market risk.

In common with many financial institutions, the Group meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources, and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The Group's forecasts and objectives, which take into account potential changes in trading performance and funding retention, indicate that the Group expects to be able to operate at adequate levels of both liquidity and capital for the foreseeable future.

Directors' Report *(continued)*

Consequently, after reviewing the Group's forecasts and the risks it faces, the Directors are satisfied that there are no material uncertainties that may cast significant doubt about the Group's ability to continue as a going concern and have, therefore, continued to adopt the going concern basis in preparing these Annual Accounts, as explained in note 1a) to the Accounts.

Directors' statement of longer term viability

In accordance with the UK Corporate Governance Code, the Directors have assessed the prospects and the ongoing viability of the Group over a longer period than the 12 month period required by the going concern basis of accounting.

The Directors' assessment of the medium term prospects of the Group is based on the Group's corporate plans, which project the Group's performance, profitability, capital, liquidity and funding position over a five year period. The assessment also included a review of the Group's current position relative to the market and a review of the Group's strategic priorities over the medium term including management actions to achieve these strategic goals.

The assessment also included a robust review of the Group's principal risks and uncertainties (outlined on pages 64 to 69), which were taken into account to ensure that the possible likelihood or impact of these risks materialising would not materially impact the prospects of the Group and to ensure that the necessary control framework was in place to mitigate the impact of these risks on the future prospects of the business. Specifically, the Directors took account of those risks which could threaten the Group's business model, future performance, solvency and liquidity, including the economic, regulatory and political environments.

The Directors concluded that the medium term prospects of the Group are satisfactory and the financial strength of the business remains healthy throughout the period of assessment.

The Directors have assessed the viability of the Group with the period of assessment being a five year period, to the end of 2023. Having considered various options, the Directors determined that a five year period is an appropriate period for the purposes of the Group's viability assessment. This period reflects the Group's five year corporate planning horizon over which the prospects of the Group and principal risks threatening these prospects are assessed as outlined above, and also the period for which associated stress testing is performed.

In arriving at their conclusion on the longer term viability of the Group, the Directors considered the following:

- The Group's prospects over the five year period as outlined above.
- Stress testing carried out on the 2019 – 2023 business plans through the Group's Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process. The key economic stress test modelled reflected a market-wide fall in residential house prices of 33%, unemployment reaching 9.5% and the Bank Base Rate increasing to 4.0% during the five year period, each of which would adversely impact on the level of losses experienced within the Group's loan portfolio. The Directors concluded that the impact of this severe economic environment would not threaten the longer term viability of the Group.
- Reverse stress testing carried out by the Group, which considers scenarios specific to the Group that could cause the Group to fail. The Directors have concluded that any such scenarios are unlikely to materialise.
- The potential impact of emerging regulation, where there is sufficient information regarding the future regulation.
- The principal risks facing the Group and the control framework in place to manage and mitigate these risks (as outlined in the Risk Management Report), including an assessment of the likelihood and impact of these risks on the Group. This includes specific consideration of the potential impacts that may result from the UK's planned departure from the EU in March 2019.
- A number of severe but plausible scenarios, arising from the principal risks, which are remote, but if they arose could threaten the longer term viability of the Group.

There are inherent limitations in preparing long term financial plans with regard to a number of factors including, but not limited to, economic, political and regulatory factors. The Directors consider that the outer years of the financial planning period are more difficult to predict and therefore these years have a greater degree of uncertainty. In particular, the Group may be affected, albeit more indirectly than businesses with international trade relationships, by the impact of the UK leaving the EU and the associated political and economic implications that may arise. These impacts may have an effect on the performance of the Group within the Group's financial planning period; the extent of the impact is currently unknown.

However, based on the results of this assessment, the Directors concluded that 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 next five years.

Directors

The Directors of the Society during the year were as follows:

Mr R D East	(Chairman)
Mr M J Lund	(Deputy Chairman, appointed to position 24 April 2018)
Mr G E Picken	(former Deputy Chairman, resigned 23 April 2018)
Mr A P Bottomley*	
Ms A J Burton	
Ms M Cassoni	
Mr J R Coates	
Mrs D P Cockrem	
Mr I M Cornelius*	
Mr D J Cutter*	(Group Chief Executive)
Mr D A Hall	
Ms H L Jackson	(appointed 24 October 2018)
Mr R S D M Ndawula*	
Ms H C Stevenson	

*Executive Directors

Details of Directors' service contracts are disclosed in the Directors' Report on Corporate Governance on page 53. No Director of the Society had any interest in the shares of any Group undertaking as at 31 December 2018.

Auditor

Due to an update to EU legislation, KPMG LLP is legally required to resign as the Society's external auditor following the audit of the 2020 Annual Report and Accounts, however KPMG will resign as the Society's external auditor at the forthcoming AGM of the Society in April 2019 to coincide with the required rotation of the current senior partner.

The external audit process was put out to tender during the year and the Board concluded that they believe Ernst & Young LLP (EY) should be appointed as the Society's external auditor.

In accordance with Section 77 of the Building Societies Act 1986, a resolution for the appointment of EY will be put to the forthcoming AGM of the Society.

The Directors who held 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 Society's auditor is unaware, and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

Responsibility statement of the Directors in respect of the Annual Report and Accounts

The Directors who held office at the date of approval of this Directors' Report confirm that, to the best of their knowledge:

- the Annual Accounts, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society; and
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and Society, together with a reference to the principal risks and uncertainties they face.

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

Signed on behalf of the Board

Robert East
Chairman

26 February 2019

Directors' Report on Corporate Governance

As Chairman of the Society and, in line with the Society's ethos, I view good governance as being at the heart of a well-run business and am committed to complying with prevailing best practice. This report sets out the framework of how the Society oversees its business in a prudent and well organised manner, thereby maintaining high standards of governance for the benefit of our current and future members.

Our approach is based on the principles and provisions of the UK Corporate Governance Code ('the Code') published by the Financial Reporting Council (FRC) which applies to listed companies. This report benchmarks the Society against the prevailing version of the Code (published in April 2016), which is applicable to entities with accounting periods commencing on or after 17 June 2016. A copy of the Code is available at frc.org.uk. A revised Code comes into operation on 1 January 2019 and we will report on how we comply with this in next year's report.

The Board's philosophy is to comply with the Code and the guidance issued by the Building Societies Association on it, to the extent that it is relevant to a building society. Section E of the current Code requires the Chairman to discuss governance matters with major shareholders and relay their views to the Board as a whole. As a mutual organisation, owned by its members with each voting member having one vote, there are no major shareholders and hence this specific requirement is not relevant to the Society.

During 2018 the Board believes that the Society complied with the guidance issued by the Building Societies Association on the Code.

Governance framework

The Skipton Group comprises Skipton Building Society (the Society), which is regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), and its direct and indirect holdings in a number of legal entities, some of which are also regulated by the FCA. Skipton International Limited is regulated by the Guernsey Financial Services Commission.

The Society's governance arrangements are designed to ensure that it meets the requirements and expectations of its members, employees and regulators through a framework which organises the Group into three divisions:

- Mortgages and Savings
- Estate Agency
- Investment Portfolio

The Society sits within the Mortgages and Savings division which also includes related subsidiaries Amber Homeloans Limited, North Yorkshire Mortgages Limited and Skipton International Limited, our Guernsey-based banking subsidiary.

On a day-to-day basis the Group Chief Executive, Mr Cutter, is responsible for ensuring that the Group meets its strategic and operational objectives as defined in the corporate plan. Mr Cutter is assisted by the Executive Committee, comprising the Executive Directors and other senior Society executives, which he chairs.

Each subsidiary of the Group is governed by a board, which normally contains at least two Society executives as shareholder Non-Executive Directors (appointed by the Society) and the business' own executive management. In addition, Ms Burton, a Society Non-Executive Director, is also a Non-Executive Director of Connells Limited, being the only Non-Executive Director of the Society to hold such a role. These Boards are responsible for the prudent management of the business, operating within delegated authorities, to deliver agreed corporate plan objectives.

The Board's 'Principles of Governance', which are summarised below, provide the framework through which the Society establishes its systems and processes concerned with the overall direction, effectiveness and control of the Group.

Directors

The role of the Board

The Board's terms of reference clearly set out its responsibility for the overall stewardship of the Group within the context of the Society's 'Principles of Governance' which are:

- **Governing body** - *The Society is headed by an effective Board which is responsible for the long term success of the Group.*

  The Board formulates strategy and establishes the Society's risk appetite and balance sheet strategy. It is organised so as to have a proper understanding of, and competence to deal with, the current and emerging issues facing the business of the Group, exercising independent judgement and effectively reviewing and challenging the performance of management.

- **Management and oversight** - *The Society's management and oversight framework enables the Board to provide strategic guidance to, and effective oversight of, management throughout the Group.*

  The governance framework clarifies the respective roles and responsibilities of Directors and senior executives in order to facilitate Board and management accountability to both the Society and its members. This ensures a balance of authority such that no single individual has unfettered powers. It has clear lines of sight into activities to enable challenge and oversight, allowing the Board to obtain assurance over performance, the integrity of reporting and effectiveness of control implementation.

- **Recognise and manage risk** - *The Board has a sound system of risk oversight, risk management and internal control supported by timely and transparent reporting.*

  This framework identifies, assesses, manages and monitors risk on an ongoing basis. It informs management and the Board of material changes to the risk profile of the Society or any of its subsidiaries and facilitates challenge of the effectiveness of actions taken to mitigate risk. It is designed to be forward-looking in approach so as to reduce both the likelihood and the impact of known risks crystallising.

To support delivery of this, it has established a framework of authorities that maps out the structure of high level delegation below Board level and specifies those issues which remain the responsibility of the Board. The Board also has a general duty to ensure that the Group operates within the Society's Rules, relevant laws, regulations and guidance issued by relevant regulatory authorities and that proper accounting records and effective systems of internal control are established, maintained and audited.

Board meetings

The Board meets at least 10 times per year and the Non-Executive Directors also meet, without the Executive Directors present, at least once a year. The attendance record of each Director at these Board meetings and each committee member at relevant Board committee meetings is set out on page 55.

The Board also holds two strategy meetings each year, in June and December, where the Group's strategic objectives are agreed, as are the financial and operational resources to deliver these.

Through the Secretary, the Chairman ensures that Directors receive accurate, timely and clear information to facilitate effective contribution to Board discussions and decision making. Each month, the Board receives a Board pack containing matters for review and approval, as well as a comprehensive management information pack covering financial and non-financial information (including operational and customer service metrics), with risk management being an integral part of the reporting. This is issued the week prior to the meeting to ensure that it reflects the most up to date position of the Group whilst allowing Directors sufficient time to review the content.

The Board agenda also includes:

- Minutes of Board Committee meetings held before the previous Board meeting and verbal updates from the chairmen of Board Committees on the main issues discussed and matters agreed at recent meetings (usually held the day before the Board meeting) for which minutes are not yet available. This ensures that all Board members are kept up to date on the key discussions and decisions made by the committees;
- Reports from the Chairman, Group Chief Executive and Group Finance Director;
- Items for decision and key matters that need to be debated, including any new business initiatives;
- Matters for review which include updates on specific areas of strategy allowing the Board to keep up to date with developments, identify opportunities and challenge progress; and
- Matters for information aimed at drawing to the Board's attention matters it should be aware of, such as proposed regulatory change.

For the Board to be effective, the relationship between the Executive and Non-Executive Directors must be constructive and one of openness and respect. The Boardroom environment at Skipton is collegiate with all encouraged to contribute. The role of the Non-Executive Directors is not only to challenge but to support the executive team and bring their experience to bear. To this end, the Non-Executive Directors are welcomed to meetings outside of the Board committee structure which develops their understanding of the business whilst allowing the management teams to benefit from their experience and fully understand the non-executive perspective on particular issues.

Board composition

The Rules of the Society detail the appointment process for Directors and require that the Board comprises not less than six and not more than 15 Directors. At 31 December 2018 the Board comprised 13 Directors, being four Executive Directors and nine Non-Executive Directors. Details of the Directors are set out on pages 40 to 45. This composition is designed to be able to meet the needs of the business and allow for efficient operation of the Board's committees.

The Board considers all the Non-Executive Directors to have been independent at the time of their appointment and to have continued to be so in accordance with the criteria set out in the Code. One Director, Mr Coates, appointed in 2017 was previously Managing Director of a former Society subsidiary, Baseline Limited, but retired from the Group's employment in 2008. No Board members have any direct business relations with the Society or any of its subsidiaries or have any personal or family ties with any of the businesses' advisers, Directors or senior employees.

The Chairman regularly reviews the size and composition of the Board and its committees which are reviewed formally by the Nominations Committee at least annually. This ensures that there exists the required mix of skills and experience on the Board and that succession planning is adequately addressed; our Board Composition Policy is available on the Society's website. The Nominations Committee aims to ensure that the Board's committees are optimally resourced and are refreshed at appropriate intervals to avoid reliance on any one individual.

Non-Executive Directors

As part of their Board responsibilities, the Non-Executive Directors are responsible for bringing independent judgement to the Board and for constructively challenging the executive team. The Non-Executive Directors meet, without the Executive Directors present, at least annually to discuss relevant matters, including the performance of the executive team.

Mr Lund (Deputy Chairman) is the Senior Independent Director on the Board. Whilst the Senior Independent Director role is more pertinent within a quoted company, the role does provide a point of contact for members and other stakeholders with concerns which have failed to be resolved or would not be appropriate to pursue through the normal channels of the Chairman, Group Chief Executive or Group Finance Director. The Senior Independent Director also provides a sounding board for the Chairman and serves as a trusted intermediary for other members of the Board, if necessary. As part of our governance regime, he meets annually with the other Directors, without the Chairman present, in order to appraise the performance of the Chairman.

One of the criteria which the Board takes into consideration when recruiting a Non-Executive Director is their ability to have sufficient time to take on the position. In addition, throughout their term of office with the Society, Directors are required to inform the Board in advance of any other positions that they wish to take up so that the time commitment and any potential conflict of interest can be considered. The Society's letters of appointment to Non-Executive Directors give an indication of the time commitment required, although this will depend on Board Committee memberships; typically it involves at least three days per month on Society business. For the Chairman this will usually be, on average, two days per week.

The letters of appointment also identify the key responsibilities of the Non-Executive Directors in relation to:

- Strategy – constructive challenge and contribution to the development of strategy.
- Performance – scrutiny of the performance of management in meeting agreed business goals and objectives.
- Risk – obtaining assurance that financial controls and systems of risk management are robust and allow for production of accurate financial reporting.
- People – determination of appropriate levels of remuneration for Executive Directors and oversight of succession planning.

Copies of the letters of appointment of each of the Non-Executive Directors are available for inspection on request from the Society's Secretary.

Chairman and Group Chief Executive

The offices of the Chairman and the Group Chief Executive are distinct and held by different individuals. The role of each is set out in their role profiles and terms of appointment.

As Chairman I am responsible for leading the Board, ensuring it performs effectively, and for promoting high standards of corporate governance. The Chairman is also responsible for communicating with the Society's members on behalf of the Board. I can confirm that I am independent and have no conflicting relationships or circumstances that might affect my judgement on Group matters.

The Group Chief Executive has overall responsibility for managing the Society and the subsidiaries. He leads the executive team and is responsible for implementing the strategies and policies agreed by the Board.

The Board elects its Chairman and Deputy Chairman annually at the Board meeting immediately following the Annual General Meeting (AGM).

Appointments to the Board

The Nominations Committee, which comprises all the Society's Non-Executive Directors, is chaired by myself, as the Society Chairman, and leads the process for Board appointments and succession planning. The Committee has succession planning as a key area of focus and at least annually reviews the structure, size and composition (including diversity) of the Board to ensure it contains the required balance of skills, knowledge and experience relevant to the activities of the Group and that it will continue to do so. This review assesses what is required both in the short term and the longer term to deliver the Society's strategy in light of its strategic priorities and changing customer behaviours.

Appointments to the committees of the Board (see page 54 for details) are made by the Board on the recommendation of the Nominations Committee, in consultation with the relevant committee's chairman. Both the Nominations Committee and the Board have regard to ensuring a range of skills, experience, knowledge and professional qualifications exist on each Board committee to enable it to fulfil its duties effectively.

The Nominations Committee carries out an annual review of succession planning for Directors and senior executives. The succession plan ensures ongoing recruitment of Directors so that the Board continues to have the relevant skills and experience throughout any period of change in its composition. Senior executive succession planning is reviewed at least annually by the Committee to ensure that those identified with having potential at this level and in the talent pool below are provided with relevant development opportunities and, where appropriate, that effective contingency arrangements are in place.

2018 saw a new addition to the Board with Heather Jackson joining as a Non-Executive Director. The Committee used the services of Warren Partners, an external recruitment agency independent of the Society, in making this appointment.

Induction and professional development

On appointment, new Directors receive a comprehensive and tailored induction programme covering the Group's business and regulatory environment. Ongoing training and development needs are identified and addressed through regular review and usually take the form of attendance at external seminars and Board training sessions led by relevant internal and external specialists. Those Directors from a non-banking background are provided with specific training on the capital and liquidity regimes governing the Society's operations. Non-Executive Directors are encouraged to contact individual members of the executive team to discuss any queries they may have and to undertake subsidiary, branch and department visits on an ongoing basis.

Directors have access to the advice and services of the Secretary who is responsible for advising the Board on all governance matters and who is responsible for ensuring that Board procedures are followed. The appointment of the Secretary is a matter reserved to the Board.

All Directors also have access to independent professional advice, if required, at the Society's expense and have the benefit of appropriate liability insurance cover.

Diversity

At Skipton, we believe a diverse and inclusive culture is integral to our core values, fostering an environment where everyone is enabled to perform well and fulfil their potential. We respect and appreciate the value our colleagues' unique differences bring. The Board's policy is designed to enable us to build a stronger Society – attracting, developing and retaining talented people to serve the needs of our diverse customer base today and in the future.

Our work on diversity and inclusion is led by a steering group including members of our Executive Committee. We have formed five key working groups with involvement of colleagues from all areas and all levels of the Society, to focus on key issues and opportunities in relation to gender, disability, LGBTQ, ethnicity and flexible working. Examples of activity underway include developing mental health first aiders, improving diversity management information, supporting Leeds Pride and unconscious bias training whilst improving general education and awareness. We have introduced a policy of blind CVs and mixed gender interview panels to reduce the risk of unconscious bias at the recruitment stage and ensure our workforce is representative of the wider society.

All appointments to the Board are made on merit. In so doing, the Board considers all aspects of diversity, including age, experience and gender, when reviewing its composition. It has a Composition policy which, in line with the recommendations of the Davies Report, seeks to ensure that at least 33% of its composition will be female.

A Davies progress report issued in October 2015 recommended that FTSE 350 boards should endeavour to achieve this target by 2020. At 31 December 2018, five members (38.5%) of the Society's Board were female.

Performance evaluation

The Board undertakes an annual evaluation of its, and its committees', performance and effectiveness. At least every three years, this review is conducted by an external facilitator. The reviews address matters including the balance of skills on the Board, its diversity, how the Board and its committees work together and other factors relevant to its effectiveness.

In 2016 the Board engaged Praesta Partners LLP, who had no other connection with the Society, to undertake an external performance evaluation of the Board and its committees. The 2017 and 2018 reviews were led by myself as Chairman, supported by the Secretary; the 2019 review will, again, be externally facilitated.

The 2018 results were considered by the Board at its January 2019 meeting. This found that the Board and its committees are considered to be operating effectively whilst the culture of the Board and its collaborative style continues to be regarded positively. Steps taken following the Praesta review are thought to have been effective and should be continued. The review identified several areas where the Board could improve focus, including assurance that suppliers met expected standards of behaviour and were treated fairly by the Society, the impact of environmental and social issues on the Society and its business model, and succession planning, particularly in subsidiary businesses. It was agreed that these topics would be added to the Board agenda and subject to ongoing discussion throughout the year.

Individual Non-Executive Directors are evaluated on a one-to-one basis by the Chairman. Executive Directors are evaluated by the Group Chief Executive against agreed performance targets for their areas of responsibility and their own personal performance. The Chairman evaluates the Group Chief Executive's performance whilst the Deputy Chairman and Senior Independent Director leads the Board evaluation of the Chairman's performance. All such reviews are conducted at least annually.

Re-election policy

The Code recommends that all Directors of FTSE 350 companies should stand for annual re-election. Adopting this best practice, the Society's Rules require that Directors stand for re-election every year. Generally, Non-Executive Directors are initially appointed for a period of three years and, whilst expected to serve for six years, this may be extended to nine years in total.

The Board and Nominations Committee at their October meetings agreed with my recommendation that, as a very effective member of the Board, Ms Stevenson's tenure as a Non-Executive Director be extended to nine years. The Society is currently reviewing its Group remuneration governance arrangements and it was considered efficient and appropriate to extend the term of office of Ms Stevenson as Chairman of the Remuneration Committee to oversee developments.

Remuneration

Details relating to Directors' remuneration are contained in the Directors' Remuneration Report on pages 70 to 87.

Directors' service contracts and notice periods

The Executive Directors are employed on rolling service contracts which can be terminated by either the Society or the Director giving one year's notice. Unless notice to terminate is given by either party, the contracts continue automatically.

Non-Executive Directors do not have service contracts.

Accountability and audit

Financial reporting

The Directors, after making appropriate enquiries and on review of internal management reports and completion of the external audit, consider that these Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for members to assess the Group's performance, business model and strategy. Further details on how this conclusion has been arrived at can be found on page 58 of the Audit Committee Report.

The responsibilities of the Directors in relation to the preparation of the Group's Annual Accounts and a statement that the Group is a going concern are contained in the statements of Directors' responsibilities on pages 47 and 48 in the Directors' Report.

Risk management and internal control

The Board is responsible for determining the Society's strategy for managing risk and overseeing its systems of internal control which includes reviewing and approving its risk appetite on, at least, an annual basis.

The Executive Directors and senior management are responsible for the continuous operation of an effective risk management framework based on a robust system of internal control. Such systems are designed to manage rather than eliminate the risk of failure to achieve the Society's business objectives. The principal categories of risk confronting the Group are described in greater detail in the Risk Management Report on pages 62 to 69, together with an explanation of the framework adopted by the Group for managing risk.

The Board reviews the ongoing effectiveness of its internal control system through a combination of processes including:

- Regular reports to the Board by the chairpersons of its various committees;
- Presentations to the Board by divisional leaders relating to the strategy and performance of businesses within each of the divisions, summarising business performance, key business risks, issues and strategies;
- Regular reports to the Board, through the Audit Committee, from the Internal Audit function in respect of its independent audits of risk management processes and effectiveness of internal controls across the Society and its subsidiaries. The Chief Internal Auditor reports to the Chairman of the Audit Committee and regularly attends the Audit Committee meetings; and
- Regular reports to the Board, through the Board Risk Committee, from the Risk functions on the principal conduct, operational, credit, market and liquidity risks facing the Group and the strength of the controls in place to mitigate these.

The Society has a comprehensive system for reporting financial results to the Board. Each division prepares monthly results with comparisons against budget which the Board reviews and challenges, as appropriate, where performance is not in line with expectations.

The Society has a number of central oversight and control functions, including Finance, Risk and Compliance, which establish and monitor the implementation of business standards across the Group. Each of these functions is subject to review by the Internal Audit function.

The Internal Audit function is responsible for independently reviewing and reporting on the adequacy and effectiveness of internal controls operated by management throughout the Group, thereby helping to evaluate and improve the effectiveness of risk management. Through its programme of work, approved by the Audit Committee, the Internal Audit function is able to provide assurance on control effectiveness.

To ensure sufficient focus is devoted to all areas of risk, the Society operates two discrete risk functions headed by the Chief Financial Risk Officer and the Chief Conduct Risk Officer. These are Senior Executive positions with both post holders being members of the Executive Committee. The Board Risk Committee and Board receive regular reports from the two Risk Officers throughout the year. The Board is satisfied that it understands the risks confronting the business and that senior management take appropriate action to mitigate these. More detail is provided on these in the Risk Management Report on pages 62 to 69.

The Board is satisfied that during 2018 the Society maintained an adequate system of internal control and managed the risks confronting the business effectively. This was carried out in a manner that met the requirements of the Code and good business practice generally.

Board Committees

The Board has delegated certain matters to Board Committees in order that these can be considered in more detail.

The committee structure includes:

- The Audit Committee – further detail is contained in the Audit Committee Report on pages 56 to 61;
- The Board Risk Committee – further detail is contained in the Risk Management Report on pages 62 to 69;
- The Remuneration Committee and Non-Executive Directors' Remuneration Committee – further detail is contained in the Directors' Remuneration Report on pages 70 to 87; and
- The Nominations Committee – further detail is contained in the section on 'Appointments to the Board' on page 52 of this report.

The terms of reference of Board Committees are available on the Society's website (skipton.co.uk) or from the Secretary, on request.

Board and Committee membership attendance record

The attendance of current Directors at scheduled Board and committee meetings of those who are also members during the year is set out below:

	Board	Audit Committee	Nominations Committee	Remuneration Committee	Board Risk Committee
Mr R D East	10/10	-	4/4	-	-
Mr G E Picken	3/3	3/3	2/2	-	3/3
Mr A P Bottomley	10/10	-	-	-	-
Ms A J Burton	10/10	-	4/4	5/5	-
Ms M Cassoni	10/10	6/6	4/4	-	-
Mr J R Coates	10/10	6/6	4/4	-	4/4
Mrs D P Cockrem	10/10	6/6	4/4	5/5	-
Mr I M Cornelius	10/10	-	-	-	-
Mr D J Cutter	10/10	-	-	-	-
Mr D A Hall	10/10	-	4/4	5/5	7/7
Ms H L Jackson	2/2	-	1/1	-	-
Mr M J Lund	10/10	-	4/4	-	7/7
Mr R S D M Ndawula	10/10	-	-	-	-
Ms H C Stevenson	9/10	-	4/4	5/5	6/7

Note: Where Directors are not available to attend meetings, they, nonetheless, receive all papers and provide feedback as appropriate. Mr Picken retired from the Board at the 2018 AGM in April whilst Ms Jackson joined the Board in October 2018.

The Annual General Meeting (AGM)

Each year the Society gives all eligible members at least 21 days' notice of its AGM. At the meeting, the Chairman and Group Chief Executive address members on the previous year's performance and the main developments in the business. Members have the opportunity to raise questions and put forward their views. All Directors attend the AGM, unless their absence cannot be avoided, and are available for questions both during a 'question and answer' session in the meeting and on an individual basis before and after the meeting.

All eligible members are encouraged to vote at the AGM, either in person or by voting proxy although the voting form includes a 'vote withheld' option. Members can vote either by post, in any of our branches, online at skipton.co.uk/agm or at the AGM itself. All votes are returned to independent scrutineers. A poll is called in relation to each resolution at the AGM and the results of the vote are published on the Society's website and in branches. As a minimum, the Society's members at the AGM are asked to vote on the Society's Annual Report and Accounts, election or re-election of the Directors, appointment or re-appointment of the external auditor and the Report on Directors' Remuneration.

Relations with members and other investors

The Society's membership comprises its savers, holders of its Permanent Interest Bearing Shares (PIBS) and non-corporate borrowers which 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 its activities and seeks to respond quickly to all enquiries received.

We conduct regular market research with members to evaluate their experience of dealing with the Society and how satisfied they are with their relationship with us. We carry out interviews with members each year to help us understand how we can improve the service we provide to them. We also engage with members in numerous other ways, including through our customer forums. These consist of face-to-face sessions with customers to get their feedback on our strategies and initiatives. In addition, we have a members' customer panel which we use to gather feedback on a wide range of topics including new product and proposition development.

Finally, the Society's senior executive and Treasury teams hold meetings with banks and debt investors, where appropriate, to update them on the Society's performance and respond to any questions.

In summary, I believe that the governance arrangements operated by the Society align with the Code's requirements and enable the Board to exercise effective oversight of business performance, regulatory requirements and delivery of our customer proposition.

On behalf of the Board

Robert East
Chairman

26 February 2019

Audit Committee Report

On behalf of the Committee, I am pleased to present this year's Audit Committee Report, which provides an overview of how we, as a Committee, have discharged our responsibilities, setting out the significant issues we have reviewed and concluded on during the year.

The report focuses mainly on the following three areas:

- The role and responsibilities of the Committee;
- The main activities of the Committee during the year; and
- A review of the effectiveness of the Committee.

Membership and attendees

The members of the Audit Committee during the year were:

Ms M Cassoni	Non-Executive Director (Committee Chairman)
Mrs D P Cockrem	Non-Executive Director
Mr J R Coates	Non-Executive Director
Mr G E Picken	Non-Executive Director (retired from the Committee 23 April 2018)

The Committee met six times during 2018 and the attendance of its members at these meetings is set out on page 55 in the Directors' Report on Corporate Governance. We also held private discussions during the year with the external auditor KPMG LLP (KPMG), the Chief Conduct Risk Officer and Secretary, the Chief Financial Risk Officer, the Group Finance Director, the Chief Internal Auditor, the Connells Group Finance and Commercial Director, the Finance Director of Jade, the Finance Director of Skipton Business Finance and the Finance Director of SIL, to provide an opportunity for any relevant issues to be raised directly with Committee members.

In addition to its members, the Group Chief Executive, the Group Finance Director, the Chief Conduct Risk Officer and Secretary, the Head of Compliance Monitoring, external audit representatives and the Chief Internal Auditor regularly attend meetings, by invitation.

The Committee is currently comprised of three members, all of whom are independent Non-Executive Directors. Consideration is given towards ensuring that the Audit Committee as a whole has competence relevant to the financial services sector.

The Board is satisfied that the composition of the Audit Committee includes Non-Executive Directors with recent, relevant financial experience to provide appropriate challenge to management. As Chairman of the Committee, I am a Chartered Accountant who has held senior finance appointments with a number of large organisations, most recently as Group Finance Director at the John Lewis Group prior to retirement in 2012, and have chaired a number of audit committees in the quoted sector. Mrs Cockrem is currently Group Chief Financial Officer at the Ecclesiastical Insurance Group, was recently Chief Financial Officer at the Good Energy Group and has also held senior finance positions at RSA Group and Direct Line. Mr Coates has a wealth of experience, having spent 30 years in senior roles at KPMG.

In terms of good governance and to ensure holistic oversight, Mr Coates is also a member of the Board Risk Committee. As part of my role as Chairman of the Audit Committee, I also attended meetings during the year of the Remuneration Committee (of which Mrs Cockrem is a member), the Board Risk Committee and a number of subsidiary board meetings.

Having completed my six year tenure as a Non-Executive Director of the Society I will be stepping down from the Board at the Society's AGM in April 2019. I will be succeeded as chair of the Committee by Mr Coates who will complete this report next year.

Role and responsibilities of the Committee

The responsibilities of the Committee are delegated by the Board and are set out in its written terms of reference which are available on our website at skipton.co.uk/about-us/governance/board-committees. These are in line with the provisions of the Financial Reporting Council's 'Guidance on Audit Committees' which was last updated in April 2016. Our primary responsibilities are:

- To keep under review the effectiveness of the Group's internal controls, including financial controls and risk management systems;
- To monitor the integrity of the Group's financial reporting process, specifically by reviewing, challenging and recommending the Group's annual and interim financial statements to the Board for approval, reviewing and approving any formal announcements relating to the Group's financial performance and reviewing and challenging, as necessary, the significant estimates and judgements in relation to the financial statements and reporting how these were addressed;
- To provide advice to the Board on whether the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the Group's strategy, business model and performance;
- To provide oversight of the external audit process by monitoring the relationship with the external auditor, agreeing their remuneration and terms of engagement, monitoring their performance, objectivity and independence, ensuring that the policy to provide non-audit services is appropriately applied and making recommendations to the Board on their appointment, re-appointment or removal;
- To review the effectiveness and independence of the Internal Audit and Compliance Monitoring functions, approve their annual plans, review performance against these plans on a quarterly basis, review their material findings and oversee plans to remedy any shortcomings; and
- To report to the Board on how we have discharged our responsibilities.

The minutes of the Audit Committee are distributed to the Board following each meeting and, as Chairman of the Committee, I provide a verbal report to the next Board meeting after each meeting of the Committee.

Activities of the Committee during the year

During 2018 our work fell under three main areas, in line with our responsibilities, as follows:

a) Internal controls and risk

The Group recognises the importance of good systems of internal control in the achievement of its objectives and the safeguarding of its assets. Good internal controls also facilitate the effectiveness and efficiency of operations, help to ensure the reliability of internal and external reporting and assist in compliance with applicable laws and regulations.

The Group operates in a dynamic business environment and, as a result, the risks it faces change continually. Management is responsible for designing the internal control framework to ensure thorough and regular evaluation of the nature and extent of risk and the Group's ability to react accordingly. Management is also responsible for implementing the Board's policies on risk and control, noting that all employees are responsible for internal control as part of their individual objectives.

Further details of the Group's risk management practices are provided in the Risk Management Report on pages 62 to 69.

Through the Committee, the Group's Internal Audit function provides independent assurance to the Board on the effectiveness of the internal control framework. The information received and considered by the Committee during 2018 provided assurance that there were no material breaches of control and that the Group maintained an adequate internal control framework that met the principles of the UK Corporate Governance Code.

Internal Audit is supported by external advisers who are able to provide specialist technical support in connection with matters such as Treasury, Information Technology, Credit Risk and Operational Resilience. The Chief Internal Auditor reports to me and as a Committee we are responsible for ensuring that Internal Audit has adequate skills and resource levels that are sufficient to provide the level of assurance required. The Committee is satisfied that, throughout 2018, Internal Audit had an appropriate level of resources in order to carry out its responsibilities effectively and that it continues to do so.

The Audit Committee is also responsible for agreeing the annual budget of Internal Audit and for approving its annual plan of work. This is prepared on a risk based approach by Internal Audit, reflecting input from management and the Committee.

We review reports produced by Internal Audit and, through Internal Audit, track management actions to completion; Internal Audit then verifies these periodically after management has reported them as complete. Internal Audit provides the Committee with reports on material findings and recommendations and updates on the progress made by management in addressing their findings.

We monitor and assess the role and effectiveness of the Internal Audit function in the overall context of the Group's risk management systems. The Committee assesses the effectiveness and independence of Internal Audit annually, immediately following the year end, and this is reported to and discussed at a meeting of the Committee shortly thereafter.

The Committee also has oversight responsibility for the Group's Compliance Monitoring function which provides second line assurance over conduct risk on activities regulated by the FCA across the Group. The Compliance Monitoring annual plan includes both thematic reviews and customer outcomes testing which includes, but is not limited to, investment, pension, mortgage and protection advice, complaint handling and post-sale client outcomes. The outputs of the Compliance Monitoring function's monitoring activities are reported to the Committee, together with progress updates on management's implementation of the findings. The Compliance Monitoring function's annual plan of work is also approved by the Committee.

During the year, the main areas of internal control which were reviewed were as follows:

- the governance framework surrounding the use of data models by the Society, in particular the use of credit risk models following a move to a more advanced credit risk approach in 2016 (the Internal Ratings Based approach);
- the implementation of new models to facilitate the calculation of loan impairment provisions and the fair valuation of the equity release portfolio in line with the requirements of IFRS 9 *Financial Instruments*, which became effective from 1 January 2018;
- Information Technology and cyber security risks to ensure that the Group has robust controls, in line with good practice, in this rapidly evolving area;
- the governance framework surrounding key significant system related projects;
- the governance framework and key controls associated with the provision of pension advice services;
- a number of specific areas of internal control, in particular new and emerging regulatory changes to ensure that the Group meets regulatory expectations at all times; and
- the internal controls and governance within the Connells group.

The Committee periodically reviews the use of the confidential reporting channel in the Group. Awareness of 'whistle blowing' arrangements is maintained through internal communication and is covered as part of employees' induction and ongoing development. The Committee receives annual updates from the Head of Financial Crime on the systems and controls in place for the detection and prevention of fraud. The Committee also receives biannual updates from the Head of Group Tax on tax matters impacting the Group.

As part of the external audit process, KPMG also provide us with internal control reports. During the year, they did not highlight any material control weaknesses.

The Committee requires an external effectiveness review of Internal Audit at least every five years, which considers the quality, experience and expertise of the function. As outlined in the 2014 Annual Report and Accounts, a review was carried out during 2014 by an external firm appointed by the Committee and that review concluded that the Internal Audit function was operating effectively. An action plan to address the areas recommended for further improvement was developed and has been monitored by the Committee. Substantially all actions from the 2014 effectiveness review have been completed and the new audit software which was implemented during 2018 will be further embedded in 2019. Good practice requires that such assessments are conducted at least every five years; accordingly, a further external assessment is to be performed early in 2019.

The Chief Internal Auditor will step down from this role in 2019 after eleven years in post. She will remain in position until the end of July, which allows time to complete the search for her successor and ensure a smooth transition.

b) Financial reporting

The Committee considers the financial information published in the Group's annual and interim financial statements and considers the accounting policies adopted by the Group, presentation and disclosure of financial information and, in particular, the key estimates and judgements made by management in preparing the financial statements.

The Directors are responsible for preparing the Annual Report and Accounts. At the request of the Board, we considered whether the 2018 Annual Report and Accounts were fair, balanced and understandable and whether they provided the necessary information for members to assess the Group's position and performance, business model and strategy. This was assessed in the following ways:

- best practice guidance and recommendations, including those published by the Financial Reporting Council and leading audit firms, were reviewed and analysed against the Annual Report and Accounts, and enhancements implemented as a result of this analysis where necessary;
- the Executive Committee and the Board have been involved in reviewing and commenting on various drafts of the Annual Report and Accounts, to help ensure that the final draft is fair, balanced and understandable;
- the Committee reviewed and was satisfied that the alternative performance measure of underlying profit before tax (defined on page 24 in the Strategic Report), which is reported alongside the IFRS numbers, gives a clearer view of the underlying performance of the business for our members and is in line with the agreed policy; and
- robust verification by the Financial Reporting team took place to ensure there was appropriate supporting evidence for the content of the Annual Report and Accounts.

The Committee is satisfied that, taken as a whole, the 2018 Annual Report and Accounts are fair, balanced and understandable and include the necessary information as set out above. The Committee has confirmed this to the Board, whose statement in this regard is set out on page 49 of the Directors' Report.

We pay particular attention to matters we consider to be important by virtue of their impact on the Group's results, and particularly those which involve a high level of complexity, judgement or estimation by the Board. The key areas of estimate and judgement that we considered in reviewing the 2018 Annual Report and Accounts are set out below:

Significant matter	Committee action taken
Going concern and long term viability review	We have reviewed the adoption of the going concern assumption for the Interim and Annual Accounts, adopting the same, comprehensive approach for both reporting periods. This involves rigorous consideration, based on reports produced by key risk functions around the business as requested by the Committee, of our current and projected liquidity, capital and funding positions, together with the potential risks (for example, credit risk, liquidity risk, operational risk and conduct risk) which could also impact the business, as well as consideration of potential stress scenarios. Based on this review, we concluded that the adoption of the going concern assumption to prepare the financial statements remains appropriate. The Committee has reviewed the statement on the longer term viability of the Group in the Directors' Report on page 48, together with papers produced by management and key risk functions in support of this statement. This includes consideration of the Group's latest corporate plans, the impact of these plans on the Group's liquidity, capital and funding positions, and the impact of potential risks and stress scenarios. The stress scenarios included consideration of scenarios that could cause the Group to fail, and the Committee agreed that any such scenarios are considered sufficiently unlikely to materialise and thus threaten the Group's longer term viability. The Committee also gave consideration to the potential impacts on the Group of the UK's planned departure from the EU in March 2019 and the related disclosures made by management. Based on this analysis, the longer term viability statement on page 48 was recommended to, and approved by, the Board.

Significant matter	Committee action taken
Impairment of financial assets	As outlined in note 1b) to the Accounts, the Group adopted IFRS 9 *Financial Instruments* with effect from 1 January 2018. Under IFRS 9, impairment of financial assets is now assessed on an 'expected loss' basis (previously an 'incurred loss' basis under IAS 39). The 2018 Annual Report and Accounts reflects the Group's revised accounting policies for IFRS 9 (see note 1 to the Accounts) and presents information regarding the impact of initial implementation of IFRS 9 on the Group's financial position (see note 1b) to the Accounts). The Committee has continued to monitor loan impairment provisions taking account of the new requirements of IFRS 9. We have reviewed the appropriateness of critical judgements made by management, including the definition of default and the determination of significant increase in credit risk. We have considered the impact of key assumptions within the Group's loan impairment models (such as house prices and forward-looking economic scenarios) on the level of provisions made and the relevant disclosure in the Accounts. We have examined and challenged the assumptions adopted and, by requesting and scrutinising reports produced by management, are satisfied with the models used during the year to calculate loan impairment provisions for both the residential and commercial mortgage portfolios. The Committee has also monitored the level of impairment held against treasury assets under IFRS 9, including scrutinising reports produced by the Market & Liquidity Risk function. We consider the level of impairment held against these assets to be appropriate.
Fair valuation of the equity release portfolio	The Group holds an equity release portfolio, closed to new business, and a no negative equity guarantee (NNEG) has been given to customers under the terms and conditions of the mortgages in this portfolio. Prior to IFRS 9, the equity release loans were held at amortised cost and the NNEG was held at fair value. Following implementation of IFRS 9, the entire equity release asset (including the NNEG) is now held at fair value with resulting gains / losses taken to the Income Statement. The impact of initial implementation of IFRS 9 on the amounts relating to the equity release portfolio is disclosed in note 1b) to the Accounts. As outlined in note 1e) to the Accounts, there is no single industry pricing methodology for valuing the Group's equity release portfolio. The Group has therefore internally devised a fair valuation model, using inputs including mortality rates, voluntary prepayment rates, estimates of future RPI and the House Price Index, and associated volatility, to predict future cash flows on the portfolio. The valuation is also impacted by selection of an appropriate discount rate (which includes an illiquidity premium). As the valuation technique uses some inputs that are not based on observable market data, judgement is required in determining appropriate assumptions. The Committee has reviewed the assumptions within the equity release fair valuation model and scrutinised supporting papers prepared by management. Taking into account the specific characteristics of this portfolio and also general macro-economic indicators, the Committee considers that the inputs and assumptions are appropriate, and therefore that the valuation of the equity release portfolio is appropriate in the 2018 Annual Report and Accounts. The Group hedges the interest rate risk arising from its equity release portfolio through the use of derivatives. These derivatives are valued using discounted cash flow models which include estimated redemption profiles and, due to the long-dated nature of these derivatives, any changes to estimates or assumptions can have a significant effect on the valuation of the derivatives. During 2018, the swap valuation model was also updated to include a fully stochastic RPI forecast. As the underlying mortgage portfolio is no longer held at amortised cost, hedge accounting can no longer be applied. Both the equity release portfolio and the swaps are held at fair value through profit and loss. There is some offsetting between the changes in value of the portfolio and the derivatives but this is not perfect, partly due to the different discounting requirements. The Committee has reviewed papers prepared by management that support the assumptions used and which outline the control framework management has in place; the Committee is satisfied that the amounts recognised in the Income Statement are fairly stated and that the valuations of these derivatives are appropriate.
Effective interest rate review	Interest income on the Group's mortgages is measured under the effective interest rate method, as explained in note 1e) to the Accounts. This method includes an estimation of mortgage product lives which is based on observed historical data and Directors' judgement. During the year, the Group's estimate of mortgage lives for certain products has been updated to reflect changes in market conditions and customer behaviours. In accordance with accounting standards, the impact of this change in assumption on expected future cash flows is recognised immediately in the Group's Income Statement. As a result of the review, the estimate of mortgage lives was reduced resulting in a £5.8m (2017: £12.5m) charge through interest income.

Governance

Audit Committee Report *(continued)*

Significant matter	Committee action taken
Appropriateness of provisioning for legal or regulatory matters	The Committee received reports from management on the recognition and amounts of provisions, the existence of contingent liabilities, and the disclosures relating to provisions and contingent liabilities for legal and regulatory matters. The Committee examined these reports and concluded that all such provisions were appropriately accounted for and disclosed in these Accounts, and agreed with management's conclusion on the existence or otherwise of any contingent liabilities. Specific areas addressed included the assessment of the probability of future cash outflows arising following the Board's decision, in 2010, to remove the ceiling on the Society's Standard Variable Rate (SVR) in light of a judgment in 2016 by the Court of Appeal regarding a company's power to vary the rate of interest payable on a tracker mortgage. The Committee concluded that the probability of this remains remote.
Defined benefit pension liability	The Group manages a funded defined benefit pension scheme which at 31 December 2018 had a deficit of £99.5m (31 December 2017: £100.2m). The Committee has examined and challenged the pension scheme assumptions and is satisfied that these are reasonable and appropriate. As explained in note 29 to the Accounts, there has been a recent legal ruling regarding the equalisation of Guaranteed Minimum Pension (GMP) benefits for members of UK pension schemes. The Group has included a provision of £3.0m in respect of this matter. The Committee has examined the latest available information from the Group's pension scheme trustees, including information regarding the estimated impact on the Group's pension scheme deficit, and considers that the amounts and disclosures included in these Accounts are appropriate.

The Group will adopt a new accounting standard, IFRS 16 *Leases*, with effect from 1 January 2019. The Committee has maintained oversight of the Group's preparations for this new standard, including key judgements and decisions, and has considered the appropriateness of disclosures made in these Annual Accounts. As reported in note 40 to the Accounts, the initial application of IFRS 16 is not expected to impact on the Group's reserves as at 1 January 2019.

We considered matters raised during the statutory external audit and the half year independent review and, through discussion with senior management of the business and the external auditor, concluded that there were no adjustments required that were material to the financial statements.

The Committee has considered the other risk identified by the external auditor within the external audit report on pages 90 to 95 relating to the recognition of revenue within the Estate Agency division and we are comfortable that this has been appropriately considered within the Accounts.

c) External auditor

The Committee assesses the effectiveness and independence of the external auditor annually, following completion of their year-end audit, and this is reported to and discussed at a meeting of the Committee shortly thereafter. This assessment is facilitated by the Group's Financial Reporting function and is made by reference to the Financial Reporting Council's 'Guidance on Audit Committees' which details what is expected of the Audit Committee to ensure that the annual external audit cycle is effective. The assessment covers the external audit of the previous Annual Report and Accounts, whilst the proposed approach to the next audit is also discussed at this meeting, and includes consideration of matters such as:

- any risks to audit quality that the external auditor identified;
- the key controls that the external auditor relied on to address any identified risks to audit quality, such as appropriate audit methodologies, training and quality control policies and procedures;
- the findings from internal and external inspections of the external audit and the audit firm;
- whether the original audit plan was met;
- openness of communication between the external auditor and senior management;
- the skills and experience of the audit team including whether, in the opinion of the Committee, the external auditor demonstrated a sound understanding of the business by, inter alia, identifying the key risks of material misstatement to the financial statements;
- whether an appropriate degree of challenge and professional scepticism was applied by the external auditor; and
- the proposed strategy to be used in the next audit, including the proposed level of materiality to be used.

Based on the above, senior management in the Financial Reporting function prepared a report for the Committee which outlined the principles contained within the Financial Reporting Council's guidance and set out management's view on each principle. The Committee scrutinised this report and, together with its own experience, formed an opinion as to the effectiveness of the external auditor. We concluded that the relationship with the external auditor continued to work well and we are satisfied with their effectiveness and independence.

The Committee regularly monitors the Group's relationship with the external auditor and has adopted a policy for ensuring auditor independence and objectivity. This policy defines prohibited non-audit assignments (which include all tax-related assignments) and procedures for approval of other non-audit assignments across the Group. All non-audit assignments are required to be pre-approved by designated mandate holders and a limit is in place above which approval can only be given by the Committee; a report detailing any approved expenditure is also sent to the Committee every six months.

KPMG undertook a number of non-audit related assignments for the Group during 2018. These were conducted in accordance with the policy and are consistent with the professional and ethical standards expected of the external auditor. Details of the fees paid to the external auditor for audit and non-audit services are set out in note 5 to the Annual Accounts and during the year non-audit fees represented 50% of the total Group audit fee (2017: 88%). Non-audit assignments undertaken during the year included services provided by KPMG Nunwood, who provide our commercial teams with customer feedback analysis and insights for management's consideration. Our engagement with Nunwood pre-dates KPMG's acquisition of Nunwood in 2015 and the Committee concluded that KPMG Nunwood remained the appropriate provider of this service and the use of this service has no impact on the independence of KPMG as the Group's auditor. The Group continues to monitor the non-audit services ratio in preparation for changes to EU rules which will limit this percentage to 70% and we intend to comply with these rules once they become effective for the Group in 2020.

To further maintain auditor independence, the Group has a policy, approved by the Committee, regarding the employment of former employees of the auditor.

The Committee also reviews auditor independence by considering regular rotation of the key external audit partner. The audit partner was most recently rotated in 2014, following a five year term by the previous partner as responsible partner. The current audit partner is Jonathan Holt who has held the role since 2014; Mr Holt is required to rotate off the audit as responsible partner following the audit of the 2018 financial statements.

KPMG LLP, or its predecessor firm, has been the Society's auditor since the 1980s. The Corporate Governance Code recommends FTSE 350 companies put their external audit out to tender at least every 10 years. Due to an update to EU legislation, KPMG is legally required to rotate off the audit following the audit of the 2020 Annual Report and Accounts; however, to coincide with the required rotation of the current audit partner (as outlined above), KPMG will resign as the Society's external auditor at the Annual General Meeting on 29 April 2019 following completion of the audit of the 2018 Annual Report and Accounts.

In preparation for KPMG's resignation, the external audit process was put out to formal tender by the Committee during the year. The Committee oversaw the tendering and selection process and ensured that all tendering firms had the necessary access throughout the process to appropriate information and individuals. The selection panel consisted of the Committee members, with attendance, input and recommendations also coming from the Group Chief Executive and the Group Finance Director. Each firm was objectively evaluated by the selection panel based on both written submissions and oral presentations. The evaluation criteria included, inter alia, understanding of the business, relevant expertise, organisational fit and value for money. Following a robust and thorough process, the Committee made a recommendation to the Board that EY be appointed as the Society's next external auditor; the Board approved this recommendation. It is therefore proposed to appoint EY as the Society's external auditor for the year ending 31 December 2019, subject to approval by the Society's members at the Annual General Meeting on 29 April 2019.

Effectiveness of the Audit Committee

The effectiveness of the Committee is assessed annually and as part of the annual Board and Committee effectiveness review, further details of which are set out in the Directors' Report on Corporate Governance on page 53. The 2018 review, recently completed, concluded that we operated effectively during the year.

Committee members are expected to undertake relevant training as part of their ongoing development and, periodically, the Committee as a whole receives training on current topics such as current sector challenges, regulatory developments, conduct risk issues and financial reporting 'hot topics' to ensure we remain effective in our role.

Marisa Cassoni
Chairman of the Audit Committee

26 February 2019

Governance

Risk Management Report

As the Chair of the Board Risk Committee, I am pleased to present the 2018 Risk Management Report. This report explains the risk oversight arrangements we operate at Skipton, and what we believe to be the principal risks facing the Group.

During the year the Group has continued to monitor closely developments surrounding negotiations to leave the EU and the impact that this may have on the Group's principal risks. The Directors acknowledge that, whilst uncertainties remain regarding how the business environment may change over the coming years as the UK completes the exit process, the changing economic environment could directly impact some of the principal risks discussed in this report. The economic and, indeed, political uncertainty emphasises the need to maintain a forward-looking focus and run appropriate stress scenarios to test the Group's resilience to unforeseen risk events and, where appropriate, build mitigating strategies. The Board is monitoring developments closely and is confident that the Group is well placed to react to any developments accordingly.

More generally the Group continues to maintain focus on the rapidly changing external environment. Throughout the year the Board Risk Committee has challenged management to ensure there are appropriate strategies in place to mitigate the risks identified, whilst enabling business plans to be progressed maintaining the prudential strength of the Group.

The Committee has, during the year, ensured focus on:

- **Liquidity risk**, ensuring that the Group maintains a prudent liquidity position and is well placed to respond to the uncertain political and economic environment, whilst implementing our longer term funding strategy to diversify our funding base;
- **Interest rate risk**, to ensure that the Group has an effective balance sheet strategy and hedging arrangements in place to manage interest rate risk;
- **Credit risk**, to ensure that the Group appropriately balances risk and reward in a highly competitive mortgage market;
- **Capital management**, to ensure that the Group maintains and projects sufficient capital resources to support our corporate plan, in a period of changing capital rules;
- **Cyber risk**, to ensure that the Group has an appropriate risk framework in place to reduce the likelihood of a successful attack;
- **Financial planning and mortgage advice**, to ensure training and competence standards are appropriate, customers receive good advice and documentation standards substantiate this. As a result of the Board approving a new financial advice proposition the Committee has been closely monitoring the risks associated with its development and implementation; and
- **Risk appetite**, to ensure that this remained appropriate against a changing business and economic backdrop.

To assist the Committee's deliberations it receives regular reports from the Chief Financial Risk Officer and Chief Conduct Risk Officer. These reports provide clarity of the key and emerging risks faced by the Group, and direct the Committee's attention to those matters which the Risk Officers believe warrant further consideration, enabling challenge of first line management on the actions being taken to mitigate the risks.

Risk overview

Day-to-day operation of the business naturally exposes the Group to a range of potential risks. To limit the level of risk accepted by Group entities in the normal course of business, the Board has established a risk appetite which it reviews, at least annually, in the context of prevailing economic conditions. This covers a number of areas such as capital, liquidity and operational risk. In terms of core credit risk appetite, that for the Society and Skipton International Limited (SIL) is restricted to prime residential lending, either to owner occupiers or buy-to-let investors. The Board does not have any appetite for the Society or SIL to carry out new business in commercial or sub-prime lending.

Central to operating within this appetite is a management culture which promotes awareness of actual and potential risks and an understanding of their impact on the portfolio should they crystallise.

Governance structure

To enable appropriate focus on risk matters, the Board has delegated oversight of risk management to the Board Risk Committee although ultimate responsibility for risk management continues to reside with the Board.

The Board Risk Committee is responsible for considering and recommending the Group's risk appetite and capital adequacy and liquidity management policies to the Board. It is also responsible for ensuring that the Group maintains an effective risk governance structure to ensure that internal and external risks across the Group are identified, reviewed, managed and reported on.

Membership and attendees

The members of the Board Risk Committee during the period were:

Mr D A Hall	(Chairman)
Mr J R Coates	Non-Executive Director (appointed 24 April 2018)
Mr M J Lund	Non-Executive Director
Ms H C Stevenson	Non-Executive Director

The Board Risk Committee is supported by a number of executive committees, which have day-to-day responsibility for risk management oversight, as outlined in the diagram below:

* Following an internal review of conduct and operational risk governance, the Board Risk Committee approved the disbanding of the Conduct and Operational Risk Committee on 1 February 2019, as well as the allocation of its primary responsibilities to relevant senior managers in line with requirements of the Senior Managers Regime.

Whilst the committees operate under delegated Board authority, the success of the framework relies on effective reporting, rigorous challenge and appropriate escalation of issues to the Board Risk Committee where an enterprise-wide view of risk is held. The committees perform self-effectiveness reviews each year to ensure they continue to operate effectively.

Risk management framework

Through the Board Risk Committee approved risk management framework and governance structure, the Group has a formal mechanism for identifying and managing risks throughout the business. This framework is designed to deliver the corporate plan in line with the Board's overall risk appetite and is based upon the best practice 'three lines of defence' model which operates as follows:

First line of defence, being line management within the business who, through the implementation of the organisation's risk framework, identifies, assesses and manages risk.

Second line of defence, comprising independent risk functions (Operational, Credit and Market & Liquidity) and related independent compliance functions. These functions challenge, monitor, guide and support the business in managing its risk exposure. The risk framework includes the four sub-committees of the Board Risk Committee described above which are responsible for recommending and monitoring the Group's adherence to policy. The independent risk functions are represented on each of these sub-committees. The Board Risk Committee Chairman is responsible for maintaining the independence of the second line of defence to ensure there are no obstacles to its independent challenge of first line operations.

Third line of defence, provided by Internal Audit, is designed to provide independent assurance to the Board (through the Board Audit Committee) of the adequacy and effectiveness of control systems operating within the first and second lines in identifying and managing risk.

The principal risks and uncertainties faced by the Group, which are managed within the framework described above, are set out later in this report.

Risk environment

As a business with a retail franchise in financial services, the management of conduct and operational risk is key to the ongoing success of the Group. Central to managing these risks is maintenance of a robust product governance

Risk Management Report *(continued)*

framework, to ensure that we develop and market compliant and fair products and services designed to meet the needs of our target market.

The Group is predominantly active in the UK and, to a large extent, exposed to the UK property market. Therefore, the general UK macro-economic environment is a key factor in determining the success of the Group. The main drivers that impact the Group include:

- interest rates;
- inflation;
- unemployment; and
- the housing market (volume of transactions and house prices).

The Mortgages and Savings division continues to operate in a low interest rate and relatively benign economic environment, which has been supported in recent years by government initiatives such as the Term Funding Scheme. Initiatives such as this have provided much needed market liquidity with the consequence of dampening competition for retail savings. During 2018 we have seen increased competition in the UK mortgage market which has put pressure on net interest margins across the sector. Our robust product governance and risk management framework plays a key role in ensuring that the Society responds appropriately to this challenge, and remains within risk appetite.

Whilst levels of mortgage arrears have continued to fall throughout 2018 we remain cognisant that the situation can change at any time. A general downturn in the economy, a material increase in interest rates, higher unemployment or a material decline in house prices would impact the Mortgages and Savings division through higher levels of arrears and possessions and ultimately higher credit losses. Whilst the division's specialist mortgage portfolios of Amber Homeloans Limited (Amber) and North Yorkshire Mortgages Limited (NYM) are likely to be more susceptible to economic shock, these portfolios have been closed to new business since 2008 and are in run-off.

The results of the Estate Agency division are principally driven by the volume of UK property transactions, particularly second hand property sales. This market is heavily influenced by consumer confidence, driven by the general state of the economy, level of unemployment and interest rates, together with the availability of mortgages, particularly for first time buyers. A slowdown in the housing market puts pressure on Connells' income levels. However, the Estate Agency division is partially protected against the performance of its core business through its own diversification into complementary businesses such as property asset management and lettings. The changes proposed by the Government in the 2016 Autumn Statement eliminating the charging of lettings fees will impact Connells' revenue flows when implemented in June 2019.

It is clear that we are in a period of great uncertainty. Domestically it remains unclear what the eventual outcome will be of negotiations between the UK and the EU regarding implementation of the referendum result for the UK to leave the EU, and the associated political and economic implications that may arise from this. Globally we are seeing heightened political tensions, changing trading arrangements, and a slowing of economic growth across a number of key regions, whilst there remain question marks around the underlying health of the European financial sector.

Our response to this uncertainty is to maintain strong capital and liquidity positions, and to undertake stress analysis to consider how we may respond to secondary impacts to an economic stress should it arise. Our recent ICAAP demonstrated that the Society is appropriately placed to deal with a severe economic stress of the severity recently outlined by the Bank of England of a poor outcome to the Brexit negotiations.

Uncertainty surrounding the economic impact and progress of EU negotiations combined with political uncertainty at home and global tension underlines the need to continue to observe a robust risk policy.

Principal risks and uncertainties

The principal risks and uncertainties presented below are those that are inherent to the Group's business model and strategy, as well as the economic environment within which the Group operates. The Society merged with the Holmesdale Building Society on 1 October 2018 but the scale of its operations and size of its balance sheet had little impact on Skipton's operations. As such there has not been a material movement in the principal risks and uncertainties facing the Group during the year.

The prudential risks facing the Group are presented first below, followed by strategic and business risks and finally operational and conduct risks.

Risk	Risk mitigation and management
Credit Risk	
Credit risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group. The Group faces this risk from its lending to: • individual customers (retail mortgages); • businesses through historical commercial lending and ongoing debt factoring and invoice discounting; and • wholesale counterparties for the purposes of liquidity management.	The Society's retail and commercial credit exposure is managed by a team of experienced professionals, with oversight provided by the Retail Credit Committee. Similarly, the Group Wholesale Credit Committee manages treasury credit exposures, with formal oversight provided by ALCO. The Group has established comprehensive risk management processes in accordance with the Board's credit risk appetite which defines a number of limits regarding concentration risk as well as customer and collateral credit quality to which all lending activity must adhere. The Group maintains what the Board considers to be a low risk approach to new lending and will continue to do so. As part of the Group's preparations for the implementation of IFRS 9 on 1 January 2018, the Group's credit risk management strategy was reviewed and, where appropriate, its policies and processes were enhanced. As the Group already applied an IRB 'expected loss' model for regulatory capital purposes, the introduction of IFRS 9 did not result in significant changes to the Group's credit risk management practices. The credit decision process utilises automated credit scoring and policy rules within lending policy criteria supported by manual underwriting. All aspects of the credit decision process are subject to regular development, as well as independent review by the Credit Risk function, ensuring they support decisions in line with the Board's risk appetite. The Group's collections and recoveries functions provide a responsive and effective arrears management process. We seek to engage in early communication with borrowers experiencing difficulty in meeting their repayments, to obtain their commitment to maintaining or re-establishing a regular payment plan. We consider forbearance options on a case-by-case basis in line with industry guidance and best practice. The impact of any such forbearance is recognised within our provisioning policy. The Society has a commercial mortgage portfolio which is UK-based and, following a reduction in the Group's risk appetite, was closed to new lending in November 2008. The gross carrying value of this portfolio as at 31 December 2018 was £268m, representing 1.5% of total Group loans and advances. In addition, the Group includes specialist lending businesses Amber and NYM which were also closed to new lending in 2008. The combined gross carrying value of these portfolios as at 31 December 2018 was £745m, representing 4.1% of total Group loans and advances. We have retained an appropriately skilled team of people to manage these loans. As with residential lending in the Society, we consider forbearance options on a case-by-case basis in line with industry guidance and best practice. The impact of any such forbearance is recognised within our provisioning policy. During 2018 we have seen arrears levels continue to reduce, and the underlying risk within our portfolios improve, although we remain alive to the impact that an economic stress would have on these metrics. The Group has no immediate plans to stop new lending in any of its other portfolios other than the commercial portfolio and the Amber and NYM portfolios.
Liquidity Risk	
Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due.	The Society's Treasury function is responsible for the day-to-day management of the Group's liquidity and wholesale funding. The Board sets the Group's liquidity risk appetite and limits over the level, composition and maturity of liquidity and deposit funding balances, reviewing these at least annually. Compliance with these limits is monitored daily by Finance and Risk personnel and, additionally, a series of liquidity stress tests are performed weekly by the Risk function. Liquidity stress testing is carried out against a number of scenarios including those prescribed by the PRA, considering a wide range of liquidity and economic factors. Early warning indicators are regularly assessed by a variety of functions across the Society to ensure liquidity is maintained at appropriate levels and reported to ALCO and the Board on a monthly basis. On an annual basis, a detailed and forward-looking assessment of our liquidity is undertaken as part of our corporate planning process. This formal review is known as our Internal Liquidity Adequacy Assessment Process (ILAAP) and is reviewed and approved by the Board and also passed to the PRA.

Risk Management Report *(continued)*

Risk	Risk mitigation and management
Liquidity Risk (continued)	
	Our longer term funding strategy is to continue to diversify our funding sources, through increasing the volume and diversity of our longer term wholesale funding. During 2018 we issued two covered bond transactions, raising £400m in April and €500m in October, the latter of which has been appropriately hedged by entering into a cross-currency swap transaction. We have also raised c.£602m of funding from our hugely successful Lifetime ISA product, attracting over 129,000 customers by the end of December 2018. This source of funding has helped to diversify our funding base. We have also maintained the quality of the Group's liquidity portfolio, with 57% of total liquidity held within the Statement of Financial Position comprising balances held at the Bank of England, with a further 5% held in UK gilts. We also hold a portfolio of high quality but less liquid assets.
Interest Rate Risk	
Interest rate risk is the risk of loss arising from adverse movements in market interest rates.	Interest rate risk arises from the mortgages, savings and other financial products we offer. This risk is managed through the use of appropriate financial instruments, including derivatives used to hedge exposures, with established risk limits, reporting lines, mandates and other control procedures. Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between market rates), are also monitored closely and regularly reported to ALCO, the Board Risk Committee and the Board. This risk is also managed, where appropriate, through the use of derivatives, with established risk limits and other control procedures. Derivatives are only used to limit the extent to which the Group will be affected by changes in interest rates, foreign exchange rates or other indices which affect fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Group are interest rate contracts such as interest rate swaps. The Group holds capital to absorb potential losses for any risks that are unable to be mitigated through the use of derivatives. The Group's forecasts and plans take account of the risk of interest rate changes and are prepared and stressed accordingly, in line with PRA guidance.
Capital Risk	
Capital risk is the risk that the business does not maintain sufficient capital levels to protect it against the principal risks it faces such as severe recession or business shocks.	The Group Financial Risk team conducts an Internal Capital Adequacy Assessment Process (ICAAP) at least annually to assess the Group's current and projected capital requirements to support the current risks in the business and future risks arising from the corporate plan. The ICAAP addresses all the Group's material risks and includes Board-approved stress scenarios which are intended, as a minimum, to meet regulatory requirements. The ICAAP is approved annually by the Board and reviewed by the PRA when setting the Total Capital Requirements. The Group adopts the following approaches to calculate its Pillar 1 minimum capital requirements: • IRB approach for mortgage exposures of the Society, Amber and NYM; • IRB approach for exposures relating to investments in subsidiaries outside the regulatory group; • Standardised approach for other lending exposures; • Standardised approach for treasury portfolios; and • Standardised approach for operational risk. Within the ICAAP we consider the impact of emerging capital regulation, including the requirement to hold additional "bail-in-able" liabilities to ensure that the Society has sufficient capital to recapitalise itself in the event of a resolution scenario. This additional capital requirement is referred to as the Minimum Required Own Funds and Eligible Liabilities (MREL). The ICAAP approved by the Board in December 2018 confirms that the Group projects that it will have sufficient capital and MREL resources to support the corporate plan as the MREL and changing capital regime is phased in over the plan horizon. The Society satisfies all of the current capital requirements under CRD IV.

Risk	Risk mitigation and management
Pension Obligation Risk	
Pension obligation risk is the risk that the value of the schemes' assets, together with ongoing contributions, will be insufficient to cover their obligations over time. The schemes are also exposed to possible changes in pension legislation.	The Group has funding obligations for three defined benefit schemes which carry funding deficits. The two primary schemes were closed to new entrants on 5 April 1995 and closed to future accrual of benefit by 31 December 2009. Whilst the pensions Trustees oversee the investment strategy for the pension funds, it is for the boards of the Society and Connells to ensure that the schemes are adequately funded to meet all liabilities. To manage the Group's exposure to pension obligation risk: • The Board regularly reviews the Group's pension risk strategy; • The pension scheme Trustees meet at least quarterly to monitor the investment performance of scheme assets and make investment decisions, liaising with the principal employer in accordance with the scheme rules and taking advice from professional investment consultants; • The pension scheme Trustees also monitor the pension obligation position (on the Trustee's funding basis); and • The pension obligation position (on an IAS 19 basis) is updated every six months and reported, along with key pension risk metrics, to the Board Risk Committee.
Model Risk	
Model risk is the risk that, as a result of weaknesses or failures in the design or use of a model, a financial loss occurs or a poor business or strategic decision is made.	To mitigate this risk the Model Governance Committee (MGC) provides a formal forum for managing and assessing model risk in the Society, ensuring that all material models: • go through a formal review and approval process; • have a robust change control process; • undergo a consistent model, development and validation process; and • are monitored routinely and reviewed periodically in line with a risk based timetable. MGC manages model risk with reference to a defined model risk appetite and governance policy which have both been approved by the Board Risk Committee.
Business Risk	
Business risk is the risk of changes in the environment in which the Group operates or the occurrence of events which damage the franchise or operating economics of the Group's businesses.	The Executive Committee of the Society and the boards of Group subsidiary firms are responsible for ensuring that business risk is effectively managed. Potential sources of business risk include revenue volatility due to factors such as macro-economic conditions, inflexible cost bases, structural inefficiencies or new market entrants with lower cost structures or innovative service propositions such as open banking. Delay or inability to respond to changing customer behaviours presents itself as a clear risk as customers' preferred means of accessing financial services evolves in a rapidly changing digital environment. The Group addresses these risks within its corporate plan which is approved by the Board along with the Group's key strategies. The Board Risk Committee is also provided with the results of stress and scenario tests to assess the potential impact on the Group of a stressed business environment such as a severe economic downturn. This enables the Committee to monitor the risk impact of business strategies and to determine whether changes to these may be required to protect the sustainability of the Group. In line with regulatory requirements the Society maintains a recovery plan detailing the steps it would take to sustain itself through such severe business stresses.
Conduct Risk	
Conduct risk is the risk of delivering poor or inappropriate outcomes for customers.	The Executive Committee of the Society and the boards of Group subsidiary firms are responsible for ensuring that conduct risk is effectively managed. The framework to control this area is maintained and overseen by the Conduct and Operational Risk Committee. *Mortgage advice* - Likely to be the largest financial commitment undertaken by borrowers, the need for reliable mortgage advice is paramount. The Society provides advice directly and through its Estate Agency division, Connells. Rigorous quality checking and compliance monitoring are operated by the Society and Connells.

Risk	Risk mitigation and management
Conduct Risk (continued)	
	The Society and SIL (which advances non-advised residential loans in the Channel Islands and 'expat' buy-to-let loans in the UK via the intermediary market) operate rigorous affordability assessments as part of the mortgage underwriting process. This is subject to regular review to ensure that arrears experience does not exceed expectations, thus enabling early preventative action. *Pensions and investment advice* - Whilst the Society prides itself on the quality of advice offered to customers, the provision of pensions and investment advice is inherently complex and, on occasion, can subsequently be found not to be suitable for the customer. The liberalisation of pensions by the Government has increased the complexity of this area significantly and with it the risk of providing unsuitable advice. Alert to this risk, the Group maintains a robust compliance capability which supports development of appropriate customer offerings and closely monitors the suitability of advice provided to customers. During 2018 the Board approved significant investment to develop the Society's financial advice proposition to deliver a more advanced and efficient service for our customers. This inevitably creates increased operational risk in development and conduct risk in delivery. The Board Risk Committee is alive to this and monitors how these risks change and are managed.
Operational Risk	
Operational risk is the risk of financial loss or reputational damage arising from inadequate or failed internal processes, systems or human error.	The Executive Committee of the Society and the boards of Group subsidiary firms are responsible for ensuring that operational risk is effectively managed. The framework to control this area is maintained and overseen by the Conduct and Operational Risk Committee. *Change management* - The scale and pace of regulatory change has been significant in recent years and shows little sign of abating. The scale of this change may impact our ability to progress defined business growth strategies as IT and project resource is directed to ensuring delivery of new regulatory requirements. The regulatory horizon is scanned continuously to enable us to respond in a timely manner to mitigation of this risk. Alongside this, the Society has an ambitious change programme designed to ensure that our customer proposition and service delivery are aligned to customer expectations. The Board and senior management are cognisant that a large and demanding change programme could, if inadequately managed, lead to the crystallisation of unforeseen risks resulting in poor service to customers. Focus and resource has been devoted to developing a robust governance regime to deliver effective oversight of projects from business case approval through to progress monitoring using standard project lifecycle methodology and capacity planning. *Information Technology* - The pace of technological development has created a period of significant change in financial services. The Society will continue to invest in its technology provision to provide an excellent level of customer service and manage risks in this area which include: *Cyber crime* – Cyber risk incorporates a wide array of potential threats to Group businesses. These can include network or perimeter threats, a breach of online controls leading to increased risk of online fraud as well as data leakage. These threats are of increasing significance given the expected growth in online customer transaction levels. In response to this, Group businesses continue to focus efforts on proactively managing the evolving nature of cyber threat to ensure that the Group is best placed to protect itself and its customers. *Business resilience* – Market experience has shown that executing IT change has significant risk attached to it and can lead to the loss of core systems and the ability to provide expected levels of customer care. The Society is aware of these inherent risks and continues to review its approach to business resilience and continuity to ensure that this is reflective of business changes over time and remains fit for purpose. A specialist team has been formed to oversee this area and assist first line teams to assess and challenge their operational resilience and ability to deliver a reliable service to our customers.

Risk	Risk mitigation and management
Reputational Risk	
Reputational risk is the risk to earnings, liquidity or capital arising from negative market or public opinion.	The Executive Committee of the Society and the boards of Group subsidiary firms are responsible for ensuring that reputational risk is effectively managed. Such risk effectively arises through the poor management of risks generally. The consequences would adversely impact the future prospects of the Group and could expose it to litigation and financial loss. This risk is managed by: • maintaining and investing in control structures; • continuing to focus on customer outcomes; • promoting the Society through marketing and external communications; and • working within the risk management framework which has reputational risk as a key consideration.

To meet the CRD IV Pillar 3 requirements, the Group publishes further information about its exposures and risk management processes and policies on the Society's website skipton.co.uk.

Conclusion

We are operating in a period of significant political and economic uncertainty, both domestically and globally. Whilst it may be difficult to predict the outcome of such uncertainty, I am confident that the risk management framework operated by the Skipton Group enables it to identify, assess and manage the risks confronting it and support business sustainability. To underpin this, the Board Risk Committee will continue to promote the embedding of a culture which views risk management not as an additional activity but the manner in which the business is run.

Denis Hall
Chairman of Board Risk Committee

26 February 2019

Directors’ Remuneration Report

Annual statement from the Chairman of the Remuneration Committee

Dear Member,

I am pleased to share the Directors’ Remuneration Report on behalf of the Remuneration Committee, which sets out the details of pay, incentive payments and benefits for the Directors for the year ended 31 December 2018.

The Committee comprises four Non-Executive Directors. The members of the Remuneration Committee during the period were:

Ms H C Stevenson	Non-Executive Director (Chairman of the Committee)
Ms A J Burton	Non-Executive Director
Mrs D P Cockrem	Non-Executive Director
Mr D A Hall	Non-Executive Director

We constantly strive to maintain the highest standards of governance in relation to Directors’ remuneration and to provide meaningful information to our members. We have therefore set out this Directors’ Remuneration Report in four key sections:

- This annual statement.
- An ‘at a glance’ summary, highlighting the key performance measures which inform our remuneration awards and the outcomes for the Executive Directors for the year.
- The Directors’ Remuneration Policy, which is unchanged for 2019 and was approved at the Annual General Meeting (AGM) in April 2016.
- The Annual Report on Remuneration in 2018 on pages 79 to 87 which explains how we put our existing policy into practice in 2018 and how we intend to apply the policy in 2019.

Remuneration policy

We recognise that remuneration for our colleagues needs to be clearly aligned to our vision of ‘Building a better Society’. Our policies, principles and practices are therefore designed to enable the business to attract, retain and reward people with the right skills, experience, knowledge and behaviours to support the achievement of business goals and objectives within a positive cultural environment, for the benefit of our members.

The Directors’ Remuneration Policy, approved at the AGM in April 2016, remains unchanged for 2019. In line with the Large and Medium-sized Companies and Groups Regulations 2013, which requires shareholders (or in our case, members) to vote on policy every three years, the Remuneration Policy is included in full in this report. This will be put to an Advisory Vote at the AGM in April 2019.

In developing our approach to remuneration, we consider a broader context for total reward than the financial numbers. Mutuality, a strong values based culture and supporting a diverse workforce are also key to our thinking. Our approach is therefore to take into account but not to match other organisations and to maintain a ‘feels fair’ approach to remuneration.

We intend to be well positioned on fixed pay (including pensions and other benefits) but some way below total compensation opportunity for businesses which have a greater emphasis on performance related pay within their remuneration arrangements.

Our full policy for the Society’s Executive Directors is explained on pages 73 to 76 but the key elements of policy and its implementation in 2018 are set out below:

- 2018 was the third year of operation for the Single Variable Pay Arrangement (SVPA) (a single variable pay scheme which replaced the previous short term incentive (STI) and medium term incentive (MTI) arrangements). Payments from the 2015–2017 MTI scheme are phased and will conclude in 2020;
- The SVPA, which has a maximum opportunity of 50% of base salary, is made up of a balanced scorecard of measures which are targeted and assessed annually and which align with the corporate plan;
- As indicated in our 2017 Directors’ Remuneration Report, within the framework of the current policy, the Committee made an adjustment to the SVPA in 2018, to place more emphasis on four key strategic team objectives which are outlined on pages 80 and 81 of our Annual Report on Remuneration in 2018. This increased the weighting of personal and team strategic objectives from 20% to 30% overall;
- The long term focus of the scheme is maintained by a requirement that at least 50% (or more if required by regulation) of any variable pay awarded from the scheme is deferred and will vest over a period of either five years or three to seven years (as required by regulation);
- In addition to normal malus and clawback arrangements, these deferred payments are subject to a sustainability assessment one year after award and can be reduced if the Committee determines that the performance which generated the award has not been materially sustained in line with Board expectations.

In addition to the focus on the continuous improvement of the Directors’ remuneration structures within the current policy, the Committee has been engaged in a number of important projects considering the broader issues of remuneration in the Society.

- During the year, the Committee has maintained an active interest in our gender pay reporting and gender workstream activities. A separate report on gender reporting and the key considerations for the Society resulting from this is available on our website, skipton.co.uk. This work is part of a wider Society initiative on diversity aimed at improving the representation and inclusion of women, ethnic minorities, LGBTQ and people with disabilities in the Society.
- We are taking into consideration for 2019, the Department for Business, Enterprise and Industrial Strategy (BEIS) amendments to Directors’ Remuneration Reporting Regulations (for listed companies) in respect of reporting the CEO and employee pay ratio.
- We have started preparations for the introduction of the Financial Reporting Council’s (FRC) revised UK Corporate Governance Code (‘the Code’) and the impact of this on our remuneration practices. While we are confident that many aspects of our current remuneration policies and practices are already aligned to the Code, we will be taking the opportunity, during 2019, to review what ‘fairness’ means to us as a Society. We will be setting out our Fair Pay Strategy to explain our principles and how our approach to reward cascades through the Society. Adjustments to our policy as a result of this work will be considered for 2020 implementation.

Remuneration in respect of 2018

The Society’s performance has remained strong, with membership numbers increasing by 91,366 to a record 1,010,426. Profit before tax in 2018 was £188.2m (2017: £200.1m) but underlying profit before tax increased by 12.3% to £186.1m (2017: £165.7m). This is despite continuing margin pressures and the current uncertain political and economic climate.

The core Mortgages and Savings division profit before tax increased to £114.3m (2017: £89.1m); 2017’s profits included a loss of £15.0m on the disposal of a £220m portfolio of mortgage assets.

As a result of our broad range of competitive mortgage products and our strong intermediary partnerships, we have continued to meaningfully grow our mortgage book by 10.0% during 2018 (2017: 8.3%). Our above-market-average interest rates have also helped us to grow our retail balances, by £1.1bn up to £16.1bn (2017: £15.0bn). On average, we paid 0.59% higher interest (2017: 0.52%) than the market average for banks and building societies during 2018 (source: CACI Current Account & Savings Database).

The Strategic Report has already outlined that our success in 2018 was not just limited to financial performance. Our drive to put customers first and provide excellent customer service was recognised by three gold UK Customer Experience Awards. Our highly engaged people delivered not only for our customers but also for our communities and charitable partnerships raising (in addition to our regular donations) over £79,000 for the Alzheimer’s Society and Alzheimer Scotland.

Taking into account the market competition, economic factors, our acceptable risk profile and this continued strong performance, the Committee made awards under the Society’s SVPA with respect to the 2018 outturn. The average variable pay awards made are set out in the table below:

	2018 award	2017 award	Maximum achievable
Executive Directors	45.5%	46.6%	50.0%
Other Executive Committee members	35.8%	36.3%	40.0%
Senior Leadership team	29.0%	28.3%	From 25% to 50%
Other colleagues	7.7%	7.7%	15.0%

Note
1. The calculations for average bonus awards are based on full year participation.

The Committee approved a salary increase of 2% for the Group Chief Executive and an average increase of 2.7% for the other three Executive Directors. This was lower than the increases applied in the Society as a whole (3.2%).

The Remuneration Committee continues to focus on managing risk in its remuneration schemes including risk adjustment arrangements. In 2019, the Committee will continue its work in this area and will also implement the requirements of the FRC’s updated UK Corporate Governance Code and other industry best practice guidance on companies’ approaches to wider stakeholders.

Conclusion

The Annual Report on Remuneration for 2017 was put to an advisory vote at our AGM in April 2018 and received majority votes in favour. Details of the votes are included in the final section of this report (‘Statement of voting at the 2018 AGM’).

On behalf of the Committee, I hope this report gives you a clear view of how we have implemented the policy in 2018. The Committee recommends that members vote in favour of the 2018 Annual Remuneration Report and the Directors’ Remuneration Policy at the forthcoming AGM.

Helen Stevenson
Chairman of the Remuneration Committee

26 February 2019

At a glance summary

The tables below highlight the key metrics considered for remuneration and how they align with the Society's strategy, as well as a focus on personal and strategic objectives.

	Generating profits for the Society...	...in a sustainable way...	...while delivering value to members and treating them fairly...	...and managing risks and processes while complying with regulation
SVPA measures				
Group profit (adjusted)[1]	●			
Mortgages and Savings division profit (adjusted)[1]	●			
Efficiency measure	●	●	●	
Net growth in Society members	●		●	
Net customer satisfaction	●		●	
Risk and governance		●	●	●
People			●	
Personal objectives		●	●	●
Strategic team objectives	●	●		
Features of the scheme				
Risk adjustment		●	●	●
Deferral of at least 50% of incentive		●		●
Discretion to reduce / defer / recover payments		●	●	●

Note

1. For bonus purposes, the Group profit and Mortgages and Savings profit are adjusted for those items that are not considered part of the Group's core strategy or for those items that are outside of the Directors' control, as set out in the scheme rules. The adjusted profit is calculated prior to dividends receivable from subsidiary undertakings, fair value gains or losses on financial instruments, fair value gains or losses on the equity release portfolio, Connells management incentive scheme costs, FSCS charges, profit or loss on disposal of Group undertakings, and impairment of Group undertakings or goodwill.

Single Variable Pay Award (SVPA)

The tables below show the 2018 performance measures and level of achievement:

Financial Measures	Weight
Group profit (adjusted)[1]	10%
Mortgages and Savings division profit (adjusted)[1]	30%
Mortgages and Savings Cost Income ratio	10%

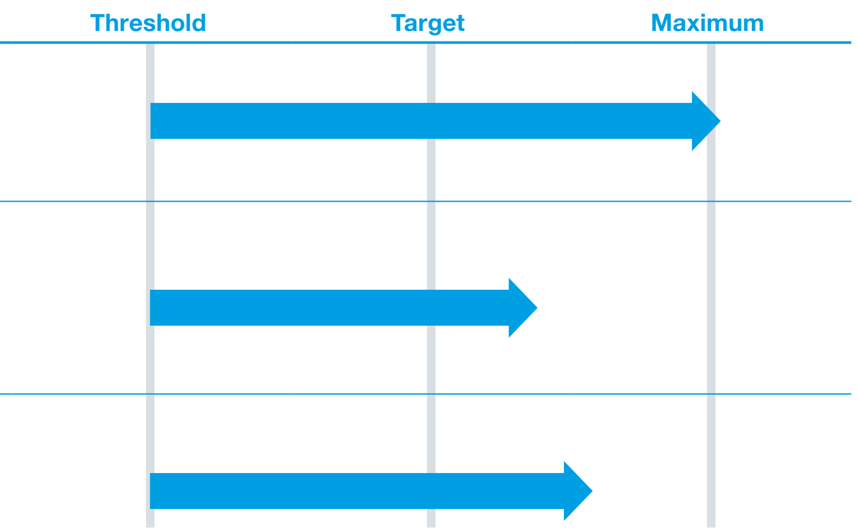
Performance achieved

Notes

1. For bonus purposes, the Group profit and Mortgages and Savings profit are adjusted for those items that are not considered part of the Group's core strategy or for those items that are outside of the Directors' control, as set out in the scheme rules. The adjusted profit is calculated prior to dividends receivable from subsidiary undertakings, fair value gains or losses on financial instruments, fair value gains or losses on the equity release portfolio, Connells management incentive scheme costs, FSCS charges, profit or loss on disposal of Group undertakings, and impairment of Group undertakings or goodwill.
2. More detail on the financial targets and outcomes for 2018 can be found on page 81.

Other Measures	Weight
Team KPIs Net Member Growth Net Customer Satisfaction Risk and Governance Colleague Engagement	20%
Strategic team objectives Growth of the Financial Advice business Achievement of Digital Strategy Optimising our cost base Risk Adjusted Return on Capital	10%
Personal objectives	20%

Performance achieved



The table below summarises the total payments made to Executive Directors in respect of the 2018 financial year. The figures shown in the graph are included in the single figure table on page 79. Further details on the variable pay awards, the performance measures and the extent to which they are achieved are on pages 80 and 81.

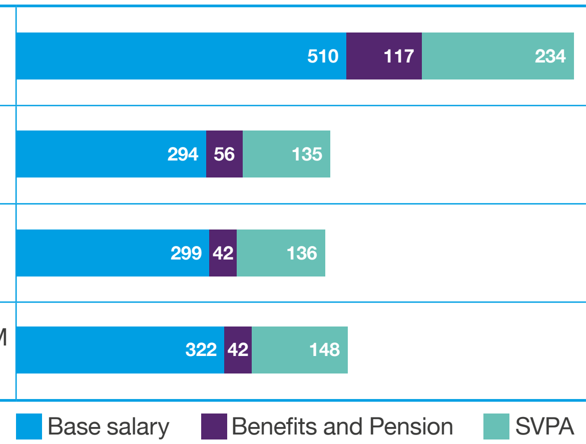
Key highlights of 2018

2.5% average salary increase for Executive Directors

45.5% average SVPA award – minimum of 50% deferred for between 1 to 5 years or 60% deferred between 3 to 7 years

No new MTI awards made since 2016 – deferred payments continue until 2020

	Total £000	Amount deferred to future years £000
Mr D J Cutter	**861**	140
Mr A P Bottomley	**485**	67
Mr I M Cornelius	**477**	68
Mr R S D M Ndawula	**512**	89



Directors' Remuneration Policy

Overview of Remuneration Policy for Executive Directors

The Board's policy is designed to ensure that Executive Directors' remuneration reflects performance and enables the Group to attract, retain and motivate a sufficient number of high calibre individuals to lead and direct the organisation and deliver sustainable business performance for our members. The policy received a majority vote from members at the Annual General Meeting held on 25 April 2016 and remains unchanged. However, in line with the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, the policy is included in full in this report and will be put to an advisory vote at our AGM in April 2019.

Development of policy

In establishing, implementing and maintaining the remuneration policy, the Committee applies a set of general remuneration principles for the Group. The general principles set out the Committee's standards with regard to remuneration, governance, risk management and the link to performance. There are specific requirements for those firms captured by the PRA consolidation group, which includes the Society. The general principles for these firms have been reviewed and updated for 2019 and are set out below. The full remuneration principles are available on request from the Secretary.

In addition to these general principles, the Committee sets out requirements for the operation of variable pay, setting appropriate rules and limits around incentive related payments, including approving executive salaries in excess of £200,000 and being informed of individuals earning in excess of £275,000 (including base salary, annual and any long term bonus pay out) in any one calendar year. Additional rules apply to the calculation of termination payments to ensure they are fair to both the employee and the Skipton Group and do not reward failure or misconduct. Further requirements on deferral and performance adjustment apply specifically to Material Risk Takers (as defined on page 86). The principles are reviewed annually and are supported by key policies.

General principles of remuneration 2019

a. We believe it is important to offer remuneration which is competitive and able to attract and retain talented people with the skills, knowledge and experience needed for our business while offering a positive work environment where people can develop and progress.

b. Our values underpin an inclusive culture where individuals are supported to achieve their personal and professional goals, while maintaining a good work/life balance.

c. We believe in strong corporate governance and expect Leaders responsible for drafting remuneration schemes to adhere to these principles in our remuneration policies and scheme design. All schemes must comply with the relevant PRA, FCA and European Banking Authority (EBA) Remuneration regulations applicable to the business or type of employee. Remuneration must be paid in accordance with the principles and not by any other means intended to circumvent the regulatory requirements. Business Leaders are also responsible for ensuring that remuneration practices meet national pay legislation requirements (e.g. Minimum wage, salary sacrifice, gender pay requirements).

d. It is important that remuneration policies, procedures and practices reflect sound, effective risk management and do not encourage risk taking which falls outside the Board Risk Appetite, which is reviewed annually, or the scope of Board policies. Remuneration practices should be formally reviewed at least annually by the senior Leaders in each business, responsible for approving remuneration, to ensure they do not encourage inappropriate risk taking behaviour or present uncontrolled conflicts of interest which may result in poor outcomes for our customers.

e. It is important to us that our colleagues are rewarded fairly regardless of race, colour, creed, ethnic or national origin, marital status, disability, age, gender, gender reassignment, sexual orientation, political opinion, religion, trade union or non-trade union membership.

f. We align our remuneration practices to our business strategy and the long term aims of the Society, taking account of the Board's risk appetite and the need to provide sustainable growth which will benefit our members/customers, colleagues and our communities.

g. Where remuneration is performance related, it is important that the assessment of the individual/team, the business unit and overall Group performance (if appropriate) is taken into account. In assessing individual performance, it is important to take into account a balance of financial and non-financial criteria, including appropriate risk and quality measures.

h. We believe in a consistent and fair approach to remuneration which reflects individuals' responsibilities and performance. Basic pay will reflect the core role and responsibilities of the individual whereas variable pay will reflect the achievement of annually agreed targets, or objectives.

i. Remuneration policies, practices and procedures should be transparent, cost effective and, as far as possible, free from conflicts of interest. Where some potential conflicts of interest are unavoidable, systems and controls should be in place to mitigate the risk. Remuneration policies, practices and procedures should be clearly documented and straightforward to understand, administer and communicated in a timely fashion.

j. Employees in control functions (such as Risk, Compliance and Internal Audit) should be rewarded competitively to attract and retain adequately experienced employees. Their reward will be based predominantly on personal and non-financial measures and objectives.

The table below shows the key elements of remuneration for Executive Directors and the reasons for their inclusion.

Element How element supports our strategy	Operation	Maximum potential value	Performance conditions and assessment
Base salary • Supports the recruitment and retention of Executive Directors, reflecting their individual roles, skills and contribution.	Base salary reflects the size of the role and responsibilities, individual performance (assessed annually) and the skills and experience of the individual. In setting appropriate salary levels, the Committee takes into account data for similar positions in comparable organisations. The data is independently commissioned and the Society aims to position Executive Directors competitively within this reference group.	Increases to base salary are determined annually by the Committee taking into account: • Individual performance; • The scope of the role; • Pay levels in comparable organisations; and • Pay increases elsewhere within the Group.	None applicable, although we do take account of individual performance when considering base pay increases.
Pension • Supports recruitment and retention of Executive Directors at a cost that can be controlled by the Society.	Generally, the Society contributes to a defined contribution pension scheme for the Executive Directors. The contribution can instead be paid in cash (which is excluded from incentive calculations) if the Executive Director is likely to be affected by the limits for tax-approved pension saving.	The maximum is 20% of base salary. Mr Cutter receives 20% of base salary and the other Executive Directors between 10% and 15% of base salary.	None applicable.
Benefits • To attract, retain and provide security for Executive Directors; and • Provide a competitive level of benefits to assist Executive Directors to carry out their roles effectively.	A number of benefits are provided to Executive Directors, including a car or car allowance, private medical insurance, life insurance and disability benefits. The Committee reviews benefits from time to time and may make changes, for example, to reflect market practice or the needs of the business.	The Society bears the cost of providing benefits, which may vary from year to year.	None applicable.
Single Variable Pay Arrangement (SVPA) • Supports the attraction and retention of Executive Directors; • Supports the development of a high performance culture; • Rewards performance within the context of achieving corporate goals and objectives as set out in the corporate plan; and • Encourages the right behaviours in respect of sustainable performance that supports the achievement of strategic goals.	A combination of financial and non-financial measures and targets are set with a weighting which will not exceed 50% of the total incentive opportunity for financial measures and which will not exceed 60% for non-financial measures. The latter includes personal objectives (normally up to 20%). Targets are set and assessed against these criteria each year relative to the Society's strategic aims. 50% of earned incentive is normally paid in cash shortly after performance has been assessed. The remaining 50% of earned incentive is deferred over a period of one to five years, or three to seven years if required by regulation, and is normally paid in cash subject to performance adjustment. Current regulations also require that for those whose total remuneration exceeds £500,000 or whose variable pay (for the relevant performance year) exceeds 33% of total remuneration (de minimis threshold), 60% of the SVPA will be deferred and 50% of the initial up-front award will be delivered in the form of an 'instrument' which will be subject to a further holding period (currently 12 months). The instrument will be subject to a write down if the CET 1 ratio falls below a prescribed level. An element of the performance assessment will be made over a period of more than one financial year to meet regulatory requirements and to maintain a longer term perspective in the scheme. This will be achieved by the Remuneration Committee making a sustainability assessment one year after the award of the incentive. Up to 25% of the incentive originally awarded can be reduced or cancelled as a result of this assessment. The percentage of deferred incentive, the deferral period (one to five years or three to seven years) and the payment instrument may be amended in response to changes in regulation. The Committee may reduce or withdraw the payment of a deferred amount in certain circumstances and has the power to reduce, cancel or recover payments under the SVPA if it believes there are circumstances where the payments are not appropriate, for example due to failure to maintain certain capital levels, evidence of systemic conduct risk, or evidence of significant control failures or weaknesses.	The maximum incentive which may be earned for any year by the SVPA is 50% of base salary. For each performance measure, the Committee determines a threshold, target and maximum level of performance. No incentive is payable for performance below the threshold level, with varying levels of pay-out for performance between threshold and maximum. On-target performance generally attracts an incentive of 60% of the maximum.	The performance measures attached to the SVPA will be determined by the Committee from year to year, but might typically include (but are not limited to) any of the following: • Group profit (adjusted); • Mortgages and Savings division profit (adjusted); • Efficiency measures; • Customers (growth and satisfaction); • Risk and governance; • People; • Personal objectives (includes an element for strategy development and implementation). Performance against the measures is reviewed and approved by the Remuneration Committee. The weightings attached to the types of measure and the individual weightings attached to each individual measure may vary from year to year as determined by the Committee.

Notes to the table

Performance measures

The performance conditions attached to the SVPA scheme have been selected as they support the sustainable success of the Society. The Committee believes that the use of a range of financial and non-financial measures provides a balanced assessment of the overall performance of the Society.

The Committee considers the targets attached to the SVPA to be commercially sensitive and will not therefore disclose these at the beginning of the financial years to which they relate. The Committee will, however, disclose the weightings that will be attached to each SVPA performance measure at the beginning of the relevant financial year.

A summary of performance against the targets will be disclosed following the end of the relevant financial year. In setting the target and maximum payments, the Committee considers both the market position and the risk appetite of the Society and sets these levels accordingly. The weightings for 2019 are outlined in the 'Statement of implementation of Remuneration Policy in 2019' section of this report.

MTI Scheme

The Society has a legacy MTI scheme which was discontinued from 2016. The final three year performance cycle ended in December 2017 and payments were phased 50% in 2018 with the remaining 50% to be paid pro-rata in 2019 and 2020.

Remuneration for other employees

All employees of the Society receive a base salary and benefits consistent with market practice and are eligible to participate in the Society's pension plan and in the incentive arrangements relevant to their role.

Members of the Executive Committee and other selected senior managers may be eligible to participate in the SVPA on the same terms as the Executive Directors, subject to the discretion of the Group Chief Executive and the Committee. The award size for these individuals may be lower than for the Executive Directors.

A variable pay arrangement for all employees (excluding the Executive Committee and certain senior managers) is in place, so that everyone employed by the Society will have the opportunity to share in the Society's success. The key measures for the scheme are aligned with those that apply for senior management.

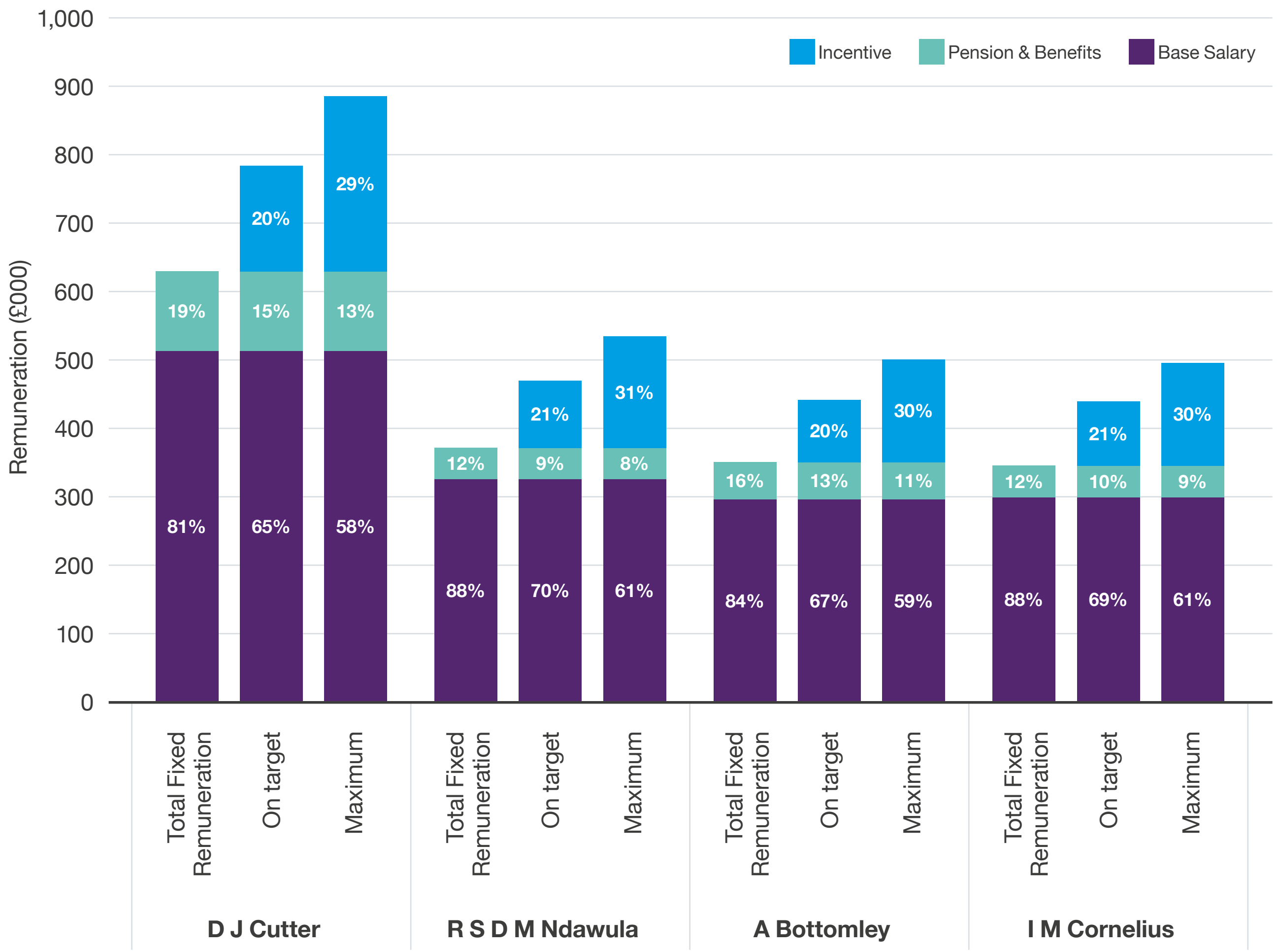
Committee's discretion in relation to the SVPA and MTI schemes

As noted above, the Committee has the discretion to reduce, defer or recover payments under the SVPA in accordance with the Society's Policy on Malus and Clawback. Malus refers to the reduction or withdrawal of deferred awards and clawback is the repayment of amounts already paid. The Committee also has the discretion to cease or amend the operation of either arrangement where this is necessary to ensure the arrangements continue to meet the Committee's overriding remuneration principles and risk criteria. This might include, for example, amending the deferral arrangements to comply with changing regulation.

Illustration of application of remuneration policy

The chart below illustrates the 2019 remuneration that would be paid to each of the Executive Directors under three different performance scenarios: (i) Minimum; (ii) On-target; and (iii) Maximum. The minimum scenario assumes that no pay-out is achieved from any variable elements of remuneration and on-target and maximum scenarios are as defined in the policy table on page 80.

The elements of remuneration have been categorised into three components: (i) Base salary; (ii) Pensions and benefits; and (iii) Incentive (Single Variable Pay Arrangement).



Each element of remuneration is defined in the table below:

Element	Description
Base salary	Base salary as at 1 January 2019
Pensions and benefits	Pension contributions or pensions allowance plus taxable benefits
Incentive	Single Variable Pay Arrangement at on-target and maximum payment levels

Policy on remuneration of Non-Executive Directors

The table below sets out the elements of Non-Executive Directors' remuneration and the policy on how each element is determined.

Element	Approach to determination
Base fees	Reviewed annually based on time commitment and responsibility required for Board and Board committee meetings. Review takes into account fees paid by comparable financial services organisations.
Additional fees	Additional fees are payable for additional responsibilities such as committee chairmanship or other duties.
Other items	Non-Executive Directors are not eligible to participate in any form of performance pay plans and do not receive pensions or other benefits. Travel and subsistence expenses, including between home and Skipton offices, are reimbursed.

The Remuneration Committee determines the Chairman's fee while the fees of the other Non-Executive Directors are determined by the Non-Executive Remuneration Committee.

Approach to recruitment remuneration

Overall, the Committee aims to recruit Executive Directors using remuneration packages that are market-competitive and as consistent as possible with the existing remuneration structure. In doing so, the Committee seeks to pay no more than necessary to attract talented individuals to join the Society.

Newly recruited Executive Directors are eligible to receive the same remuneration elements as existing Executive Directors, as set out in the policy table above, namely:

- Base salary – set at an appropriate level taking into account the experience and quality of the candidate;
- Pension and benefits – in line with our standard policy; and
- Single Variable Pay Arrangement – in line with our standard policy.

The Committee does not expect to make additional recruitment arrangements (such as signing on bonuses) as standard practice but may (subject to regulation), from time to time, be required to do so in order to secure the appointment of the right candidate.

In addition to ongoing remuneration arrangements, the Society may, where necessary, make replacement awards to 'buy-out' any remuneration awards or opportunities that an incoming Executive Director has forfeited in order to join the Society. Where this is necessary, the Committee will ensure that the overall value does not exceed the value of remuneration being given up and will take into account regulatory requirements, performance conditions and timing of payments.

Newly appointed Non-Executive Directors will receive fees in line with the policy outlined above.

Directors' service contracts and notice periods

The Executive Directors are employed on rolling service contracts which can be terminated by either the Society or the Director giving one year's notice. Unless notice to terminate is given by either party, the contracts continue automatically.

Non-Executive Directors do not have service contracts.

Policy on termination payments

The Committee's overarching aim is to treat departing Executive Directors fairly, taking into account the circumstances of their departure, but always taking care to ensure that the interests of members are considered and that there are no rewards for failure.

Executive Directors are entitled to be paid their base salary and contractual benefits (including pension contributions) during the notice period. The Society has the discretion to pay these as a lump sum benefit in lieu of notice.

The Rules of the SVPA scheme and the MTI scheme* set out the treatment of awards for individuals who cease to be an employee or Director of the Society.

In the following circumstances an individual will be eligible for a payment under the SVPA scheme:

- Normal retirement;
- Death;
- Injury or disability; or
- Any other circumstances which the Committee may in its discretion determine.

In exercising discretion on eligibility for payment of annual or deferred amounts, the Committee will consider the circumstances surrounding the departure.

For the SVPA and until the outstanding MTI cycles are completed, the Society will continue to pay any payment due in respect of a completed performance year. Deferred awards for completed performance periods and for part completed performance periods will be paid on the due date, except in the event of death, when the Committee may exercise its discretion and pay the deferred amount due immediately.

Eligible leavers (as set out above) will be considered for a bonus in respect of a partially completed performance year. Such an award would be pro-rated to take account of the service completed during the year. The award would be paid at the usual time, after the end of the performance year, taking account of the outcome of any performance conditions. Any deferred element of the SVPA scheme for eligible leavers will continue to be paid on the usual payment dates.

* The rules of the MTI scheme remain unchanged from our 2016 policy and include redundancy in the eligible leaver criteria in addition to those set out for the SVPA above.

Consideration of remuneration for individuals elsewhere in the Society

The Committee is responsible for setting the remuneration of the Executive Directors and approves the policy for senior managers who have a material impact on the Society's risk profile (Material Risk Takers). In addition, the Committee reviews recommendations from the Group Chief Executive for approval of the remuneration for other key executives.

The Committee does not currently consult employees on remuneration policy for Directors but it does take into consideration remuneration arrangements for the wider population in the Society when determining executive remuneration.

As part of adopting, on a voluntary basis, the new FRC Corporate Governance Code for listed companies, the Society has designated, with effect from January 2019, a Non-Executive Director with a particular focus on engagement with employees as a further step to ensure that their views are reflected in Board discussions and decision making.

Consideration of member views

The Committee has, for a number of years, invited members to vote (on an advisory basis) on the Remuneration Policy and annual Remuneration Report and takes member feedback into account when determining policy and outcomes.

Annual Report on Remuneration in 2018

Executive Directors' remuneration

The total remuneration for Executive Directors in 2018 is set out in the table below:

2018 Audited	**Mr D J Cutter £000**	**Mr A P Bottomley £000**	**Mr I M Cornelius £000**	**Mr R S D M Ndawula £000**	**Total £000**
Salary	510	294	299	322	**1,425**
Benefits[1]	15	12	12	12	**51**
2018 annual performance award (SVPA)[2]	234	135	136	148	**653**
Pension[3]	102	44	30	30	**206**
Total remuneration in respect of performance periods ending in 2018	**861**	**485**	**477**	**512**	**2,335**
Total 2018 performance pay deferred[4]	(140)	(67)	(68)	(89)	**(364)**
Prior years' deferred performance pay now released[5]	147	71	69	85	**372**
Total paid in 2018 or payable in 2019[6]	**868**	**489**	**478**	**508**	**2,343**

2017 Audited	Mr D J Cutter £000	Mr A P Bottomley £000	Mr I M Cornelius £000	Mr R S D M Ndawula £000	Total £000
Salary	500	287	292	312	1,391
Benefits	15	12	12	12	51
2017 annual performance award (SVPA)	234	133	137	148	652
MTI (2015/2017)	163	97	95	99	454
Pension	100	43	29	31	203
Total remuneration in respect of performance periods ending in 2017	1,012	572	565	602	2,751
Total 2017 performance pay deferred	(222)	(115)	(116)	(139)	(592)
Prior years' deferred performance pay now released	85	33	32	30	180
Total paid in 2017 or payable in 2018	875	490	481	493	2,339

Notes

1. Benefits comprise the provision of a car or car allowance and private medical insurance contributions.
2. £140,130 (60%) of the 2018 SVPA award for Mr Cutter (2017: SVPA £140,227, MTI £81,436) will be deferred in equal amounts for between three to seven years. Half of the initial up-front award (i.e. 20% of the total) will be paid in March 2019 and the remaining half will be retained for a further twelve month period and paid subject to CET 1 capital remaining at or above the agreed level in March 2020. £88,805 (60%) of Mr Ndawula's 2018 SVPA award will also be deferred on the same basis as Mr Cutter's (2017: SVPA £88,949, MTI £49,656). 50% of the 2018 awards for Mr Bottomley and Mr Cornelius will be deferred for between one and five years in line with the SVPA scheme rules.
3. Mr Cutter's 2018 pension figure includes the additional value earned in the defined benefit scheme during 2018 and a non-consolidated allowance paid in lieu of contributions. For the other Executive Directors, the figure relates to contributions to the defined contribution pension scheme and/or a non-consolidated cash allowance.
4. These are amounts which have vested in respect of the performance period ending in December 2018 (from the 2018 SVPA scheme) which are due to be paid in future years in line with the scheme rules.
5. These are deferred amounts from STI schemes from 2015 onwards plus deferred payments from the 2014/2016 and 2015/2017 MTI schemes which are payable in 2019.
6. Total payable is salary, benefits, pension and other payments which have been paid in 2018 and variable pay from 2018 (and from prior years) which is payable in 2019.

In 2018, no payments were made to past Directors or for loss of office.

Directors' Remuneration Report *(continued)*

Base salary

Our annual salary review process for Executive Directors takes place in April each year and the following adjustments were made to the Executive Directors' base salaries taking into account data from PwC and the average pay review award in the wider Society, which was 3.2% for employees below Executive Committee level. The increases were effective from 1 April 2018:

Director	% increase	April 2018	April 2017
Mr D J Cutter	2.0%	£512,170	£502,121
Mr A P Bottomley	2.6%	£295,650	£288,150
Mr I M Cornelius	2.6%	£301,400	£293,760
Mr R S D M Ndawula[1]	3.0%	£324,580	£315,120

Note
1. Mr Ndawula was awarded a 3% increase, based on market review and alignment to the market.

Variable pay

Single Variable Pay Arrangement (SVPA)

The measures, weightings and the final payments from the 2018 SVPA scheme are set out below:

Director	Target bonus opportunity (% of salary)	Maximum bonus opportunity (% of salary)	Weighting					SVPA award	
			Group profit (adjusted)	Mortgages and Savings division profit (adjusted)	Efficiency measure	Team KPIs[1]	Personal and team strategic objectives	% of salary	£000
Mr D J Cutter	30%	50%	10%	30%	10%	20%	30%	45.6%	234
Mr A P Bottomley	30%	50%	10%	30%	10%	20%	30%	45.6%	135
Mr I M Cornelius	30%	50%	10%	30%	10%	20%	30%	45.1%	136
Mr R S D M Ndawula	30%	50%	10%	30%	10%	20%	30%	45.6%	148

Note
1. Team KPIs include the measures for growth in Society members, net customer satisfaction, risk, governance and people as set out in the policy table on page 72.

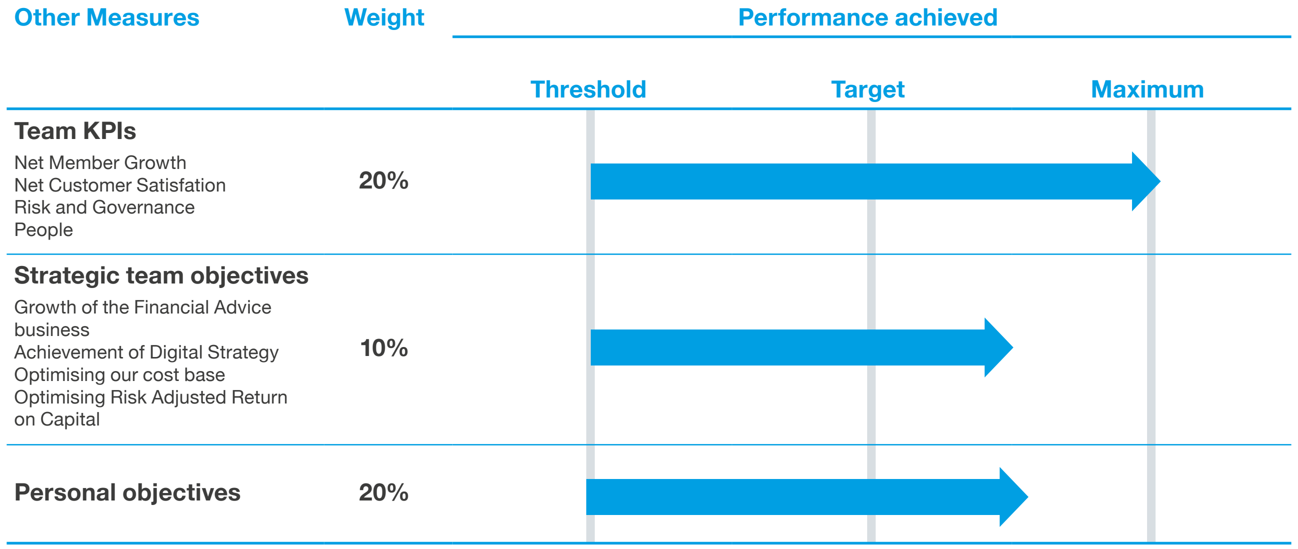
In 2018, four key strategic team objectives were introduced into the SVPA scheme, which were focused on the growth of our financial advice business, achieving our digital strategy, optimising our cost base and optimising the risk adjusted return on capital (RAROC). A weighting of 10% was assigned to the strategic team objectives and 20% to personal objectives. The weighting of our ongoing team KPIs was reduced from 30% to 20%.

The management expense ratio was not included in the efficiency measures for 2018, which instead were focused solely on the cost income ratio.

The table below summarises the outcome against the various measures underlying the SVPA:

Financial Measure	Weight	Performance achieved	Threshold	Target	Maximum
Group profit (adjusted)[1] (£m)	10%	181.3	152.8	179.8	215.8
Mortgages and Savings division profit (adjusted)[1] (£m)	30%	112.5	79.1	93.1	111.7
Mortgages and Savings Cost Income ratio (%)	10%	56.3%	61.9%	59.9%	57.9%

Note
1. For bonus purposes, the Group profit and Mortgages and Savings profit are adjusted for those items that are not considered part of the Group's core strategy or for those items that are outside of the Directors' control, as set out in the scheme rules. The adjusted profit is calculated prior to dividends receivable from subsidiary undertakings, fair value gains or losses on financial instruments, fair value gains or losses on the equity release portfolio, Connells management incentive scheme costs, FSCS charges, profit or loss on disposal of Group undertakings, and impairment of Group undertakings or goodwill.



On average, the Executive Directors achieved 80% of the maximum for strategic team objectives and 84% of the maximum for personal objectives.

Risk considerations

As part of approving incentive outcomes for 2018, the Committee reviewed a report from the Board Risk Committee outlining how the Society and Executive Directors had performed in relation to the risk objectives and appetites set for 2018, taking into account the context and impact of operational decisions. The Committee also considered the Board Risk and Audit Committees' views on whether there were any material issues to consider, e.g. a significant risk failing, regulatory breach or material error which may trigger malus or an adjustment to the outcome of the SVPA.

Having taken into consideration the information provided by each committee, the Remuneration Committee was satisfied that, given there were no significant risk events in 2018 and that performance remained within risk appetite, no adjustment to remuneration was required.

Governance

Deferral arrangements for 2018

SVPA

The SVPA scheme requires a minimum deferral of 50% of the award over a period of five years for all participants but this increases to 60% for Executive Directors if remuneration for the current performance year exceeds de minimis limits, i.e. the total remuneration awarded for the current performance year is greater than £500,000 or the variable amount awarded for the current year is more than 33% of total remuneration. Where remuneration exceeds these limits, then 50% of the SVPA award will need to be paid in 'instruments'. In a listed company, this would be a form of share instrument, but for ourselves as a mutual organisation this means that 50% of the award payable in each year will be retained for a further 12 months and will only be paid subject to meeting agreed capital levels. The retained amount cannot increase or attract interest payments during the deferral and retention periods.

Deferred awards are released on a pro-rated basis between three and seven years if the Director is classified as a 'Senior Manager' under the PRA Senior Managers Regime and remuneration exceeds the de minimis level.

In 2018, the total remuneration awarded to Mr Cutter and Mr Ndawula exceeded the de minimis level and therefore 60% of the SVPA will be deferred and released during a period of three to seven years as per the schedule below:

	Total award (£000)	Non-deferred element	Mar-19	Mar-20	Deferred element	Mar-22	Mar-23	Mar-24	Mar-25	Mar-26	Mar-27
Mr Cutter	234	40%	20%	20%	60%	6%	12%	12%	12%	12%	6%
Mr Ndawula	148	40%	20%	20%	60%	6%	12%	12%	12%	12%	6%

Notes
1. The table reflects the percentage of the total award and how the payments are phased over time.
2. The 20% due in March 2020 is the retained element of the non-deferred portion of the award.

Mr Bottomley and Mr Cornelius' awards were below the de minimis threshold. 50% of the award will be deferred over a period of five years in line with the SVPA scheme rules.

Current and deferred awards can be reduced or clawed back at the discretion of the Remuneration Committee. This could be in the event of a significant loss, a material error, material failure of risk management or failure to meet appropriate standards of fitness and propriety or some other substantial reason.

Medium Term Incentive (MTI)

The three year performance cycle for the 2015 – 2017 MTI ended in December 2017. Payments resulting from this performance cycle, which are phased 50% in 2018, 25% in 2019 and 25% in 2020, are subject to malus and clawback in the usual way. The MTI scheme was discontinued from 2016 and no new awards are due to be made.

Directors' pension benefits

Mr Cutter is a deferred member of the Skipton Building Society (2015) Group Pension Scheme which is a defined benefit fund registered with HM Revenue and Customs under the Finance Act 2004. The scheme is closed to the future accrual of benefits and no member contributions were made during the year. The value of his benefits in the scheme is set out below.

Audited 2018	Normal retirement date	Member's contribution for the year ended 31 December 2018 £000	Accrued pension entitlement at 31 December 2017 £000 pa	Accrued pension entitlement at 31 December 2018 £000 pa	Value of remuneration for the year ended 31 December 2018 £000
Mr D J Cutter	1 January 2027	-	90	93	-

Normal retirement date for members of the scheme is when they reach the age of 65. The scheme rules specify that this is the earliest date at which members are entitled to benefits from the scheme:

- without consent (from the employer or the Trustee of the scheme); and
- without actuarial reduction in the benefits;
- but disregarding any special provisions in the scheme rules relating to a member's entitlement to early payment of their benefits on the grounds of ill health, redundancy or dismissal.

Audited 2017	Normal retirement date	Member's contribution for the year ended 31 December 2017 £000	Accrued pension entitlement at 31 December 2016 £000 pa	Accrued pension entitlement at 31 December 2017 £000 pa	Value of remuneration for the year ended 31 December 2017 £000
Mr D J Cutter	1 January 2027	-	89	90	-

During the year Mr Cutter's accrued pension entitlement was revalued in line with the scheme rules. The value of remuneration shown above is calculated using a modified version of HM Revenue and Customs' tax rules for pension savings, as laid out in the regulations. The additional value earned by Mr Cutter during the year due to his membership of the scheme is included in his total remuneration.

Non-Executive Directors' remuneration

Non-Executive Directors' fees (excluding those of the Chairman) are reviewed annually by the Non-Executive Directors' Remuneration Committee, in line with the policy outlined earlier in the report. The Non-Executive Directors' Remuneration Committee makes recommendations concerning Non-Executive Directors' remuneration to the Board and in 2018 recommended that the basic Non-Executive Director fee and Deputy Chairman fee should be increased by 2% (£1,000) to £51,000 and by £1,120 to £57,120 respectively with effect from 1 August 2018. Ms Burton was appointed as a Non-Executive Director of Connells Limited on 1 May 2018 for which she receives an annual fee of £26,500 (increased from £26,000 with effect from 1 August 2018) included pro-rata in the table below.

The fees for chairing the Audit and Board Risk Committees were increased by £300 to £14,300 per annum and the fee for the chair of the Remuneration Committee was similarly increased by £200 to £12,200 per annum with effect from 1 August 2018.

The Chairman's fees are reviewed and approved by the Remuneration Committee. Mr East's fee was increased by 2% to £153,000 (2017: £150,000).

Audited		2018				2017			
	Note	Fees £000	Committee chair fees £000	Taxable benefits[1] £000	Total £000	Fees £000	Committee chair fees £000	Taxable benefits[1] £000	Total £000
Mr R D East (Chairman)	2	152	-	6	158	118	4	6	128
Mr M J Lund (Deputy Chairman)	3	54	-	4	58	49	-	5	54
Ms A J Burton	4	68	-	3	71	49	-	3	52
Ms M Cassoni	5	50	14	6	70	49	13	4	66
Mr J R Coates	6	50	-	2	52	38	-	-	38
Mrs D P Cockrem		50	-	6	56	49	-	6	55
Mr M H Ellis	7	-	-	-	-	52	-	2	54
Mr D A Hall	8	50	14	3	67	38	5	3	46
Ms H L Jackson	9	10	-	-	10	-	-	-	-
Mr G E Picken	10	25	-	2	27	81	-	3	84
Ms H C Stevenson	11	50	12	4	66	49	11	4	64
		559	40	36	635	572	33	36	641

Notes
1. The taxable benefits shown in the table above relate to the reimbursement of travel and subsistence expenses between home and Skipton head office (and for Mr Picken and Ms Burton, who, during 2018 have also been Non-Executive Directors of Connells, Connells' head office), including for attendance at Board and Committee meetings.
2. Mr East was appointed Chairman on 24 April 2017 and was also the Chairman of the Board Risk Committee until he stepped down on 31 August 2017 following appointment as Chairman of the Board.
3. Mr Lund was appointed as Deputy Chairman on 24 April 2018.
4. Ms Burton was appointed as a Non–Executive Director of Connells Limited on 1 May 2018 for which she receives an annual fee of £26,500, included pro-rata in the table above.
5. Ms Cassoni is the Chair of the Board Audit Committee.
6. Mr Coates was appointed to the Board on 27 March 2017.
7. Mr Ellis (former Chairman) retired from the Board on 24 April 2017.
8. Mr Hall was appointed to the Board on 27 March 2017 and appointed Chairman of the Board Risk Committee on 1 September 2017.
9. Ms Jackson was appointed to the Board on 24 October 2018.
10. Mr Picken (former Deputy Chairman) retired from the Society Board on 23 April 2018. He was a Non-Executive Director of Connells Limited between January and April 2018, for which he received an annual fee of £26,000, included pro-rata in the above table (2017: £26,000).
11. Ms Stevenson is the Chair of the Remuneration Committee.

History of Group Chief Executive's remuneration

The table below shows a breakdown of the total remuneration of the Group Chief Executive over the last ten years, together with the SVPA/STI and MTI awarded to the Group Chief Executive as a percentage of his maximum possible award.

Year	Base pay[1] £000	Benefits and pension £000	Variable pay (SVPA)[2] £000	Variable pay (MTI)[3] £000	Total remuneration £000	SVPA/STI as % of maximum	MTI as % of maximum
2018	510	117	234	N/A	861	91	N/A
2017	500	115	234	163	1,012	93	79
2016	490	113	161	157	921	66	79
2015	418	99	149	N/A	666	71	N/A
2014	408	96	195	N/A	699	95	N/A
2013	366	89	296	N/A	751	94	N/A
2012	352	84	181	N/A	617	60	N/A
2011	344	85	53	N/A	482	18	N/A
2010	320	75	68	N/A	463	25	N/A
2009	320	60	-	N/A	380	-	N/A

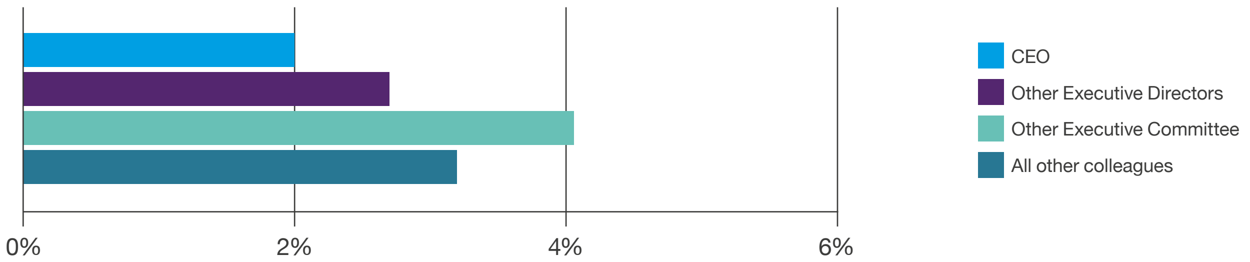
Notes
1. The Group Chief Executive's base pay was increased by 15.4% in 2016 to compensate for the reduction in his variable pay opportunity (from 100% to 50%).
2. From 2018, the SVPA (max. 50% of salary) is the only variable pay awarded.
3. A proportion of the SVPA and MTI is deferred and paid in future years as set out on page 73.

Comparison to the remuneration of other employees in 2018

Comparison of average base salary increases awarded in the annual pay review

The table below illustrates the average annual base salary increases, expressed as a percentage of salary, made as part of the annual pay review.

Base salary increase

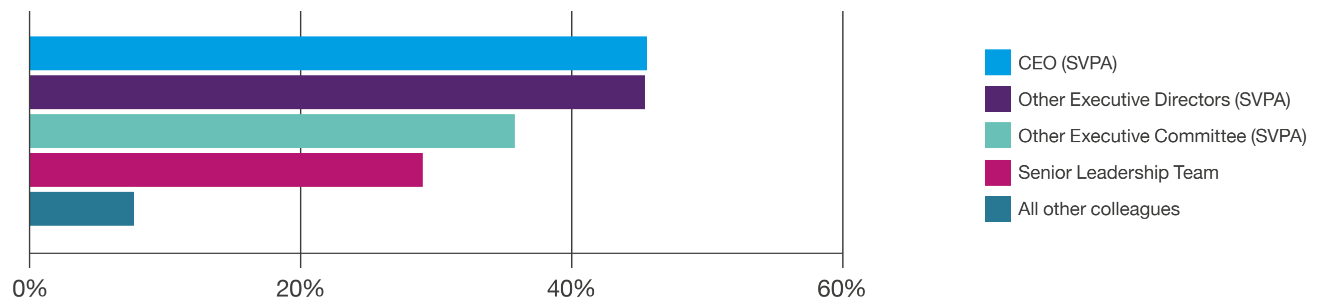


As outlined earlier in the report, the Group Chief Executive's base salary increased in April 2018 by 2.0% (2.0% in April 2017). This compares to an annual average pay review award in April 2018 of 3.2% of base salary for all other Society employees below Executive level (3.2% in April 2017). The Society remuneration comparator relates to Society employees only as this is considered to be the most appropriate comparator to use due to the varying remuneration policies across the Group's subsidiaries. The salary increase figure for other Executive Committee members includes an element to address market position for a number of Executive Committee members.

Comparison of annual variable pay awarded in 2018

The table below illustrates the average annual variable pay awards, expressed as a percentage of salary, made in 2018.

Variable pay award as a % of salary



Note
1. The calculations for average bonus awards are based on full year participation.

The Group Chief Executive's award under the Society's SVPA scheme in respect of 2018 represented 45.6% of his base salary (2017: 46.6%). This compares to the average amount awarded to the other Executive Directors of 45.4% (2017: 46.6%) and other Executive Committee members of 35.8% (2017: 36.3%). The average amount awarded to the Senior Leadership Team was 29.0% (2017: 28.3%) and to the remainder of our people in the Society was 7.7% (2017: 7.7%).

From 2019, the Society has elected to publish, on an annual basis, the ratio between the Chief Executive's pay and the median, lower and upper quartile pay for Society employees. Given the diversity of the wider Skipton Group, the Society measure was thought to be more appropriate as it would provide a more meaningful comparison with our peers in Financial Services.

Statement of implementation of Remuneration Policy in 2019

As outlined in our Annual Report on Remuneration for 2018, the base salaries of our Executive Directors will be reviewed in April 2019.

The SVPA for 2019 will continue to be based on a balanced scorecard of financial and non-financial measures, as is outlined in our policy section. The measures and weightings in 2019 are set out in the table below:

Financial measures	Weighting	Team KPIs (non-financial measures)	Weighting	Objectives	Weighting
Group profit	10%	Net customer growth	5%	Personal objectives	15%
Mortgages and Savings division profit	30%	Net customer satisfaction	5%	Strategic team objectives	15%
Mortgages and Savings division cost income ratio	10%	Risk and governance	5%		
		People	5%		
Total weighting	**50%**		**20%**		**30%**

The 30% weighting for personal and strategic team objectives is designed to give a continued focus on the achievement of longer term strategic objectives. For 2019 there is a small re-balancing with the weighting for strategic objectives increased from 10% to 15%, and for personal objectives reduced from 20% to 15%.

The maximum opportunity will remain as 50% of base salary and will be 30% at target.

For participants in the Risk, Audit or Compliance areas of the business, the personal objectives will have a 50% weighting with a 15% weighting on strategic objectives, 15% weighting on financial measures and 20% on team KPIs.

Their maximum opportunity will range between 15% and 40% with target being 60% of these figures.

The deferral arrangements operating in 2018 will continue to apply in 2019 and Directors' salaries will be reviewed on 1 April 2019 as they are for all colleagues in the Society.

Directors' Remuneration Report *(continued)*

On a broader level in 2019, the Committee will be implementing the remuneration requirements of the FRC's revised UK Corporate Governance Code and the broader remit that this will bring. As part of this, we will continue to review our overarching approach to remuneration, setting out principles of fairness for the Society and reviewing how our current remuneration practices align with these and cascade through the Society.

The fair pay review also supports the actions to address the Society's gender pay and bonus gaps and the achievement of the Society's vision of a diverse and inclusive Society. As indicated earlier in the report, the BEIS amendments to Directors' Remuneration Reporting Regulations (for listed companies) in respect of reporting the CEO and employee pay ratio will also form part of our 2019 agenda.

The Committee will maintain close links with the Board Risk and Audit Committees to ensure full compliance with regulatory guidelines from European and domestic authorities throughout 2019 and will maintain its focus on managing risk within remuneration schemes including consideration of risk adjustment arrangements.

Material Risk Takers

Material Risk Takers (MRTs) are those 'whose professional activities have a material impact on an institution's risk profile' and, in accordance with CRD IV and the criteria set out by the European Banking Authority (EBA), we have identified MRTs in the Society and in the Group subsidiary companies who are in scope of the regulations.

The Remuneration Committee is responsible for approving remuneration policies, maintaining oversight of the remuneration of MRTs and for ensuring that remuneration is paid to them in accordance with regulatory requirements.

Details of the MRTs' remuneration arrangements for 2018 are included in the Pillar 3 document which is available at skipton.co.uk/about-us/pillar-3-disclosure.

The Committee and its advisers

The purpose of the Remuneration Committee is to determine, on behalf of the Board, the Remuneration Policy and to:

- Ensure that remuneration policies, principles and practices are appropriate to enable the business to attract, retain and reward people with the right skills, experience, knowledge and behaviours to support achievement of business goals and objectives;
- Maintain policies that are compliant with governing laws and regulations;
- Ensure that remuneration arrangements support and encourage desired behaviours and culture; and
- Ensure appropriate governance of remuneration practices across the Society and its subsidiary companies and exercise effective oversight of these.

Amongst its other duties, the Committee specifically:

- Determines and agrees, on behalf of the Board, the Society's Remuneration Principles and Policy, ensuring alignment to the business strategy, risk profile, corporate values, regulatory requirements and the long term interests of the Society and its members;
- Provides adequate oversight arrangements to ensure policies are operating as intended;
- Works closely with the Board Audit and Board Risk Committees to ensure that Remuneration Policy promotes sound and effective risk management;
- Maintains an effective risk adjustment policy and process which take into account the Board Risk Appetite, capital and liquidity levels and ensure remuneration levels reflect overall performance;
- Assesses with regard to variable pay, the achievement of performance targets and the need for ex-ante or ex-post risk adjustments, including the application of malus and clawback arrangements;
- Determines and agrees remuneration for the Chairman of the Society Board and Society Executive Directors which shall be subject to the Remuneration Principles;
- Oversees the remuneration of the senior officers in the Risk and Compliance functions;
- Receives recommendations from the Group Chief Executive for approval of the remuneration for Senior Executives which shall be subject to the Remuneration Principles;
- Determines the policy, term, objectives and content of Society Executive Directors' and Society Senior Executives' service contracts to ensure they remain aligned to the Committee's overarching Remuneration Policy, regulatory requirements and good practice guidance; and
- Reviews any proposed remuneration structures or pay proposals which fall outside the parameters of the agreed Remuneration Principles.

The Committee ensures that clear remuneration principles for the Society and its subsidiaries are set and agreed annually. For the PRA and FCA regulated businesses, the principles set out appropriate standards for remuneration design, governance, risk management, and, where applicable, remuneration for MRTs. The Committee receives reports from the Group Remuneration Oversight Committee on the implications of the remuneration policies within the Group and compliance with the principles. The Chief Risk Officers update the Committee on risk related matters and provide information and insight as part of the risk adjustment process.

The full terms of reference of the Remuneration Committee and the Remuneration Principles are available on request from the Secretary.

The terms of reference are also available online at skipton.co.uk/about-us/governance/board-committees.

The Remuneration Committee met five times during 2018. In discharging its duties, the Committee reviews and takes into account independently produced data in relation to similar financial services organisations. Remuneration consultants advising the Committee are independent from the Group.

The Non-Executive Directors' Remuneration Committee, which currently comprises Messrs East (Chairman), Bottomley, Cutter, Cornelius and Ndawula, determines the level of the other Non-Executive Directors' fees.

The Chairman, Group Chief Executive, Chief Conduct Risk Officer and Secretary and Chief Human Resources Officer have regularly attended meetings by invitation and external advisers are invited to attend meetings as and when appropriate.

PwC were appointed by the Committee in 2015 following a review of potential advisers. Their remuneration team have continued to support the Committee in 2018 and have received £69,500 (net of VAT) in fees in respect of remuneration services provided. The Committee maintains oversight of remuneration policy and practice through an annual internal audit which is supported by other independent remuneration experts.

In addition to remuneration, PwC provide other services to the Society such as accounting, internal audit and tax advice.

Statement of voting at the 2018 AGM

At the 2018 AGM the Directors' Remuneration Report was subject to an advisory vote of members, the results of which were as follows:

	Votes		
	For	Against	Withheld
2017 remuneration report	**59,138 (89.1%)**	**7,235 (10.9%)**	**1,451**

Helen Stevenson
Chairman of the Remuneration Committee

26 February 2019

Governance

3 Financial Statements

KPMG

Independent auditor's report

to the members of Skipton Building Society

1. Our opinion is unmodified

We have audited the Group and Society annual accounts of Skipton Building Society for the year ended 31 December 2018 which comprise the Income Statements, Statements of Comprehensive Income, Statements of Financial Position, Statements of Changes in Members' Interests, Statements of Cash Flows, and the related notes, including the accounting policies in note 1.

In our opinion the annual accounts:

- give a true and fair view of the state of affairs of the Group and of the Society as at 31 December 2018 and of the income and expenditure of the Group and of the Society for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it and, as regards the Group annual accounts, Article 4 of the IAS Regulation.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit Committee.

We were first appointed as auditor by the members before 1989. The period of total uninterrupted engagement is for more than the 30 financial years ended 31 December 2018.

We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard applicable to listed public interest entities. No non-audit services prohibited by that standard were provided.

Overview		
Materiality:		£9.0m (2017: £7.5m)
Group financial statements as a whole		4.8% (2017: 4.6%) of normalised Group profit before tax
Coverage		92% (2017: 97%) of Group profit before tax
Key audit matters		vs 2017
Recurring risks	New: Fair value of equity release portfolio	▲
	New: Expected credit losses on loans and advances to customers	▲
	Revenue recognition under the EIR method	◀▶
	Revenue recognition in respect of estate agency income	◀▶
Event driven	New: Impact of uncertainties due to the UK exiting the EU on our audit	▲

2. Key audit matters: including our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including 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. We summarise below the key audit matters in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
The impact of uncertainties due to the UK exiting the European Union on our audit *Refer to pages 62 and 64 (Risk Management Report), page 58 (Audit Committee Report) and page 131 (financial disclosures)*	**Unprecedented levels of uncertainty:** All audits assess and challenge the reasonableness of estimates, in particular as described in the **fair value of the equity release portfolio, expected credit losses on loans and advances to customers** and **revenue recognition under the EIR method** below, and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements (see below). All of these depend on assessments of the future economic environment and the Group's future prospects and performance. Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: – **Our Brexit knowledge:** We considered the Directors' assessment of Brexit-related sources of risk for the Group's business and financial resources compared with our own understanding of the risks. We considered the Directors' plans to take action to mitigate the risks. – **Sensitivity analysis:** When addressing the fair value of the equity release portfolio, expected credit losses on loans and advances to customers and revenue recognition under the EIR method, and other areas that depend on forecasts, we compared the Directors' analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecast cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty. – **Assessing transparency:** As well as assessing individual disclosures as part of our procedures on the fair value of the equity release portfolio, expected credit losses on loans and advances to customers and revenue recognition under the EIR method, we considered all of the Brexit related disclosures together, including those in the Strategic Report, comparing the overall picture against our understanding of the risks. Our results As reported under the fair value of the equity release portfolio, expected credit losses on loans and advances to customers and revenue recognition under the EIR method, we found the resulting estimates and related disclosures of the fair value of the equity release portfolio, expected credit losses on loans and advances to customers and revenue recognition under the EIR method, and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.
Fair value of the equity release portfolio (£410.9 million) *Refer to page 59 (Audit Committee Report), pages 115 and 116 (accounting policy) and page 151 (financial disclosures)*	**Subjective valuation:** The Society holds a portfolio of equity release mortgages that carry a no negative equity guarantee ('NNEG'). This guarantee limits the Society's maximum return to the value of the relevant customer's property on redemption. The Society is therefore exposed to potential losses on the portfolio, albeit any loss is limited in part by a guarantee provided to the Society by a third party. Judgement is required as to the classification and measurement of the portfolio under IFRS 9, for which the Directors have determined that the mortgages are to be recognised at fair value as a single financial instrument. A Monte Carlo model has been developed to estimate this fair value, which requires the Directors to identify and determine a number of key input assumptions to the valuation model. The most critical areas of estimation are: – Future increases in house prices; – Volatility in future house price increases; – Levels of property dilapidation at redemption;	Our procedures included: – **Accounting analysis:** We analysed the judgements made by the Directors in determining the classification and measurement of the portfolio to consider the appropriateness of the measurement basis for the portfolio. – **Historical comparison:** We compared assumptions applied in the valuation model against the Society's historical experience and, where relevant, against historical market data. – **Our actuarial expertise:** We used our own actuarial specialists to assess the mortality assumptions applied in the model by comparing these with our independent methodology and third party mortality data. – **Benchmarking assumptions:** We compared the assumptions over house price forecasts with third party market data. – **Sensitivity analysis:** We performed sensitivity analysis on judgemental assumptions, to critically assess the impact of alternative assumptions and those assumptions most significant to the valuation of the portfolio. This included considering the potential impacts of Brexit on the market and economy, as set out above. – **Assessing transparency:** We critically assessed the adequacy of the disclosures regarding the degree of estimation uncertainty involved in arriving at the valuation and the accounting judgements made in determining the measurement basis and valuation.

	The risk	Our response
Fair value of the equity release portfolio *(continued)*	– Early voluntary redemption rates ('prepayments'); – Mortality rates of borrowers; and – The discount rate, including illiquidity premium. Particularly given the anticipated longevity of the portfolio, there is significant subjectivity in the assumptions used in the model. The effect of these matters is that, as part of our risk assessment, we determined that the fair value of the equity release portfolio has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements (note 1t)) disclose the sensitivities estimated by the Society.	**Our results** We found the resulting valuation of the equity release portfolio to be acceptable.
Expected credit losses on loans and advances to customers fully secured on residential property and fully secured on land (£17.8 million) *Refer to page 59 (Audit Committee Report), pages 120 to 123 (accounting policy) and page 149 and 150 (financial disclosures)*	**Subjective estimate:** Under IFRS 9, the Group's incurred credit loss models used under IAS 39 are replaced with forward-looking expected credit loss ('ECL') models. The measurement of the ECLs depends on the change in credit quality of each loan since initial recognition. ECLs are determined relative to the stage of changes in credit quality. ECLs in a 12 month period are recognised on loans where there has been no significant increase in credit risk since the loan was originally recognised (stage 1). A lifetime ECL is recognised where there has been a significant increase in credit risk since initial recognition of the loan (stage 2) or where there is objective evidence of impairment and the loan is considered to be in default, or otherwise credit impaired (stage 3). The Directors use models to determine the level of ECL required to be recognised on each loan. Given the subjectivity inherent in estimating the recoverability of loan balances on a forward-looking basis, the assessment of ECLs becomes highly judgemental. In particular, there is subjectivity in the following key assumptions and judgements: – The determination of a 'significant increase in credit risk'; – The probability of an account falling into arrears and subsequently defaulting; – Loss given default; and – Forward-looking economic forecasts. The overall level of impairment provision held is also sensitive to the application of adjustments made outside the model. The effect of these matters is that, as part of our risk assessment, we determined that the expected credit loss on loans and advances to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 1t)) disclose the sensitivities estimated by the Group.	Our procedures included: – **Our sector experience:** We critically assessed the assumptions inherent in the models against our understanding of the different loan portfolios across the Group, their recent performance and industry developments. – **Historical comparisons:** We critically assessed certain assumptions used in the model, being loss given default and probability of default, against the Group's historical experience. – **Benchmarking assumptions:** We compared assumptions and judgements made by management against comparable peers to assess their reasonableness. – **Our market expertise:** Our economics specialists assessed the forward economic guidance applied by the Group in the ECL models to consider the reasonableness of assumptions against market data, our own independent assumptions and peer experience. This included considering the potential impacts of Brexit on the market and economy, as set out on page 91. – **Sensitivity analysis:** We stress tested the key assumptions to assess the sensitivity of the resulting expected credit loss to these. – **Tests of details:** For the management overlays and post-model adjustments applied, we assessed the calculation performed, and the assumptions applied in the calculation, to consider the reasonableness of the additional provision held. – **Assessing transparency:** We considered the adequacy of the Group's disclosures in respect of the sensitivity of expected credit losses to these assumptions. **Our results** We found the resulting estimate of the expected credit loss to be acceptable.

	The risk	Our response
Revenue recognition under the effective interest rate ('EIR') method (£30.0 million; 2017: £25.5 million) *Refer to page 59 (Audit Committee Report), pages 114 and 115 (accounting policy) and page 147 (financial disclosures)*	**Subjective estimate:** Using a model, interest earned and fees earned and incurred on loans and advances to customers are recognised using the effective interest rate method that spreads directly attributable expected income over the expected lives of the loans. The Directors apply judgement in assessing the expected repayment profiles used to determine the EIR period. The most critical element of judgement is the estimation of the future redemption profiles of the loan. This judgement is informed by product mix and past borrower behaviour of when loans are repaid. The effect of these matters is that, as part of our risk assessment, we determined that revenue recognition under the EIR method has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 1t)) disclose the sensitivity estimated by the Group.	Our procedures included: – **Benchmarking assumptions:** We critically assessed the expected customer lives against our own knowledge of industry experience and trends, including benchmarking with comparable lenders and considering product mix. – **Sensitivity analysis:** We observed sensitivity analysis performed using parameters determined by us for judgemental assumptions, being expected lives, to critically assess which of these the EIR asset is most sensitive to. This included considering the potential impacts of Brexit on the market and borrower behaviour, as set out on page 91. – **Historical comparison:** We critically assessed the expected life assumptions against the Society's historical experience of customer behaviour by product type. – **Tests of details:** We tested the completeness and accuracy of the data on which the historical comparison is performed. – **Assessing transparency:** We assessed the adequacy of the Group's disclosures about the degree of estimation involved in arriving at the interest income recognised and its sensitivity to key assumptions. **Our results** We found the resulting estimate of interest income under the EIR method to be acceptable (2017: acceptable).
Revenue recognition in respect of estate agency income (£271.3 million; 2017: £283.6 million) *Refer to page 60 (Audit Committee Report), pages 127 and 128 (accounting policy) and pages 137 and 138 (financial disclosures)*	**2018/2019 sales:** Revenue-based targets and incentives in place in the estate agency division may place pressure on management to influence the recognition of estate agency income. There may be an incentive for management to overstate or defer revenue recognition around the year end date to assist in meeting these current or future targets or expectations. In particular, we consider this risk relevant for the estate agency revenue streams in respect of commissions earned on property sales and property lettings as well as survey and valuations income.	Our procedures included: – **Control operation:** We evaluated the operating effectiveness of the control over branch to subsidiary income reconciliations. – **Tests of details:** We selected revenue transactions recorded around the year end date with specific risk characteristics within estate agency revenue streams and survey and valuations income, and agreed these items to underlying supporting evidence, such as bank statements and signed contracts, to agree that they are recorded in the appropriate period. **Our results** We found the resulting amount of revenue recognised to be acceptable (2017: acceptable).

We continue to perform procedures over liabilities for claims and compensation. However, as a result of the Group's exposure to liabilities for claims and compensation reducing in the year (given, for example, some liabilities have been settled in the year and others are drawing closer to a regulatory deadline, reducing the longevity of the estimation period), we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

Key audit matters were reported in 2017 in respect of 'Impairment of loans and advances to customers fully secured on residential property and fully secured on land' and the 'Equity release no negative equity guarantee'. As a result of the Group's transition to IFRS 9, these key audit matters have been replaced with 'Expected credit losses on loans and advances to customers' and 'Fair value of the equity release portfolio', respectively, in 2018.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £9.0m, determined with reference to a benchmark of Group profit before tax, normalised to exclude profit on disposal of subsidiary undertakings, profit on disposal of other Group undertakings, loss on disposal of mortgage assets and impairment of goodwill and fair value movements in equity share investments as well as the 2018 fair value gains in relation to the equity release portfolio as disclosed on page 24, of which it represents 4.8% (2017: 4.6%).

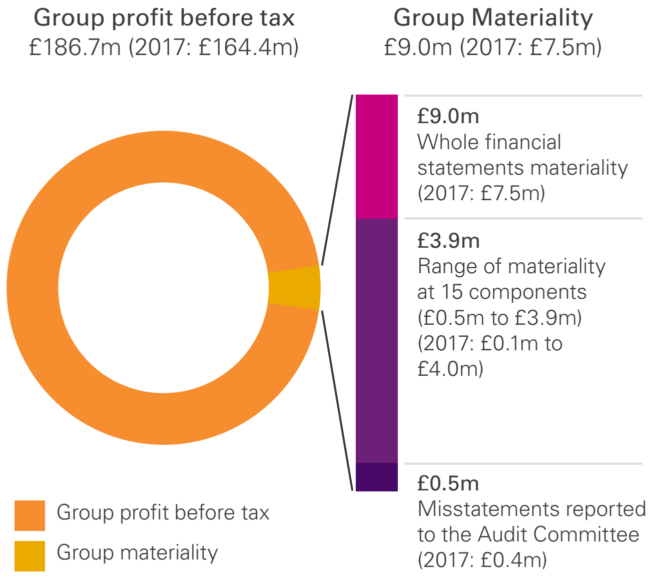
Materiality for the Society financial statements as a whole was set at £3.9m (2017: £4.0m), determined with reference to a benchmark of Society profit before tax, normalised to exclude dividend income and the 2017 impairment of investment in subsidiaries, of which it represents 4.6% (2017: 4.8%).

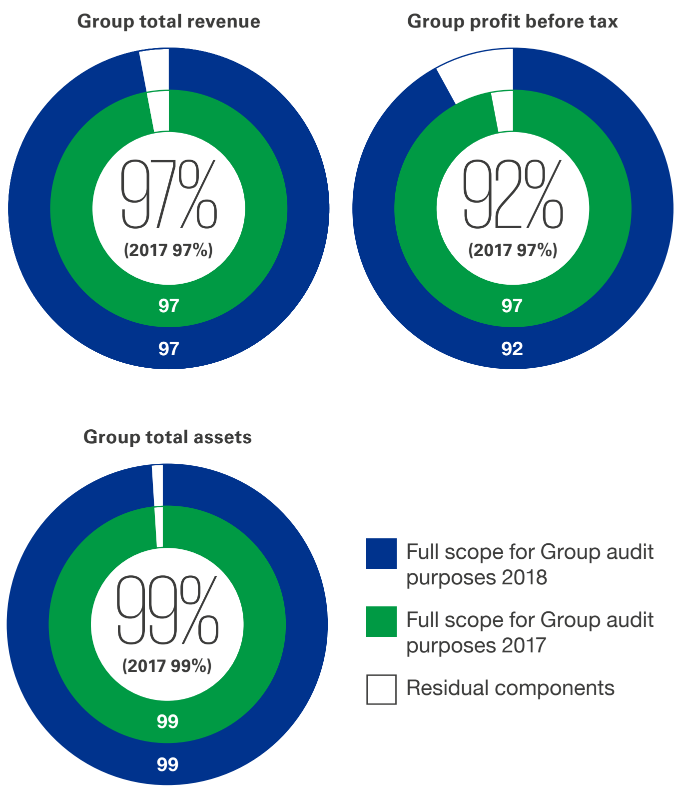
We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.5m, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's 15 (2017: 16) reporting components, we subjected 7 (2017: 8) to full scope audits for Group purposes.

The components within the scope of our work accounted for the percentages illustrated on page 94.

The remaining 3% of total Group revenue, 8% of Group profit before tax and 1% of total Group assets is represented by 8 reporting components, none of which individually represented more than 3% of any of total Group revenue, Group profit before tax or total Group assets. For these residual components, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within these.





The Group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved the component materialities, which ranged from £0.5m to £3.9m, having regard to the mix of size and risk profile of the Group across the components. The work on four of the 15 components (2017: four of the 16 components) was performed by component auditors and the rest, including the audit of the Society, was performed by the Group team. The Group team performed procedures on the items excluded from normalised Group profit before tax.

The Group team visited 11 (2017: 12) components in one location (2017: one). Telephone conference meetings were also held with these component auditors and the majority of the others that were not physically visited. At these visits and meetings, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.

4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Group or Society or to cease its operations, and as they have concluded that the Group and Society's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ('the going concern period').

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Group and Society will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group and Society's business model, including the impact of Brexit, and analysed how those risks might affect the Group and Society's financial resources or ability to continue operations over the going concern period. We evaluated those risks and concluded that they were not significant enough to require us to perform additional audit procedures.

Based on this work, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on the other information in the Annual Report

The Directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Annual Business Statement and Directors' Report

In our opinion:

– the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations thereunder;
– the information given in the Directors' Report for the financial year is consistent with the accounting records and the annual accounts; 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.

6. We have nothing to report on the other matters on which we are required to report by exception

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 annual accounts 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 these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 47, the Directors are responsible for: the preparation of annual accounts which give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and 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 they 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

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 other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the Directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence and discussed with the Directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the Group to component audit teams of relevant laws and regulations identified at Group level.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related building society legislation) and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's licence to operate. We identified the following areas as those most likely to have such an effect: health and safety, anti-bribery, employment law, regulatory capital and liquidity and certain aspects of building society legislation recognising the financial and regulated nature of the Group's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the Directors and other management and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

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.

Jonathan Holt
(Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
1 Sovereign Square,
Sovereign Street,
Leeds,
LS1 4DA

26 February 2019

KPMG

Income Statements

For the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017* £m	Society 2018 £m	Society 2017* £m
Interest receivable and similar income:					
Calculated using the effective interest rate method	2	488.5	472.5	424.6	419.2
On financial instruments at fair value through profit or loss	2	(14.7)	(72.5)	(13.2)	(72.5)
Total interest receivable and similar income		473.8	400.0	411.4	346.7
Interest payable and similar charges	3	(232.6)	(179.4)	(225.5)	(170.7)
Net interest receivable		241.2	220.6	185.9	176.0
Fees and commissions receivable	4a)	480.9	477.9	33.6	34.4
Fees and commissions payable		(7.6)	(8.1)	(2.4)	(2.1)
Fair value gains / (losses) on financial instruments mandatorily held at FVTPL:					
Hedging instruments and hedged items		1.5	1.5	0.1	1.8
Other derivatives	15	18.1	-	18.1	-
Equity release portfolio	15	(17.1)	-	(17.1)	-
Other financial instruments		(0.3)	-	1.0	-
Fair value gains on deemed loans from subsidiary undertakings designated at FVTPL		-	-	1.4	-
Profit on disposal of treasury assets held at available-for-sale		-	2.7	-	2.7
Profit on disposal of treasury assets held at amortised cost		-	-	-	0.4
Loss on disposal of mortgage assets held at amortised cost		-	(15.0)	-	-
Income from shares in subsidiary undertakings		-	-	82.9	60.5
Profit on disposal of subsidiary undertakings	17c)	3.3	11.3	-	-
Profit on disposal of joint ventures		-	0.9	-	-
Profit on disposal of equity share investments	17e)	-	38.5	-	-
Dividend income from equity share investments		-	0.6	-	-
Share of profits from joint ventures		0.8	2.0	-	-
Other income		3.7	2.7	3.9	2.8
Total income		724.5	735.6	307.4	276.5
Administrative expenses	5	(521.0)	(523.1)	(138.7)	(132.1)
Operating profit before impairment and provisions		203.5	212.5	168.7	144.4
Impairment (losses) / credit on loans and advances to customers	14	(2.5)	4.0	(1.1)	3.0
Impairment losses on debt securities	11	(0.1)	-	(0.2)	-
Provision against investments in subsidiary undertakings	17a)	-	-	-	(9.9)
Impairment losses on equity share investments	17e)	-	(0.1)	-	-
Realised losses on the equity release portfolio	15	(0.7)	-	(0.7)	-
Provisions for liabilities	27	(12.0)	(16.3)	0.4	(3.7)
Profit before tax		188.2	200.1	167.1	133.8
Tax expense	9	(40.6)	(41.9)	(22.6)	(15.2)
Profit for the financial year attributable to members of Skipton Building Society		147.6	158.2	144.5	118.6

* The Group has adopted IFRS 9 and IFRS 15 with effect from 1 January 2018. Under the transition methods chosen, comparative information is not required to be restated, except for certain hedging requirements that are not relevant to the Group. See note 1b) for further details.

Segmental performance of the Group is shown in note 38.

The accompanying notes form part of these financial statements.

Statements of Comprehensive Income

For the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017* £m	Society 2018 £m	Society 2017* £m
Profit for the financial year		147.6	158.2	144.5	118.6
Other comprehensive income:					
Items that will not be reclassified to profit or loss:					
Remeasurement (losses) / gains on defined benefit obligations	29	(3.1)	10.2	(1.4)	2.9
Income tax on items that will not be reclassified to profit or loss	31	1.0	(1.9)	0.5	(0.7)
		(2.1)	8.3	(0.9)	2.2
Items that may be reclassified subsequently to profit or loss:					
Movement in available-for-sale reserve:					
Valuation gains taken to equity		-	8.1	-	3.2
Realised gains transferred to Income Statement		-	(43.0)	-	(4.4)
Movement in cash flow hedging reserve:					
Losses taken to equity		(0.3)	(0.7)	(1.0)	(0.7)
Realised gains transferred to Income Statement		-	(1.9)	-	(1.9)
Gains reclassified to Income Statement		-	(1.7)	-	(1.7)
Movement in fair value reserve (debt securities):					
Losses taken to equity		(2.3)	-	(2.5)	-
Impairment loss allowance on debt securities held at FVOCI	11	0.1	-	0.2	-
Movement in cost of hedging reserve:					
Losses taken to equity		(0.5)	-	-	-
Exchange differences on translation of foreign operations		-	(0.4)	-	-
Income tax on items that may be reclassified to profit or loss	31	0.6	7.1	0.8	1.4
		(2.4)	(32.5)	(2.5)	(4.1)
Other comprehensive expense for the year, net of tax		(4.5)	(24.2)	(3.4)	(1.9)
Total comprehensive income for the year attributable to members of Skipton Building Society		143.1	134.0	141.1	116.7

* The Group has adopted IFRS 9 and IFRS 15 with effect from 1 January 2018. Under the transition methods chosen, comparative information is not required to be restated, except for certain hedging requirements that are not relevant to the Group. See note 1b) for further details.

The accompanying notes form part of these financial statements.

Statements of Financial Position

As at 31 December 2018

	Notes	Group 2018 £m	Group 2017* £m	Society 2018 £m	Society 2017* £m
Assets					
Cash in hand and balances with the Bank of England		2,395.7	2,396.9	2,395.7	2,396.9
Loans and advances to credit institutions held at amortised cost	10	422.7	345.3	349.5	260.8
Debt securities	11	1,383.1	791.1	1,344.9	760.3
Derivative financial instruments		72.3	94.2	68.2	98.2
Loans and advances to customers held at amortised cost	12	18,127.0	16,972.7	15,999.2	14,886.6
Loans and advances to customers held at FVTPL	16	1.9	-	1.9	-
Equity release portfolio held at FVTPL	15	410.9	-	410.9	-
Deferred tax asset	28	41.6	30.4	26.3	13.9
Investments in Group undertakings	17a)	-	-	975.0	1,086.0
Investments in joint ventures		12.2	12.8	-	-
Equity share investments	17e)	0.8	0.4	-	-
Property, plant and equipment	18	77.9	78.2	36.5	33.9
Investment property	19	12.0	14.4	12.0	14.3
Intangible assets	20	161.4	164.4	2.5	2.6
Other assets	21	84.9	122.8	15.0	13.1
Total assets		23,204.4	21,023.6	21,637.6	19,566.6
Liabilities					
Shares	22	16,113.5	14,985.8	16,113.5	14,985.8
Amounts owed to credit institutions	23	1,878.0	1,483.2	1,999.9	1,580.1
Amounts owed to other customers	24	1,690.4	1,805.1	529.2	924.7
Debt securities in issue	25	1,420.3	666.4	1,194.4	360.0
Derivative financial instruments		279.4	318.5	282.3	318.9
Current tax liability		18.6	19.9	10.0	8.2
Other liabilities	26	56.9	110.4	10.5	7.8
Accruals		48.9	50.5	16.9	15.9
Deferred income		2.7	3.7	-	-
Provisions for liabilities	27	24.3	26.1	4.4	7.1
Deferred tax liability	28	5.5	7.4	0.4	0.8
Retirement benefit obligations	29	99.5	100.2	52.2	51.7
Subscribed capital	30	41.6	41.6	41.6	41.6
Total liabilities		21,679.6	19,618.8	20,255.3	18,302.6
Members' interests					
General reserve		1,518.7	1,396.4	1,381.2	1,260.8
Available-for-sale reserve		-	3.1	-	3.1
Fair value reserve		1.6	-	1.7	-
Cash flow hedging reserve		(0.2)	0.1	(0.6)	0.1
Cost of hedging reserve		(0.5)	-	-	-
Translation reserve		5.2	5.2	-	-
Attributable to members of Skipton Building Society		1,524.8	1,404.8	1,382.3	1,264.0
Total members' interests and liabilities		23,204.4	21,023.6	21,637.6	19,566.6

* The Group has adopted IFRS 9 and IFRS 15 with effect from 1 January 2018. Under the transition methods chosen, comparative information is not required to be restated, except for certain hedging requirements that are not relevant to the Group. See note 1b) for further details.

The accompanying notes form part of these financial statements.

These Accounts were approved by the Board of Directors on 26 February 2019 and were signed on its behalf by:

Robert East — **Chairman**
David Cutter — **Group Chief Executive**
Bobby Ndawula — **Group Finance Director**

Statements of Changes in Members' Interests

For the year ended 31 December 2018

Group	General reserve £m	Available-for-sale reserve £m	Fair value reserve £m	Cash flow hedging reserve £m	Cost of hedging reserve £m	Translation reserve £m	Total £m
Balance at 31 December 2017	1,396.4	3.1	-	0.1	-	5.2	1,404.8
Adjustment on initial adoption of IFRS 9 (net of tax)	(38.7)	(3.1)	3.2	-	-	-	(38.6)
Adjusted balance at 1 January 2018	1,357.7	-	3.2	0.1	-	5.2	1,366.2
Profit for the financial year	147.6	-	-	-	-	-	147.6
Other comprehensive income							
Remeasurement losses on defined benefit obligations	(2.1)	-	-	-	-	-	(2.1)
Net losses from changes in fair value	-	-	(1.7)	(0.3)	(0.5)	-	(2.5)
Debt securities at FVOCI: Impairment loss allowance	-	-	0.1	-	-	-	0.1
Total other comprehensive income (note 31)	(2.1)	-	(1.6)	(0.3)	(0.5)	-	(4.5)
Total comprehensive income for the year	145.5	-	(1.6)	(0.3)	(0.5)	-	143.1
Transfer of engagements	15.5	-	-	-	-	-	15.5
Balance at 31 December 2018	1,518.7	-	1.6	(0.2)	(0.5)	5.2	1,524.8

For the year ended 31 December 2017*

Group	General reserve £m	Available-for-sale reserve £m	Cash flow hedging reserve £m	Translation reserve £m	Sub total £m	Non-controlling interests £m	Total £m
Balance at 1 January 2017	1,236.6	32.0	3.3	6.6	1,278.5	(1.0)	1,277.5
Profit for the financial year	158.2	-	-	-	158.2	-	158.2
Other comprehensive income							
Remeasurement gains on defined benefit obligations	8.3	-	-	-	8.3	-	8.3
Net gains / (losses) from changes in fair value	-	5.9	(0.3)	-	5.6	-	5.6
Realised gains transferred to the Income Statement	-	(34.8)	(1.5)	-	(36.3)	-	(36.3)
Cash flow hedges: gains reclassified to Income Statement	-	-	(1.4)	-	(1.4)	-	(1.4)
Exchange differences on translation of foreign operations	-	-	-	(0.4)	(0.4)	-	(0.4)
Total other comprehensive income (note 31)	8.3	(28.9)	(3.2)	(0.4)	(24.2)	-	(24.2)
Total comprehensive income for the year	166.5	(28.9)	(3.2)	(0.4)	134.0	-	134.0
Changes in ownership interest:							
Acquisition of non-controlling interests without change in control	(6.7)	-	-	(1.0)	(7.7)	1.0	(6.7)
Balance at 31 December 2017	1,396.4	3.1	0.1	5.2	1,404.8	-	1,404.8

Statements of Changes in Members' Interests *(continued)*

For the year ended 31 December 2018

Society	General reserve £m	Available-for-sale reserve £m	Fair value reserve £m	Cash flow hedging reserve £m	Total £m
Balance at 31 December 2017	**1,260.8**	**3.1**	**-**	**0.1**	**1,264.0**
Adjustment on initial adoption of IFRS 9 (net of tax)	(38.7)	(3.1)	3.5	-	**(38.3)**
Adjusted balance at 1 January 2018	**1,222.1**	**-**	**3.5**	**0.1**	**1,225.7**
Profit for the financial year	144.5	-	-	-	**144.5**
Other comprehensive income					
Remeasurement losses on defined benefit obligations	(0.9)	-	-	-	**(0.9)**
Net losses from changes in fair value	-	-	(2.0)	(0.7)	**(2.7)**
Debt securities at FVOCI: Impairment loss allowance	-	-	0.2	-	**0.2**
Total other comprehensive income (note 31)	**(0.9)**	**-**	**(1.8)**	**(0.7)**	**(3.4)**
Total comprehensive income for the year	**143.6**	**-**	**(1.8)**	**(0.7)**	**141.1**
Transfer of engagements	15.5	-	-	-	15.5
Balance at 31 December 2018	**1,381.2**	**-**	**1.7**	**(0.6)**	**1,382.3**

For the year ended 31 December 2017*

Society	General reserve £m	Available-for-sale reserve £m	Cash flow hedging reserve £m	Total £m
Balance at 1 January 2017	1,140.0	4.0	3.3	1,147.3
Profit for the financial year	118.6	-	-	118.6
Other comprehensive income				
Remeasurement gains on defined benefit obligations	2.2	-	-	2.2
Net gains / (losses) from changes in fair value	-	2.7	(0.3)	2.4
Realised gains transferred to Income Statement	-	(3.6)	(1.5)	(5.1)
Cash flow hedges: gains reclassified to Income Statement	-	-	(1.4)	(1.4)
Total other comprehensive income (note 31)	2.2	(0.9)	(3.2)	(1.9)
Total comprehensive income for the year	120.8	(0.9)	(3.2)	116.7
Balance at 31 December 2017	1,260.8	3.1	0.1	1,264.0

* The Group has adopted IFRS 9 and IFRS 15 with effect from 1 January 2018. Under the transition methods chosen, comparative information is not required to be restated, except for certain hedging requirements that are not relevant to the Group. See note 1b) for further details.

The accompanying notes form part of these financial statements.

Statements of Cash Flows

For the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017* £m	Society 2018 £m	Society 2017* £m
Cash flows from operating activities					
Profit before tax		**188.2**	200.1	**167.1**	133.8
Adjustments for:					
Impairment charge / (credit) on loans and advances to customers	14	**2.5**	(4.0)	**1.1**	(3.0)
Loans and advances written off, net of recoveries	14	**(1.7)**	(2.3)	**(0.5)**	(0.8)
Impairment losses on debt securities	11	**0.1**	-	**0.2**	-
Impairment losses on trade receivables	36c)	**0.8**	0.6	**-**	-
Impairment of goodwill	20	**2.5**	-	**-**	-
Depreciation and amortisation	18, 19, 20	**21.1**	21.0	**5.5**	5.2
Impairment of property, plant and equipment and investment property	18, 19	**2.3**	0.1	**2.3**	0.1
Income from shares in subsidiary undertakings		**-**	-	**(82.9)**	(60.5)
Provision against investments in subsidiary undertakings	17a)	**-**	-	**-**	9.9
Impairment losses on equity share investments	17e)	**-**	0.1	**-**	-
Fair value losses on equity share investments	17e)	**0.3**	-	**-**	-
Dividend income from equity share investments		**-**	(0.6)	**-**	-
Interest on subscribed capital and subordinated liabilities	3	**4.5**	6.8	**4.5**	6.8
Profit on sale of property, plant and equipment, investment property and intangible assets		**(0.3)**	(1.6)	**(0.2)**	(0.7)
Profit on disposal of treasury assets		**-**	(2.7)	**-**	(3.1)
Loss on disposal of mortgage assets		**-**	15.0	**-**	-
Share of profits from joint ventures		**(0.8)**	(2.0)	**-**	-
Fair value losses on equity release portfolio	15	**17.1**	-	**17.1**	-
Profit on disposal of joint ventures		**-**	(0.9)	**-**	-
Profit on disposal of equity share investments	17e)	**-**	(38.5)	**-**	-
Profit on disposal of subsidiary undertakings	17c)	**(3.3)**	(11.3)	**-**	-
Realised losses on the equity release portfolio	15	**0.7**	-	**0.7**	-
Other non-cash movements		**(16.4)**	5.7	**(13.8)**	(2.6)
		217.6	185.5	**101.1**	85.1
Changes in operating assets and liabilities:					
Movement in prepayments and accrued income		**(2.4)**	(0.7)	**(1.4)**	(0.1)
Movement in accruals and deferred income		**15.7**	(4.2)	**17.7**	(3.9)
Movement in provisions for liabilities		**(1.8)**	3.7	**(2.7)**	-
Movement in fair value of derivatives		**(17.2)**	(71.9)	**(6.6)**	(63.3)
Movement in fair value adjustments for hedged risk		**(8.2)**	59.7	**(16.9)**	54.8
Movement in fair value of debt securities	11	**4.3**	10.5	**3.5**	10.5
Movement in loans and advances to customers		**(1,501.4)**	(1,487.7)	**(1,454.7)**	(1,468.0)
Disposal of mortgage assets		**-**	197.3	**-**	-
Purchase of mortgage assets		**-**	(19.7)	**-**	-
Movement in shares		**1,018.0**	888.7	**1,018.0**	888.7
Income Statement (credit) / charge for fair value of subsidiary management incentive scheme liability	26	**(4.2)**	9.7	**-**	-
Net movement in amounts owed to credit institutions and other customers		**260.3**	1,138.6	**5.7**	663.5
Net movement in debt securities in issue		**746.8**	136.7	**833.6**	349.6
Net movement in loans and advances to credit institutions		**(107.1)**	49.5	**(107.1)**	47.3
Net movement in other assets		**36.5**	(4.2)	**(0.8)**	(4.0)
Net movement in other liabilities		**(37.3)**	(9.8)	**3.0**	0.4
Income taxes paid		**(40.4)**	(41.5)	**(18.9)**	(16.0)
Net cash flows from operating activities		**579.2**	1,040.2	**373.5**	544.6

Statements of Cash Flows *(continued)*

For the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017* £m	Society 2018 £m	Society 2017* £m
Net cash flows from operating activities		579.2	1,040.2	373.5	544.6
Cash flows from investing activities					
Purchase of debt securities	11	(1,763.2)	(666.5)	(1,313.9)	(419.4)
Proceeds from disposal of debt securities		1,166.9	922.9	723.1	913.9
Purchase of property, plant and equipment	18	(14.5)	(17.5)	(6.0)	(6.5)
Purchase of intangible assets	20	(4.9)	(6.0)	(0.8)	(1.0)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		1.5	4.8	0.2	1.8
Dividends received from subsidiary undertakings		-	-	82.9	60.5
Dividends received from equity share investments		-	0.6	-	-
Decrease in loans to subsidiary undertakings	17a)	-	-	111.0	223.7
Exercise of share options in subsidiary management incentive scheme	26	(9.8)	(6.5)	-	-
Exercise of put options held by non-controlling interests	26	(0.3)	-	-	-
Proceeds from disposal of equity share investments		-	40.8	-	-
Proceeds from disposal of joint ventures		-	1.0	-	-
Dividends received from joint ventures		1.4	1.6	-	-
Purchase of subsidiary undertakings, net of cash acquired		-	(0.6)	-	-
Cash acquired on transfer of engagements	42	12.9	-	12.9	-
Purchase of non-controlling interest	17b)	-	(6.6)	-	-
Contingent consideration received following disposal of subsidiary undertaking (net of costs)		5.4	-	-	-
Cash paid on disposal of subsidiary undertaking		-	(1.5)	-	-
Investment in equity share investments	17e)	(0.7)	(0.1)	-	-
Purchase of other business units	17b)	(0.6)	(1.1)	-	-
Deferred consideration paid in respect of prior year acquisitions of subsidiary undertakings and business assets		(1.6)	(1.8)	-	-
Net cash flows from investing activities		(607.5)	263.5	(390.6)	773.0
Cash flows from financing activities					
Repurchase of subordinated liabilities		-	(65.4)	-	(65.4)
Repurchase of subscribed capital	30	-	(50.0)	-	(50.0)
Redemption of subordinated liabilities		-	(10.0)	-	(10.0)
Interest paid on subordinated liabilities		-	(2.6)	-	(2.6)
Interest paid on subscribed capital	30	(4.5)	(6.3)	(4.5)	(6.3)
Net cash flows from financing activities		(4.5)	(134.3)	(4.5)	(134.3)
Net (decrease) / increase in cash and cash equivalents		(32.8)	1,169.4	(21.6)	1,183.3
Cash and cash equivalents at 1 January		2,455.0	1,285.6	2,370.6	1,187.3
Adjustment on initial adoption of IFRS 9	1b)	(0.3)	-	(0.2)	-
Cash and cash equivalents at 31 December		2,421.9	2,455.0	2,348.8	2,370.6

Analysis of the cash balances as shown within the Statement of Financial Position:

	Notes	Group 2018 £m	Group 2017* £m	Society 2018 £m	Society 2017* £m
Cash in hand and balances with the Bank of England		2,395.7	2,396.9	2,395.7	2,396.9
Mandatory reserve deposit with the Bank of England		(46.9)	(26.3)	(46.9)	(26.3)
		2,348.8	2,370.6	2,348.8	2,370.6
Loans and advances to credit institutions	10	73.1	84.4	-	-
Cash and cash equivalents at 31 December		2,421.9	2,455.0	2,348.8	2,370.6

* The Group has adopted IFRS 9 and IFRS 15 with effect from 1 January 2018. Under the transition methods chosen, comparative information is not required to be restated, except for certain hedging requirements that are not relevant to the Group. See note 1b) for further details.

The accompanying notes form part of these financial statements.

Notes to the Accounts

1. Accounting policies

The principal accounting policies applied consistently in the preparation of these consolidated Annual Accounts are set out below.

a) Basis of preparation

The Annual Accounts of the Group and the Society are prepared on a going concern basis (see pages 47 and 48 of the Directors' Report) and in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and effective at 31 December 2018 and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 and the Building Societies Act 1986 applicable to building societies reporting under IFRS.

The Annual Accounts have been prepared under the historical cost convention as modified by the application of fair value measurements required or allowed by relevant accounting standards.

The Annual Accounts are presented in pounds Sterling and, except where otherwise indicated, have been rounded to the nearest one hundred thousand pounds.

b) Changes to significant accounting policies

The Group has adopted IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* with effect from 1 January 2018. The effects of initially adopting these standards are outlined below.

IFRS 9

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement*. It introduces significant changes for the classification and measurement of financial instruments, including a new impairment approach, and new hedge accounting requirements. IFRS 9 also amends other standards dealing with financial instruments, including IFRS 7 *Financial Instruments: Disclosures*.

Impact of initial adoption

The table below summarises the impact, net of tax, of transition to IFRS 9 on 1 January 2018 on the opening general reserve of the Group and of the Society. As permitted by the standard, the Group has not restated comparative information for prior periods with respect to classification and measurement, including impairment requirements. Differences between the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 were recognised in the general reserve at the date of transition. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9.

	Decrease in general reserve on adoption of IFRS 9 at 1 January 2018 Group £m	Society £m
Reclassification of equity release portfolio (note 1)	(37.0)	(37.0)
Reclassification of debt securities (note 2)	-	(2.2)
Impairment losses on loans and advances to customers (note 3)	(1.4)	0.7
Impairment losses on liquid assets (note 4)	(0.3)	(0.2)
Total (note 5)	**(38.7)**	**(38.7)**

Notes
1. For further details on the impact of the reclassification of the equity release portfolio, see pages 106 and 107.
2. For further details on the impact of the reclassification of certain debt securities held in the Society, see page 107.
3. For further details on the impact on impairment losses on loans and advances to customers, see pages 107 to 109.
4. For further details on the impact on impairment losses on liquid assets, see pages 107 to 109.
5. The total decrease in the Group's general reserve is shown net of a £12.9m tax credit and for the Society is shown net of a £13.3m tax credit.

1. Accounting policies *(continued)*

Impact on regulatory capital

The principal impact on the Group's regulatory capital of the transition to IFRS 9 arises from the reclassification of the equity release portfolio.

The table below summarises the impact of the transition to IFRS 9 on 1 January 2018:

Unaudited	31 December 2017 £m	Reclassification and measurement (note 1) £m	Excess expected loss (note 2) £m	Tax £m	**1 January 2018 £m**
Capital resources:					
Common Equity Tier 1 capital	1,283.7	(51.9)	2.5	12.9	**1,247.2**
Tier 1 capital	1,323.7	(51.9)	2.5	12.9	**1,287.2**
Total capital	1,323.7	(51.9)	2.5	12.9	**1,287.2**
Risk weighted assets	3,864.7	(17.5)	-	12.9	**3,860.1**
Capital ratios:	%				**%**
Common Equity Tier 1 ratio (CRD IV transitional basis)	33.2				**32.3**
Leverage ratio (end-point basis)	6.1				**5.9**

Notes
1. Reclassification and measurement includes a prudential adjustment of £0.4m which relates to a deduction to capital for an Additional Valuation Adjustment ('AVA') on fair value assets. AVA has been applied to provide for the downside of fair value exposures that are intrinsically subjective in nature.
2. Under PRA rules the excess of expected loss, as calculated under the IRB approach, over accounting impairment provisions is deducted from Common Equity Tier 1 (CET 1) capital. As the accounting impairment provision is higher under IFRS 9 than under IAS 39, the difference between this and the total IRB expected loss is lower under IFRS 9 and so the deduction to CET 1 capital for excess expected loss is lower, thus resulting in the add-back above.

The Group has elected to apply transitional arrangements to the application of IFRS 9 to capital calculations from 1 January 2018. The transitional arrangements reduce the impact of expected credit loss provisions on capital resources over the period to 1 January 2023. The reduction in capital resources is being phased in at a rate of 5% in 2018, 15% in 2019, 30% in 2020, 50% in 2021, 75% in 2022 and 100% in 2023. As at 31 December 2018, 95% (or £0.8m) of expected credit loss provisions have been added back to capital resources, risk weighted assets and the leverage ratio exposure. As the impact is not significant, the capital and leverage ratios as reported on page 32 in the Strategic Report remained the same when these transitional arrangements were applied.

Classification and measurement

Financial assets

Under IAS 39 financial assets were classified into four categories; available-for-sale, loans and receivables, at fair value through profit or loss and held to maturity. Under IFRS 9 financial assets are classified into the following categories:

Amortised cost

A financial asset is measured at amortised cost only if it meets both of the following conditions and is not designated as at fair value through profit or loss (FVTPL):

- It is held within a business model whose objective is to hold assets to collect contractual cash flows ('held to collect' business model); and
- Its contractual terms give rise on specified dates to cash flows that are 'solely payments of principal and interest' (SPPI) on the principal amount outstanding.

Fair value through other comprehensive income (FVOCI)

A financial asset is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- It is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets ('held to collect and sell' business model); and
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in the investment's fair value in other comprehensive income. This election is made on an investment-by-investment basis. Gains and losses on such equity investments are never reclassified to the Income Statement and no impairment is recognised in the Income Statement. Dividends are recognised in the Income Statement. The Group has not designated any of its existing equity investments as at FVOCI.

Fair value through profit or loss (FVTPL)

All financial assets which are not classified as either amortised cost or FVOCI, as described above, are measured at FVTPL. This includes all derivative financial assets. On initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Impact on financial assets

The original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Group's and the Society's financial assets as at 1 January 2018 are shown below. The accompanying notes to the tables explain how the application of the new classification requirements under IFRS 9 has led to changes in classification of certain financial assets.

Group	**IAS 39 classification**	**IFRS 9 classification**	**Carrying amount under IAS 39 £m**	**Carrying amount under IFRS 9 £m**
Cash in hand and balances with the Bank of England (note 1)	Loans and receivables	Amortised cost	2,396.9	2,396.7
Loans and advances to credit institutions (note 1)	Loans and receivables	Amortised cost	345.3	345.2
Debt securities (notes 1 and 2)	Loans and receivables	Amortised cost	1.7	1.7
Debt securities (note 2)	Available-for-sale	FVOCI	789.4	789.4
Derivative financial instruments	FVTPL	FVTPL	94.2	94.2
Loans and advances to customers (excluding the equity release portfolio) (note 1)	Loans and receivables	Amortised cost	16,496.5	16,494.9
Equity release portfolio (note 3)	Loans and receivables	FVTPL	501.9	426.6
Equity release portfolio (no negative equity guarantee) (note 3)	FVTPL	N/A	(25.7)	-
Equity share investments (note 4)	Available-for-sale	FVTPL	0.4	0.4
Trade receivables (note 1)	Loans and receivables	Amortised cost	30.8	30.8
Contingent consideration (note 5)	Loans and receivables	FVTPL	25.1	25.1
Total financial assets			**20,656.5**	**20,605.0**

Notes
1. Financial assets that were previously classified as loans and receivables and which are now classified as amortised cost under IFRS 9 are initially recognised and subsequently measured using the same methods of accounting as they were under IAS 39, except that IFRS 9 introduces new impairment requirements. For further details see pages 107 to 109.
2. At 1 January 2018 the Group's debt securities included an investment in permanent interest bearing shares in another financial institution, which was previously classified as loans and receivables under IAS 39 and which met the criteria to be classified as amortised cost under IFRS 9. The Group's remaining debt securities are held to manage liquidity requirements and are classified as FVOCI as outlined on page 104.
3. Under IAS 39, the loan balances of the equity release portfolio were held at amortised cost and were included within loans and advances to customers. The no negative equity guarantee (NNEG), an embedded derivative, was bifurcated and held at fair value. Under IFRS 9, the equity release portfolio and the NNEG are no longer measured separately but instead are assessed together as a hybrid financial instrument. The Group has assessed the characteristics of the equity release cash flows and concluded that the contractual terms do not give rise on specified dates to cash flows that are solely payments of principal and interest. As a result, the equity release portfolio does not meet the conditions under IFRS 9 to be held at either amortised cost or FVOCI (as outlined on page 104) and is therefore classified as FVTPL. For further details on the key assumptions used in arriving at the fair value of this portfolio see pages 115, 116 and 133.
4. The equity share investments held by the Group at 1 January 2018 have been reclassified from available-for-sale to FVTPL. For further details see above and page 117.
5. The Group assessed the characteristics of the contingent consideration cash flows, based on the facts and circumstances that existed at initial recognition of the asset. As the contractual cashflows were dependent on the future performance of the counterparty, the Group concluded that the contractual terms did not give rise to cash flows on specified dates that are solely payments of principal and interest. As a result, the contingent consideration asset does not meet the conditions under IFRS 9 to be held at either amortised cost or FVOCI (as outlined on page 104) and is classified as FVTPL. This reclassification had no impact on the carrying amount of this asset at 1 January 2018; the closing carrying amount under IAS 39 and the opening carrying amount under IFRS 9 were both determined by calculating the present value of the expected future cash flows, discounted at an appropriate discount rate.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

Society	IAS 39 classification	IFRS 9 classification	Carrying amount under IAS 39	Carrying amount under IFRS 9
			£m	£m
Cash in hand and balances with the Bank of England	Loans and receivables	Amortised cost	2,396.9	2,396.7
Loans and advances to credit institutions	Loans and receivables	Amortised cost	260.8	260.8
Debt securities	Loans and receivables	Amortised cost	1.7	1.7
Debt securities	Available-for-sale	FVOCI	636.3	636.3
Debt securities (note 1)	Loans and receivables	FVTPL	84.1	81.1
Debt securities (note 2)	Loans and receivables	FVOCI	38.2	38.5
Derivative financial instruments	FVTPL	FVTPL	98.2	98.2
Loans and advances to customers (excluding the equity release portfolio)	Loans and receivables	Amortised cost	14,410.4	14,411.3
Equity release portfolio	Loans and receivables	FVTPL	501.9	426.6
Equity release portfolio (NNEG)	FVTPL	N/A	(25.7)	-
Loans to subsidiary undertakings (note 3)	Loans and receivables	Amortised cost	965.4	965.4
Trade receivables	Loans and receivables	Amortised cost	1.1	1.1
Total financial assets			**19,369.3**	**19,317.7**

Notes

1. The Society holds residential mortgage backed debt securities that were issued in previous periods by the Group's securitisation vehicles, Darrowby No.3 plc and Darrowby No.4 plc, some of which were reclassified from amortised cost to held at FVTPL on adoption of IFRS 9. For further details see page 117.
2. The remaining residential mortgage backed debt securities described above were reclassified from amortised cost to held at FVOCI on adoption of IFRS 9. For further details see page 115.
3. The impairment loss allowance on these loans as at 1 January 2018 was £nil.

Reconciliation of carrying value of financial assets from IAS 39 to IFRS 9

The following tables reconcile the carrying amount of financial assets from their previous measurement category in accordance with IAS 39 to their new measurement category upon transition to IFRS 9 on 1 January 2018.

Group	IAS 39 carrying amount at 31 December 2017	Reclassifications	Impairment	IFRS 9 carrying amount at 1 January 2018
	£m	£m	£m	£m
Cash in hand and balances with the Bank of England (note 1)	2,396.9	-	(0.2)	**2,396.7**
Loans and advances to credit institutions (note 1)	345.3	-	(0.1)	**345.2**
Debt securities (notes 1 and 2)	1.7	-	-	**1.7**
Debt securities (notes 1 and 2)	789.4	-	-	**789.4**
Derivative financial instruments	94.2	-	-	**94.2**
Loans and advances to customers (excluding equity release portfolio) (note 3)	16,496.5	-	(1.6)	**16,494.9**
Equity release portfolio (note 4)	476.2	(75.3)	25.7	**426.6**
Equity share investments	0.4	-	-	**0.4**
Trade receivables (note 5)	30.8	-	-	**30.8**
Contingent consideration	25.1	-	-	**25.1**
	20,656.5	**(75.3)**	**23.8**	**20,605.0**

Notes

1. Further details of the impact of adopting IFRS 9 on impairment held against the Group's liquid assets are found on pages 107 to 109.
2. Under IFRS 9, impairment loss allowances on debt securities held at FVOCI do not result in an adjustment to the carrying value of the asset (as detailed in note 1e)). The impairment loss allowance recognised in respect of debt securities held at FVOCI at 1 January 2018, as a result of adopting IFRS 9, was £0.1m (as outlined on pages 108 and 109).
3. Further details of the impact of adopting IFRS 9 on impairment held against the Group's loans and advances to customers are found on pages 107 to 109.
4. The impact of this reclassification on the Group's reserves at 1 January 2018 is a reduction in reserves of £37.0m (net of a £12.6m taxation credit).

   There are three key drivers behind this movement in reserves. The first is the Group's assessment of the illiquidity premium to be incorporated into the rate at which cash flows are discounted to present value in order to obtain a fair value for the portfolio. When the Group initially acquired the equity release portfolio, on merger with Scarborough Building Society in 2009, the fair value of the portfolio was assessed in accordance with IFRS 3 *Business Combinations* and was subsequently held at amortised cost; this initial fair value was used to assess the illiquidity premium inherent within this closed portfolio. This has resulted in a fair value that is lower than the carrying value as at 31 December 2017, resulting in a reduction in carrying value on adoption of IFRS 9.

   The second key driver is that hedge accounting is no longer applied to the equity release portfolio as it is fair valued under IFRS 9, resulting in a further reduction in carrying value following a reversal of the fair value adjustment for hedged risk that was held in relation to the portfolio at 31 December 2017.

   The third driver is a change in methodology for valuing the NNEG. Under IAS 39 the NNEG was treated as an embedded derivative and was fair valued separately from the rest of the portfolio and presented as an impairment provision on loans and advances to customers. Under IFRS 9 the whole portfolio is fair valued and the NNEG is not bifurcated, resulting in a reversal of the £25.7m impairment provision held within impairment losses on loans and advances to customers at 31 December 2017.

   The key estimates and judgements incorporated into the fair valuation of the equity release portfolio include the amount and timing of future cash flows arising from customer redemptions, the level of interest accruing to the point of redemption, future house price movements and the use of an appropriate discount factor.
5. There was no impact on the carrying value of the Group's trade receivables as a result of adopting IFRS 9. The IAS 39 impairment provision at 31 December 2017 and the IFRS 9 impairment allowance at 1 January 2018 were of the same amount.

Society	IAS 39 carrying amount at 31 December 2017	Reclassifications	Impairment	IFRS 9 carrying amount at 1 January 2018
	£m	£m	£m	£m
Cash in hand and balances with the Bank of England	2,396.9	-	(0.2)	**2,396.7**
Loans and advances to credit institutions	260.8	-	-	**260.8**
Debt securities	1.7	-	-	**1.7**
Debt securities	636.3	-	-	**636.3**
Debt securities (notes 1 and 2)	84.1	(3.0)	-	**81.1**
Debt securities (notes 1 and 2)	38.2	0.3	-	**38.5**
Derivative financial instruments	98.2	-	-	**98.2**
Loans and advances to customers (excluding equity release portfolio)	14,410.4	-	0.9	**14,411.3**
Equity release portfolio	476.2	(75.3)	25.7	**426.6**
Loans to subsidiary undertakings	965.4	-	-	**965.4**
Trade receivables	1.1	-	-	**1.1**
	19,369.3	**(78.0)**	**26.4**	**19,317.7**

Notes

1. The Society holds residential mortgage backed debt securities that were issued by the Group's special purpose vehicles Darrowby No. 3 plc and Darrowby No. 4 plc in previous periods. There are two tranches of these debt securities held by the Society, known as "A notes" and "B notes". The B notes are unrated and retained by the Society. The retained notes provide a level of credit enhancement to the rated A notes as a way of protecting investors against credit losses on the underlying mortgage pool used to securitise the wholesale issuance. Due to the higher level of credit risk on these debt securities, the Society has assessed that the assets are not held for the collection of cash flows that are solely payments of principal and interest and therefore these have been reclassified from financial assets held at amortised cost to financial assets held at FVTPL. The assets were fair valued on reclassification, resulting in a £3.0m decrease in their carrying value. For further details on the accounting policies regarding financial assets held at FVTPL, see pages 115 to 117. The A notes held by the Society were previously held at amortised cost and were reclassified to FVOCI on adoption of IFRS 9. These debt securities were fair valued on reclassification, resulting in a £0.3m increase in their carrying value. For further details on the accounting policies regarding financial assets held at FVOCI, see page 115.
2. Under IFRS 9, impairment loss allowances on debt securities held at FVOCI do not result in an adjustment to the carrying value of the asset (as detailed in note 1e)). The impairment loss allowance recognised in respect of debt securities held at FVOCI at 1 January 2018, as a result of adopting IFRS 9, was £0.1m (as outlined on pages 108 and 109).

Impairment of financial assets

IFRS 9 replaces the incurred loss model in IAS 39 with a forward-looking expected credit loss (ECL) model. This new impairment model applies to financial assets measured at either amortised cost or FVOCI (except equity share investments).

IFRS 9 requires an impairment loss allowance to be recognised at an amount equal to either 12-month ECLs ('stage 1' ECLs) or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument, whereas 12-month ECLs are the ECLs that result from default events that are possible within the 12 months after the reporting date. 'Stage 2' ECLs are lifetime ECLs that are recognised where there has been a significant

1. Accounting policies *(continued)*

increase in credit risk of the financial instrument (see pages 121 and 122) and 'stage 3' ECLs are lifetime ECLs that are recognised where the financial instrument is considered to be credit impaired (see page 123).

The Group has updated its accounting policies for impairment of financial assets following the adoption of IFRS 9, further details of which can be found on pages 120 to 123. The new ECL models involve a number of factors that require significant estimation and assumptions, further details of which can be found on pages 130 to 133.

The following table shows the impairment loss provision at 31 December 2017 measured in accordance with IAS 39 and the impairment loss allowance at 1 January 2018 measured in accordance with IFRS 9.

	Group		Society	
	IAS 39 impairment loss provision at 31 December 2017	**IFRS 9 impairment loss allowance at 1 January 2018**	**IAS 39 impairment loss provision at 31 December 2017**	**IFRS 9 impairment loss allowance at 1 January 2018**
	£m	**£m**	**£m**	**£m**
Cash in hand and balances with the Bank of England	-	0.2	-	0.2
Loans and advances to credit institutions	-	0.1	-	-
Debt securities	-	0.1	-	0.1
Loans and advances to customers held at amortised cost	16.1	17.7	12.5	11.6
Equity release NNEG held at FVTPL	25.7	-	25.7	-
Trade receivables	1.7	1.7	0.1	0.1
	43.5	**19.8**	**38.3**	**12.0**

The following table reconciles the prior period's closing impairment loss provision under IAS 39 to the impairment loss allowance under IFRS 9 at 1 January 2018.

	Group			Society		
	Loans and receivables (IAS 39) / Amortised cost (IFRS 9)	**Available-for-sale assets (IAS 39) / FVOCI (IFRS 9)**	**Total**	**Loans and receivables (IAS 39) / Amortised cost (IFRS 9)**	**Available-for-sale assets (IAS 39) / FVOCI (IFRS 9)**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Total impairment loss provision under IAS 39 at 31 December 2017	43.5	-	**43.5**	38.3	-	**38.3**
Reclassification of assets on adoption of IFRS 9 (note 1)	(25.7)	-	**(25.7)**	(25.7)	-	**(25.7)**
12-month ECLs against exposures that did not carry an individual provision under IAS 39 and have not suffered significant increase in credit risk since origination or acquisition (note 2)	(0.1)	0.1	**-**	(0.3)	0.1	**(0.2)**
Lifetime ECLs against exposures that did not carry an individual provision under IAS 39 but have suffered significant increase in credit risk since origination or acquisition (note 3)	2.4	-	**2.4**	0.8	-	**0.8**
Differences between IAS 39 incurred losses and IFRS 9 ECLs for assets held as credit-impaired under IAS 39 (note 4)	0.2	-	**0.2**	(0.6)	-	**(0.6)**
Impact of multiple forecast economic scenarios (note 5)	1.1	-	**1.1**	0.9	-	**0.9**
Commercial loan individual impairment (note 6)	(1.7)	-	**(1.7)**	(1.7)	-	**(1.7)**
Other	-	-	**-**	0.2	-	**0.2**
Total impairment loss allowance under IFRS 9 at 1 January 2018	**19.7**	**0.1**	**19.8**	**11.9**	**0.1**	**12.0**

Notes

1. As outlined on pages 105 to 107, the Group's equity release portfolio was reclassified as FVTPL on adoption of IFRS 9. As a result, the impairment provision which was previously recognised under IAS 39 in relation to the portfolio's NNEG is no longer required under IFRS 9.
2. The movement includes an increase of £0.4m in impairment held against liquid assets for the Group and £0.3m for the Society. It also includes a decrease in the Group of £0.4m and in the Society of £0.5m in impairment held against loans and advances to customers as a result of replacing the previous collective provision (IAS 39) with 12-month ECLs (IFRS 9). The impact of recognising impairment against loan commitments at 1 January 2018 was not material. For further details on the Group's accounting policies for recognising ECLs on loans and advances to customers, see note 1g).
3. The net increase comprises an increase of £0.5m in respect of the Society's commercial loan portfolio and an increase of £1.9m in respect of the Group's residential mortgage portfolio, £0.3m of which relates to the Society's residential mortgage portfolio.
4. For the Group, the net movement comprises a £0.5m increase in respect of the residential mortgage portfolio and a £0.3m decrease in respect of the commercial loan portfolio. For the Society, the net movement comprises a £0.3m decrease in respect of the residential mortgage portfolio and a £0.3m decrease in respect of the commercial loan portfolio. For some accounts the IFRS 9 ECL amount is lower than the IAS 39 incurred loss amount because the IFRS 9 model includes enhanced cure rate information at an individual account level.
5. Under IFRS 9 the measurement of ECLs requires the Group to consider forward-looking information, including a range of possible economic outcomes (as outlined in note 1g)). For the Group, the impact was to increase impairment held against loans and advances to customers by £1.1m, being £0.4m in respect of residential mortgages and £0.7m in respect of commercial loans. For the Society, the impact was to increase impairment held against loans and advances to customers by £0.9m, being £0.2m in respect of residential mortgages and £0.7m in respect of commercial loans.
6. Under IAS 39 the Society recognised individual impairment for commercial loans that were on a 'watchlist' due, for example, to known financial difficulties of the borrower. Where it was not possible to specifically determine the amount ultimately likely to be received, assumptions were used based on available information and management judgement. With effect from 1 January 2018, commercial loan impairment is based on a new IFRS 9 compliant model.

Financial liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, under IAS 39 all changes in fair value of liabilities designated as at FVTPL were recognised in profit or loss, whereas under IFRS 9 these fair value changes are presented as follows:

- The amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in other comprehensive income (except where this would create or enlarge an accounting mismatch in profit or loss); and
- The remaining amount of change in the fair value is presented in profit or loss.

The Society has voluntarily designated the deemed loans repayable to the Group's special purpose vehicles Darrowby No. 3 plc and Darrowby No. 4 plc, as outlined in note 1c), as FVTPL on adoption of IFRS 9. These financial liabilities were previously classified as FVTPL under IAS 39 and the voluntary designation of these financial liabilities as FVTPL under IFRS 9 did not result in an adjustment to their carrying value on adoption of IFRS 9. These financial liabilities have been designated as at FVTPL on the basis that doing so significantly reduces an accounting mismatch that would have otherwise arisen had they been held at amortised cost, given that the associated derivatives held to hedge fair value movements in the deemed loans are also held at FVTPL. The voluntary designation of these liabilities as FVTPL is irrevocable. There are no further financial liabilities that have been voluntarily designated as at FVTPL in the Group or the Society. For further details on the Group and the Society's accounting policies on financial liabilities, see note 1f).

Hedge accounting

The Group has elected to adopt the new hedge accounting requirements of IFRS 9 from 1 January 2018 for all hedge relationships covered by these requirements. The Group continues to apply the requirements of IAS 39 for portfolio fair value hedging relationships, as permitted by IFRS 9. IFRS 9 requires the Group to ensure that hedge accounting relationships are aligned with the Group's risk management objectives and strategy and apply a more qualitative and forward-looking approach to assessing hedge effectiveness.

In accordance with IFRS 9, the new hedge accounting requirements are applied prospectively from the initial application date (except as noted below regarding the accounting for certain costs of hedging). The types of hedge accounting relationship that the Group currently designates meet the requirements of IFRS 9 and are aligned with the Group's risk management objectives and strategy. The Group has enhanced its hedging documentation in line with the requirements of IFRS 9.

In accordance with IFRS 9, costs of hedging are required to be applied retrospectively and the costs recognised directly in reserves (the 'cost of hedging reserve'). The Group has assessed that, as at 1 January 2018, no hedge accounting relationships existed that would have resulted in any such hedging costs being recognised directly in reserves and therefore there is no impact on the Group's or the Society's reserves as at 1 January 2018. At 31 December 2018 the Group held a cross-currency swap that has resulted in a cost of hedging being recognised directly in reserves, as outlined in note 1c).

All hedging relationships designated under IAS 39 at 31 December 2017, with the exception of the derivatives held to hedge the equity release portfolio as outlined below, met the criteria for hedge accounting under IFRS 9 at 1 January 2018 and are therefore regarded as continuing hedging relationships.

A further change to the Group's hedge accounting policies as a result of adopting IFRS 9 relates to the Group's equity release portfolio. As discussed on pages 105 to 107, the Group's equity release portfolio is reclassified as FVTPL under IFRS 9. As a consequence of this reclassification, the associated derivatives which are held to economically hedge the equity release portfolio, and which continue to be held at FVTPL under IFRS 9, no longer qualify to be designated in a hedge relationship for accounting purposes. The changes in fair value of both the equity release portfolio and the

1. Accounting policies *(continued)*

associated derivatives are recognised in the Income Statement creating a partially offsetting effect. This offsetting is not perfect due to differing characteristics of the instruments and differing valuation requirements.

Significant accounting policies

Further details on the Group's significant new accounting policies as a result of adopting IFRS 9 can be found in note 1e) *Financial assets*, note 1g) *Impairment of financial assets* and note 1f) *Financial liabilities*.

Governance

The application of IFRS 9, in particular with respect to loan impairment, is subject to review and oversight through the Group's existing risk management framework.

A 'Loan Impairment' forum that comprises members from the Group's Finance and Risk teams meets monthly to review the outputs of the Group's loan impairment models and the key assumptions used. The forum assesses whether the outputs appropriately reflect the level of credit risk present in the Group's mortgage portfolios. The forum also reviews the results of back-testing that is performed by the Group to validate the reliability of the loan impairment models and the appropriateness of key assumptions.

As outlined in note 1g), the measurement of expected credit losses under IFRS 9 requires that the Group considers a range of future economic scenarios. To assist in this process, the Group has established an 'Economics' forum that comprises members from the Group's Finance, Risk and Treasury teams. The forum meets periodically to derive an appropriate range of economic scenarios, based upon a review of external economic data, for use in the Group's IFRS 9 impairment models. The scenarios proposed by the forum are subject to Board review and approval.

Loan impairment allowances are regularly reviewed and approved by the Board Audit Committee.

IFRS 15

IFRS 15 establishes a comprehensive framework for determining whether, how much, and when revenue is recognised. It replaces previous revenue recognition requirements, including IAS 18 *Revenue*. The Group has adopted IFRS 15 using the cumulative effect method, i.e. any impact of initially applying IFRS 15 was recognised on 1 January 2018 and therefore the financial information presented for the year ended 31 December 2017 has not been restated. Full details of the accounting policies applied to information presented for 2017 are set out in the Group's Annual Report and Accounts for the year ended 31 December 2017.

IFRS 15 requires that revenue (i.e. income) is recognised by the Group in a way that depicts the transfer of goods or services to customers. The amount of revenue so recognised should reflect the consideration to which the Group expects to be entitled in exchange for those goods or services. IFRS 15 introduces a new five-step process that is followed in order to determine the appropriate revenue recognition policies. For each significant revenue stream, the Group applied the new five-step process to determine how and when revenue should be recognised under IFRS 15; the results were compared to pre-IFRS 15 policies and practices and, where appropriate, changes were implemented.

Financial advice fees and commissions

The Group performed a detailed assessment of the impact of IFRS 15 for each of the financial advice services offered by the Group. Based on its assessment, the Group concluded that the application of IFRS 15 did not result in significant changes to its existing revenue recognition practices for financial advice services.

Estate agency services

Revenue from estate agency services includes estate agency commissions, property management income, insurance commissions and survey and valuation income. The Group performed a detailed assessment of the impact of IFRS 15 application for each estate agency income stream. Based on its assessment, the Group concluded that the application of IFRS 15 did not result in a significant change to its existing policies for the timing or measurement of revenue from estate agency services.

Software products and services

The Group assessed the impact of IFRS 15 for each of the products and services offered by the Jade group of companies. The Group identified a limited number of situations where the requirements of IFRS 15 resulted in an amendment to existing revenue recognition practices; however these changes are not considered significant.

In summary, the adoption of IFRS 15 did not significantly impact the timing or amount of revenue from contracts with customers or the related assets and liabilities recognised by the Group; there is therefore no resulting adjustment to opening reserves at 1 January 2018. Accordingly, the initial impact for the Group of IFRS 15 adoption is limited to the new disclosure requirements.

Further details on the Group's accounting policies for revenue recognition are set out in note 1m).

c) Basis of consolidation

Subsidiary undertakings

Subsidiary undertakings are entities controlled by the Society. Control exists when the Society is exposed, or has rights, to variable returns from its involvement with an entity and has the ability to affect those returns through its power over the entity. In assessing control, only substantive rights (i.e. rights that can be practically exercised) are taken into account.

Investments in subsidiary undertakings

Investments in subsidiary undertakings are recorded in the Society's Statement of Financial Position at cost, less any provision for impairment. The Group Accounts consolidate the financial statements of the Society and all its subsidiary undertakings, eliminating intra-Group transactions and balances.

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is measured at fair value, as are the separately identifiable net assets acquired. Any goodwill arising is accounted for in accordance with the Group's accounting policy for goodwill (see note 1d)). Any gain on a bargain purchase is recognised in profit or loss immediately. All transaction or acquisition costs are written off to the Income Statement as incurred.

In accordance with IFRS 3 *Business Combinations (2008)*, goodwill is accounted for only upon the acquisition of a subsidiary undertaking or as a result of a business combination. Subsequent changes in the Group's interest in a subsidiary undertaking, where control is retained, are recognised in equity. In accordance with IFRS 10 *Consolidated Financial Statements (2011)*, for business combinations which have taken place from 1 January 2010 onwards, all transactions relating to ownership interests with non-controlling interests are recorded in equity if there has been no change in control.

When the Group loses control over a subsidiary, through disposal or other changes in circumstances, it derecognises the assets and liabilities of the subsidiary and any associated goodwill, as well as any related non-controlling interest and other components of equity. Any resulting gain or loss is recognised in the Income Statement.

Put options

Within a number of subsidiary undertakings where the Group has less than 100% ownership, there is an option for the non-controlling shareholders to require the Group to purchase their shares at some point in the future. In accordance with IAS 32 *Financial Instruments: Presentation*, the Group recognises the present value of these options as a financial obligation, along with recognition of further goodwill on the future purchase of remaining non-controlling interests. Under this accounting policy the Group consolidates 100% of the results of such subsidiary undertakings to reflect the 100% implicit ownership in the recording of the future purchase of the non-controlling interests' shareholdings (i.e. the put option liability).

Any changes in the valuation of a put option obligation in respect of an entity acquired after 1 January 2010 are credited or charged through the Income Statement. Put options issued prior to 1 January 2010 are accounted for in accordance with IAS 27 *Consolidated and Separate Financial Statements (2003)* and IFRS 3 *Business Combinations (2004)* and any adjustment to the Group's estimation of the present value of the put option liability results in an adjustment to goodwill. Dividends paid to the non-controlling interests are charged to the Income Statement. The change in fair value of the liability due to the accretion of the discount of the liability is expensed in the Income Statement.

Business combinations between mutual organisations

Where trading operations, assets and liabilities of another mutual organisation are merged into the business of the Society, the Society applies acquisition accounting under IFRS 3. All assets and liabilities are incorporated into the Society's Statement of Financial Position at fair value on the date of the merger.

No consideration is transferred for business combinations between mutual organisations. The amount of goodwill recognised on merger with the mutual organisation is determined by reference to the excess of the fair value of the Society's interest in the acquiree over the fair value of the acquiree's separately identifiable net assets on the date of acquisition.

All transaction costs are written off to the Society's Income Statement as incurred.

Joint ventures

A joint venture is an undertaking in which the Group has joint control and has rights to the net assets of the arrangement.

The results and assets and liabilities of joint ventures are accounted for in these consolidated financial statements using the equity method of accounting. Investments in joint ventures are carried within the Statement of Financial Position at cost, as adjusted by post-acquisition changes in the Group's share of the net assets of the joint venture, less any impairment in the value of individual investments.

1. Accounting policies *(continued)*

Equity share investments

An equity share investment is an investment in the share capital of a company where the Group does not have significant influence.

Under IFRS 9 equity share investments are measured at FVTPL, except where an election is made at initial recognition to irrevocably designate an equity share investment as FVOCI. The FVOCI election can be made on an instrument-by-instrument basis; all of the equity share investments held by the Group at 31 December 2018 are held at FVTPL and are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in their fair value recognised in the Income Statement.

Unconsolidated structured entities

The Group invests in structured entities where the principal purpose of the structured entity is to provide investors with access to specific portfolios of assets and also provide the investor liquidity through the securitising of financial assets. A structured entity is one that has been set up so that any voting rights or similar rights are not the determining factor in deciding which party controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

A structured entity often has some or all of the following characteristics:

- Restricted activities;
- A narrow and well defined objective;
- Insufficient equity to permit the structured entity to finance its activities without subordinated financial support.

Third party funding entities

The Group invests in structured entities through the purchase of issued mortgage backed securities, as disclosed in note 11. These structured funding entities are not consolidated into the Group Accounts because the Group does not have the ability to direct the activities of the entities in question and does not control these entities through voting rights, contractual rights, funding agreements or any other means. The Group's involvement is in relation to investment activity only.

Interests in unconsolidated structured entities

The Group's interests in unconsolidated structured entities refer to involvement that exposes the Group to variability of returns from the performance of the structured entities.

Income derived from involvement with unconsolidated structured entities

Interest income on funding provided to unconsolidated structured entities is recognised within interest receivable in the Income Statement.

Special purpose funding vehicles

The Society has transferred the beneficial interest in certain portfolios of loans and advances to customers to special purpose funding vehicles (SPVs). These SPVs enable the subsequent raising of debt, either by the SPVs or the Society, to investors who gain the security of the underlying assets as collateral. The SPVs are fully consolidated into the Group Accounts in accordance with IFRS 10.

The transfers of the beneficial interest in these loans to the SPVs are not treated as sales by the Society and are not derecognised. The Society continues to recognise these assets within its own Statement of Financial Position after the transfer because it retains substantially all the risks and rewards of these mortgage portfolios through the receipt of interest income and deferred consideration from the SPVs for the transfer of the beneficial interest in the mortgage loans. For securitisations, in the accounts of the Society, the proceeds received from the transfer of mortgage loans are accounted for as a deemed loan repayable to the SPV and are included in 'Amounts owed to other customers' within the Society's Statement of Financial Position.

Where the Society issues the debt, as is the case for the covered bonds (see note 17a)), it then lends the proceeds on back-to-back terms to Skipton Covered Bonds Limited Liability Partnership (LLP); the proceeds lent to the LLP are known as the 'term advance'. Some or all of the proceeds from the term advance are then paid to the Society from the LLP as consideration for the beneficial interest in the mortgage pool and is accounted for as a deemed loan repayable to the LLP. In the accounts of the Society, the term advance and the deemed loan are not recognised separately as additional assets and liabilities; the difference between the term advance and the deemed loan are shown net within the Society's Statement of Financial Position as an amount owed from subsidiary undertakings. This is to avoid the 'grossing up' of the Statement of Financial Position.

To manage interest rate risk, the Society enters into interest rate swap arrangements with the LLP; the Society receives interest payments from the LLP relating to receipts on the mortgages in the pool and pays a floating rate of interest to the LLP. In accordance with IFRS 9 these swap arrangements are treated as part of the deemed loan and not separately fair valued because the relevant mortgage loans to which the interest swaps relate are not derecognised. All other derivatives relating to securitisations are treated as explained in note 1e).

To manage currency risk arising from the Euro-denominated covered bond issuance, the LLP has entered into a cross-currency swap transaction. These derivatives are designated in hedge accounting relationships against the term advance, which mirrors the conditions of the debt issued, effectively hedging the debt issued by the Society. In accordance with IFRS 9, any cost for currency basis spread priced within the cross-currency swap is permitted to be excluded from the hedge relationship and is recognised directly in reserves (the cost of hedging reserve). The Group has elected to apply this treatment for these hedge relationships. See note 1e) for further details.

Further details on the nature and amount of the beneficial interest transferred to the SPVs can be found in note 13 to these financial statements.

d) Intangible assets

Goodwill

Goodwill arising on the acquisition of Group undertakings or other businesses represents the excess of the fair value of the consideration paid over the fair value of separately identifiable net assets acquired at the date of acquisition. Goodwill arising on the acquisition of subsidiary undertakings is included in the 'Intangible assets' line within the Statement of Financial Position. Goodwill arising on the acquisition of joint ventures, associates or other businesses is included within the carrying value of the underlying investment within the Statement of Financial Position.

Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses, and is reviewed for impairment, at least, at each reporting date. Any impairment is recognised in the Income Statement.

For the purposes of impairment testing, goodwill is allocated to each of the Group's cash generating units expected to benefit from the synergies of combination. The impairment test compares the carrying value of the cash generating unit, being its net assets plus associated goodwill, to its associated value in use. The value in use calculations are carried out by discounting the forecast future cash flows of the cash generating unit to present value (see note 20). Future cash flows are ordinarily based upon the corporate plans of the cash generating units for the next five years and assumed growth thereafter for the subsequent 10 years, generally in line with long term growth rates. The Group estimates discount rates based upon the weighted average cost of capital which is adjusted to take account of the market risks associated with each cash generating unit. A 15-year time horizon has been used to reflect the fact that cash generating units are held for the long term.

Goodwill arising on acquisitions before the transition to IFRS on 1 January 2005 has been retained at its previous UK GAAP amount and is reviewed for impairment, at least, at each reporting date, as above.

Impairment losses are recognised in profit or loss. They are allocated first to reduce the carrying amount of any goodwill allocated to the cash generating unit, and then to reduce the carrying amounts of the other assets in the cash generating unit on a pro-rata basis.

Computer software, databases, brands and customer contracts

In accordance with IAS 38 *Intangible Assets*, computer software, databases, brands and customer contracts are recognised as an intangible asset if, and only if, the cost incurred leads to the creation of an identifiable asset whose cost can be measured reliably and it is probable that the asset created will generate future economic benefits which will flow to the Group. Further, brands and customer contracts are only eligible to be recognised as an intangible asset when purchased externally or when acquired as part of a business combination; internally generated brands and customer contracts are not capitalised. Expenditure incurred to maintain existing levels of performance is recognised as an expense as incurred.

Intangible assets are initially recognised at cost, or at fair value when acquired as part of a business combination, and subsequently amortised from the date they are available for use using the straight line method over their estimated useful economic lives (unless deemed to have an indefinite economic life), which can be up to 10 years. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Intangible assets are tested for impairment at each reporting date or when there is an indication of impairment. The Group identifies impairment by comparing the future economic benefit to the Group against the carrying value of the asset. The assessment of future economic benefit includes value in use calculations to determine recoverable amounts for cash generating units.

1. Accounting policies *(continued)*

e) Financial assets

In accordance with IFRS 9, the financial assets of the Group are classified into one of three categories (amortised cost, FVOCI or FVTPL), further details of which are provided in note 1b). In classifying each financial asset, the Group assesses:

- The objective of the business model in which the financial asset is held; and
- Whether the contractual cash flows of the financial asset are 'solely payments of principal and interest' (SPPI).

Financial assets are reclassified when, and only when, the Group changes its business model for managing the assets.

Business model assessment

The Group's business model assessment is made at a portfolio level as this best reflects the way the business is managed and how information is provided to management. The information considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. These include whether management's strategy focuses on earning contractual interest income, matching the duration of the financial assets to the duration of any related liabilities or realising cash flows through the sale of the assets;
- How the performance of the portfolio is evaluated and reported to the Group's management;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- The frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and expectations about future sales activity. Transfers of financial assets to third parties in transactions that do not qualify for derecognition are not considered sales for this purpose, consistent with the Group's continuing recognition of the assets.

SPPI assessment

For the purposes of the Group's SPPI assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making this assessment, the Group considers:

- Terms that may adjust the contractual coupon rate, including variable-rate features;
- Contingent events that would change the amount or timing of cash flows;
- Prepayment and extension features; and
- Terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse features).

As a result of the assessments outlined above, the financial assets of the Group have been classified as follows:

At amortised cost

The following have been assessed by the Group to be in a 'held to collect' business model and to have cash flows that pass the SPPI test:

- Loans and advances to customers (except for a small number of loans held at FVTPL)
- Cash balances
- Loans and advances to credit institutions
- Trade receivables
- Certain debt securities (disposed of by the Group during 2018)
- Loans to subsidiary undertakings (in the Society's Statement of Financial Position)

The Group's financial assets measured at amortised cost are initially recognised at fair value less any directly attributable transaction costs. The assets are subsequently measured at amortised cost using the effective interest method, less impairment loss allowances. The effective interest method calculates an interest rate which exactly discounts the forecast cash flows of an asset over its expected life back to its carrying value. For financial assets that are not credit-impaired (see note 1g)), interest revenue is calculated by applying the effective interest rate to the gross carrying amount of the asset. For financial assets that are credit-impaired, interest revenue is calculated by applying the effective interest rate to the amortised cost of the asset.

In accordance with the effective interest method, directly attributable upfront costs and fees such as cashbacks, mortgage premia paid or discounts received on acquisition of mortgage books, lending charges paid by customers, procuration fees and completion fees are deferred and recognised over the expected life of mortgage assets. Historical and forecast mortgage redemption data and management judgement of future performance are used to estimate the expected lives of mortgage assets.

A change to management's estimate of expected mortgage lives is accounted for on the basis that such a change is regarded as a change to the original assumptions used. This results in an immediate adjustment to the carrying amount of the mortgage asset (discounted at its effective interest rate) at the point this change is made, which recalculates the carrying value as if the revised assumptions had always been in place.

If a change is made to the rate that fixed rate mortgage customers will revert to at the end of the product's fixed term (i.e. the Society's Mortgage Variable Rate (MVR) or Standard Variable Rate (SVR)), and it can be demonstrated that this change is driven by changes in market rates, this is accounted for as a change to the effective interest rate which means that the impact of the change is spread over the remaining life of the mortgage asset. Otherwise, any change in MVR or SVR is accounted for as described in the paragraph above.

Included in loans and advances to customers of the Society are balances which have been used to secure funding issued by the Group's special purpose funding vehicles which are consolidated into the Group Accounts, further details of which are included in note 17a). The beneficial interest in the underlying loans has been transferred to these entities. The loans are retained within the Society's Statement of Financial Position however as the Society retains substantially all the risks and rewards relating to the loans.

The Group's accounting policy on impairment of financial assets held at amortised cost is found in note 1g).

At fair value through other comprehensive income (FVOCI)

The majority of the Group's debt securities, which are held to manage liquidity requirements, have been assessed by the Group to be in a 'held to collect and sell' business model and to have cash flows that pass the SPPI test.

Financial assets held at FVOCI are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in fair value recognised in equity. The fair values of financial assets held at FVOCI are based on quoted prices, which represent the bid price.

In accordance with IFRS 9, an impairment loss allowance is determined for expected credit losses (ECLs; see note 1g) for details on measurement of ECLs). For financial assets measured at FVOCI, the impairment loss allowance is not deducted from the carrying amount of the asset; instead the loss allowance is recognised through other comprehensive income. The movement in the impairment loss allowance recognised during the period is charged or credited to the Income Statement.

Interest income is recognised in the Income Statement on an effective interest basis. When the assets are derecognised, the accumulated gains or losses within equity are reclassified to the Income Statement.

The premia and discounts arising on the purchase of these assets are amortised over the period to the maturity date of the security on an effective interest basis. Any amounts amortised are charged or credited to the Income Statement in the relevant financial periods.

At fair value through profit or loss (FVTPL)

All financial assets which are not classified as either amortised cost or FVOCI, as described above, are measured at FVTPL. On initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Loans and advances to customers

A small number of loans are held at FVTPL because they contain contractual cash flows which do not pass the SPPI test. These loans consist mainly of certain lifetime mortgages. The fair value of these loans is determined by discounting future expected cash flows. Where the portfolio is so small that a probabilistic methodology to estimate future cash flows is not appropriate, management assumes that voluntary prepayments will be 100% in year one.

Equity release portfolio

On adoption of IFRS 9 on 1 January 2018 the equity release portfolio was classified as FVTPL as outlined in note 1b). The mortgage products within this portfolio provide the customer with a 'no negative equity guarantee' (NNEG). This guarantee means that the Group's maximum return on these loans is limited to the value of the customer's property on redemption. The Group's exposure to potential losses as a result of the NNEG is limited in part by a guarantee provided

1. Accounting policies *(continued)*

to the Group by a third party for the longevity element of this risk. Due to the structured nature of the portfolio there is no single industry pricing methodology and assumptions for valuing these products differ by institution. Further complexity arises on a portion of the portfolio due to the customer rate being linked to the Retail Price Index (RPI).

A stochastic model was chosen and devised internally for the purpose of this valuation. The model uses inputs including mortality rates, voluntary prepayment rates, estimates of future RPI and the House Price Index (HPI) to predict future cash flows on the portfolio. These are then discounted back to present value using a discount curve based on a Sterling Overnight Index Average (SONIA) index plus an illiquidity spread. The illiquidity spread reflects the fact that no repayments are made by the customer until the product redeems which may be many years into the future.

Where possible the inputs are market-driven or, where no market-driven data is available, based on management judgement that is informed by observable data wherever possible. Due to the high level of variability within these inputs, the model also runs several thousand scenarios for both the RPI and HPI inputs. The Group has robust control procedures in place regarding all the inputs to the valuation model.

As this valuation technique uses one or more inputs that are not based on observable market data, it is classed as a Level 3 valuation technique. For further details on the different levels of the fair value hierarchy, see note 37b). The impact of applying reasonably possible alternative assumptions of certain inputs into the valuation of the portfolio is found in note 1t).

Interest income on the equity release portfolio is recognised in the Income Statement on an effective interest basis. Fair value gains or losses on the portfolio are recognised within 'Fair value losses on equity release portfolio' in the Income Statement. Realised losses recognised on redemption of a loan within the portfolio are recognised in the 'Realised losses on the equity release portfolio' line in the Income Statement.

Derivative financial instruments

The Group's derivative financial instruments, which are held solely for hedging purposes, are measured at FVTPL and are held at fair value within the Statement of Financial Position. As outlined in note 1b), the Group has elected to adopt from 1 January 2018 the new hedge accounting requirements of IFRS 9 for all hedge relationships covered by those requirements. As permitted under IFRS 9, the Group continues to apply the requirements of IAS 39 for derivatives designated in a portfolio fair value hedge. For all other derivatives designated in a hedging relationship, the Group applies the requirements of IFRS 9.

The Group uses derivative financial instruments to hedge its exposure to market risks (for example, interest rate risk) arising from operational, financing and investment activities. In accordance with its treasury policy and the Building Societies Act 1986, the Group does not hold or issue derivative financial instruments for trading purposes. In line with accounting standards, the changes in fair value of derivatives used to hedge particular risks can either be offset in the Income Statement or deferred to equity.

There are two types of hedge accounting strategies that the Group undertakes and these are summarised below:

- Fair value hedges - Where a derivative financial instrument hedges the changes in fair value of a recognised asset or liability (or portion of a recognised asset or liability), any gain or loss on the hedging instrument is recognised in the Income Statement. To the extent that there is an effective hedge relationship, the associated hedged items (for example, mortgage assets) are stated at fair value in respect of the hedged risk, with any gain or loss also recognised in the Income Statement. As a result, fair value movements in the hedging instrument and in the hedged items offset each other and reduce profit volatility. Any residual fair value hedge ineffectiveness is also recognised in the Income Statement. In order to calculate the fair value in respect of hedged risk in relation to mortgage assets and some retail savings, the Group applies estimated prepayment assumptions using historical analysis. For fair value hedge relationships where ineffectiveness would arise as a result of foreign currency basis spread, movements are recognised in other comprehensive income (OCI) through the cost of hedging reserve (see below) in accordance with IFRS 9.
- Cash flow hedges - Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability (or portion 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 in OCI and deferred in a separate reserve. The effective portion recognised in OCI is limited to the cumulative change in fair value of the hedged item, determined on a present value basis, from inception of the hedge. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately.

In accordance with IFRS 9, where foreign currency basis spread arises in fair value hedge relationships, this is separated and excluded from the designation of a financial instrument as the hedging instrument; movements relating to the foreign currency basis spread are recognised in OCI through the cost of hedging reserve. The Group had no such relationships prior to the adoption of IFRS 9 so has not applied this treatment retrospectively. The Group calculates the value of the foreign currency basis spread by comparing the change in value of the actual foreign currency hedging instrument (excluding fees not relating to the hedge relationship) and the value of a hypothetical instrument derived and valued using market data excluding foreign currency basis spread.

Hedge accounting relationships within the scope of IFRS 9 require hedge accounting to only be discontinued when the qualifying criteria are no longer met. Additionally, if the hedge no longer meets the qualifying criteria due to a mismatch in the hedge ratio, the relationship must be rebalanced if possible rather than discontinuing hedge accounting.

Fair values are determined by the three tier valuation hierarchy as defined in IFRS 13 *Fair Value Measurement* and Amendments to IFRS 7 *Financial Instruments: Disclosures* and as described in note 37b).

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

In valuing derivatives used to hedge our mortgage and savings portfolios, the Group has not valued them as one net pool for market risk and credit risk management purposes as permitted under IFRS 13, but has valued each derivative individually.

Interest on derivatives is included within interest receivable where the derivative hedges an asset and within interest expense where the derivative hedges a liability, to align the recognition with its economic purpose.

Fair value gains and losses on derivatives and hedged items that are posted to the Income Statement are recognised in the 'Fair value gains on hedging instruments and hedged items' line in the Income Statement, with the exception of the derivatives hedging the Group's equity release portfolio, whose changes in fair value are recognised in the 'Fair value gains on other derivatives' line in the Income Statement.

Unrealised fair value gains and losses on cash flow hedging derivatives are recognised in the cash flow hedging reserve.

Where the Group enters into a cross-currency swap, as is the case for the issuance of Euro-denominated covered bonds (see page 113), the Group recognises the movement in the fair value of the derivative as follows:

- Foreign exchange movements are recognised in the 'Interest payable and similar charges' line in the Income Statement;
- Movements due to interest rate risk are recognised in the 'Fair value gains on hedging instruments and hedged items' line in the Income Statement; and
- Movements due to foreign currency basis spread are recognised directly in the cost of hedging reserve as permitted by IFRS 9.

Contingent consideration

The Group's contingent consideration asset held in relation to the disposal of a previous subsidiary undertaking was assessed to be classified as held at FVTPL as outlined in note 1b). The fair value of this asset is determined by calculating the present value of the expected future cash flows, discounted at an appropriate rate.

Equity share investments

The Group's existing equity share investments are accounted for as held at FVTPL, the accounting policy for which is found on page 105.

Debt securities

The Society holds residential mortgage backed securities that were issued in previous periods by the Group's securitisation vehicles. Certain tranches of these securities are held at FVTPL because they fail the SPPI test due to an elevated level of credit risk relative to other tranches.

Policy applicable for the year ended 31 December 2017

In accordance with IAS 39, the financial assets of the Group were classified into the following categories:

Available-for-sale

Available-for-sale assets were non-derivative financial assets that were not classified as loans and receivables, at fair value through profit or loss or held to maturity. Available-for-sale assets were initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in fair value recognised in equity, except for impairment losses which were recognised in the Income Statement. Interest income was recognised in the Income Statement on an effective yield basis. When the assets were derecognised, the accumulated gains or losses within equity were reclassified to the Income Statement.

The premia and discounts arising on the purchase of these assets were amortised over the period to the maturity date of the security on an effective yield basis. Any amounts amortised were charged or credited to the Income Statement in the relevant financial periods.

1. Accounting policies *(continued)*

The fair values of available-for-sale assets were based on quoted prices or, if these were not available, fair value valuation techniques considered appropriate by the Group. For quoted prices the bid price was used and fair value valuation techniques included, but were not limited to, the use of discounted cash flow models, option pricing models and recent arm's-length transactions.

Loans and receivables

Loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. The Group's loans and advances to customers and the Society's loans to subsidiary undertakings, together with certain investment securities and all other liquidity balances not held as available-for-sale were classified as loans and receivables and were measured at amortised cost using the effective interest method. The effective interest method implies an interest rate which exactly discounts the forecast cash flows of an asset over its expected life back to its carrying value.

In accordance with the effective interest method, directly attributable upfront costs and fees such as cashbacks, mortgage premia paid or discounts received on acquisition of mortgage books, lending charges paid by customers, procuration fees and completion fees were deferred and recognised over the expected life of mortgage assets. Historical and forecast mortgage redemption data and management judgement of future performance were used to estimate the expected lives of mortgage assets.

A change to management's estimate of expected mortgage lives was accounted for in accordance with Application Guidance 8 (AG 8) of IAS 39 on the basis that such a change was regarded as a change to the original assumptions used. This resulted in an immediate adjustment to the carrying amount of the mortgage asset (discounted at its effective interest rate) at the point this change was made, which recalculated the carrying value as if the revised assumptions had always been in place.

If a change was made to the rate that fixed rate mortgage customers will revert to at the end of the product's fixed term (i.e. the Society's Mortgage Variable Rate (MVR) or Standard Variable Rate (SVR)), this was accounted for in accordance with AG 7 of IAS 39 if it could be demonstrated that this change was driven by changes in market rates. This resulted in a change to the effective interest rate which means that the impact of the change was spread over the remaining life of the mortgage asset. Otherwise, any change in MVR or SVR was accounted for in accordance with AG 8 of IAS 39 (as described in the paragraph above).

Included in loans and advances to customers of the Society were balances which were used to secure funding issued by the Group's special purpose funding vehicles which are consolidated into the Group Accounts. The beneficial interest in the underlying loans was transferred to these entities. The loans were retained within the Society's Statement of Financial Position however as the Society retained substantially all the risks and rewards relating to the loans.

Contingent consideration assets were measured at amortised cost using the effective interest method. Therefore the asset was measured by discounting, to present value, the forecast future cash flows involved. Trade receivables were also recognised at amortised cost.

At fair value through profit or loss

Fair value through profit or loss financial assets were those that were designated on initial recognition as assets to be recognised at fair value and movements in fair value were recognised in the Income Statement.

The Group's derivative financial instruments were classified as at fair value through profit or loss and were held at fair value within the Statement of Financial Position.

The Group used derivative financial instruments to hedge its exposure to market risks (for example, interest rate risk) arising from operational, financing and investment activities. In accordance with its treasury policy and the Building Societies Act 1986, the Group did not hold or issue derivative financial instruments for trading purposes. By applying the hedge accounting rules set out in IAS 39, the changes in fair value of derivatives used to hedge particular risks could either be offset in the Income Statement or deferred to equity.

There were two types of hedge accounting strategies that the Group undertook and these are summarised below:

- Fair value hedges - Where a derivative financial instrument hedged the changes in fair value of a recognised asset or liability (or portion of a recognised asset or liability) or an unrecognised firm commitment, any gain or loss on the hedging instrument was recognised in the Income Statement. To the extent that there was an effective hedge relationship, the associated hedged items (for example, mortgage assets) were stated at fair value in respect of the hedged risk, with any gain or loss also recognised in the Income Statement. As a result, fair value movements in the hedging instrument and in the hedged items offset each other and reduced profit volatility. Any residual fair value hedge ineffectiveness was also recognised in the Income Statement. In order to calculate the fair value in respect of hedged risk in relation to mortgage assets, the Group applied estimated prepayments assumptions using historical analysis.
- Cash flow hedges - Where a derivative financial instrument was designated as a hedge of the variability in cash flows of a recognised asset or liability (or portion 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 was recognised directly in equity. Any ineffective portion of the gain or loss on the hedging instrument was recognised in the Income Statement immediately. Once the forecast transaction had occurred, the cumulative gain or loss recognised in equity was recycled to the Income Statement in the same period in which the underlying transaction affects profit or loss. If the forecast transaction was no longer expected to occur, the cumulative unrealised gain or loss recognised in equity was recognised immediately in the Income Statement.

The Group discontinued hedge accounting when:

- it was evident from hedge effectiveness testing that a derivative was not, or had ceased to be, highly effective as a hedge;
- the derivative expired or was sold, terminated or exercised; or
- the underlying item matured or was sold or repaid.

The Group could also decide to cease hedge accounting even though the hedge relationship continued to be highly effective by ceasing to designate the financial instrument as a hedge.

If the derivative no longer met the criteria for hedge accounting or was de-designated from the hedge relationship, the associated adjustment to the carrying amount of the hedged item or the amount in the cash flow hedging reserve was amortised to the Income Statement over the remaining life of the hedged item.

Certain derivatives were embedded within other financial instruments. These were treated as separate derivatives where:

- the economic characteristics and risks were not closely related to the host instrument;
- the host instrument was not measured at fair value; and
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

These embedded derivatives were measured at fair value with movements in fair value being recognised in the Income Statement. Depending on the classification of the host instrument, the host was then measured in accordance with the relevant accounting policy.

Fair values were determined by the three tier valuation hierarchy as defined within IFRS 13 *Fair Value Measurement* and Amendments to IFRS 7 *Financial Instruments: Disclosures*. All derivatives were carried as assets when their fair value was positive and as liabilities when their fair value was negative.

In valuing derivatives used to hedge our mortgage and savings portfolios, the Group did not value them as one net pool for market risk and credit risk management purposes as permitted under IFRS 13, but valued each derivative individually.

Interest on derivatives was included within interest receivable where the derivative hedged an asset and within interest expense where the derivative hedged a liability, to align the recognition with its economic purpose. Other gains and losses on all derivatives, hedged items and on the sale of available-for-sale assets were recognised in the 'Fair value gains / (losses) on hedging instruments and hedged items' line in the Income Statement, with the exception of cash flow hedging derivatives, where unrealised fair value gains and losses were recognised in the cash flow hedging reserve.

Any derivatives that did not qualify for hedge accounting were held at fair value with changes in fair value recognised in the Income Statement.

f) Financial liabilities

In accordance with IFRS 9, the financial liabilities of the Group are classified as measured at either amortised cost or FVTPL. A financial liability is classified as at FVTPL if it is classified as held-for-trading, it is a derivative or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognised in profit or loss. Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with any interest expense being recognised in profit or loss. Any gain or loss on derecognition is also recognised in profit or loss.

1. Accounting policies *(continued)*

The financial liabilities of the Group have been classified as set out below.

Borrowings, comprising shares, deposits and debt securities in issue are recognised initially at fair value, being the amounts deposited or proceeds issued, net of premia, discounts and transaction costs incurred. Borrowings are subsequently measured at amortised cost using the effective interest method. Derivative liabilities and the fair value of the put option obligation are measured at fair value through profit or loss.

Permanent Interest Bearing Shares (PIBS) with no fixed maturity are classified as financial liabilities as opposed to equity instruments since their terms do not permit the Directors discretion to avoid the payment of interest, as the only instance where interest could not be paid on these instruments would be where capital levels are insufficient to allow such a payment to be made. PIBS are carried at amortised cost.

Where financial liabilities are hedged, the Group elects to use fair value hedging for those hedged financial liabilities. This treatment has been adopted to reduce the volatility that would otherwise exist given that the interest rate risk element of the underlying liabilities is economically hedged by derivatives which are held at fair value through profit or loss.

The deemed loans from the special purpose vehicles Darrowby No. 3 plc and Darrowby No. 4 plc to the Society, as described in note 1c), are voluntarily designated as FVTPL as permitted by IFRS 9. The voluntary designation was made on adoption of IFRS 9 on 1 January 2018 and is irrevocable. Where applicable, changes in fair value of the deemed loans that are due to changes in credit risk of the Society are recognised in other comprehensive income. At 31 December 2018 the Society has considered the effect of its own credit risk and considers this to be not material.

Policy applicable for the year ended 31 December 2017

Borrowings, comprising shares, deposits, debt securities in issue and subordinated liabilities were recognised initially at fair value, being the amounts deposited or proceeds issued, net of premia, discounts and transaction costs incurred. Borrowings were subsequently measured at amortised cost using the effective interest method. Derivative liabilities and the fair value of the put option obligation were measured at fair value through profit or loss.

Permanent Interest Bearing Shares (PIBS) with no fixed maturity were classified as financial liabilities as opposed to equity instruments since their terms did not permit the Directors discretion to avoid the payment of interest, as the only instance where interest could not be paid on these instruments would be where capital levels were insufficient to allow such a payment to be made. PIBS were carried at amortised cost.

Where financial liabilities were hedged, the Group elected to use fair value hedging for those hedged financial liabilities. This treatment was adopted to reduce the volatility that would otherwise exist given that the interest rate risk element of the underlying liabilities was economically hedged by derivatives which were held at fair value through profit or loss.

The Society elected to apply the fair value option to the deemed loans repayable to the special purpose vehicles. In applying the fair value option to these financial liabilities, the Society had considered the effect of its own credit risk and considered this not to be material.

g) Impairment of financial assets

The Group recognises impairment loss allowances for ECLs on the following financial assets that are not measured at FVTPL:

- Loans and advances to customers;
- Trade receivables;
- Treasury assets, which comprise debt securities held at FVOCI, cash in hand and balances with the Bank of England and loans and advances to credit institutions, as well as certain debt securities held at amortised cost prior to their disposal by the Group in 2018; and
- Loans to subsidiary undertakings (within the Society's Statement of Financial Position)

The Group also recognises an impairment loss allowance for loan commitments where a firm offer has been made to the customer.

Measurement of ECLs

ECLs are an unbiased probability-weighted estimate of the present value of credit losses, taking account of forward-looking information that includes a range of possible economic outcomes. ECLs are measured as the difference between contractual cash flows and expected cash flows, discounted at the asset's effective interest rate.

When measuring ECLs, the Group assesses the probability of default, the expected exposure at the time of default, and the loss that is expected to arise on default. The maximum period considered is the maximum contractual period over which the Group is exposed to credit risk. The probabilities of default are adjusted to take account of expected customer redemptions. The Group typically assesses ECLs on an individual asset basis.

IFRS 9 requires an impairment loss allowance to be recognised at an amount equal to either 12-month ECLs or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument. 12-month ECLs are the ECLs that result from default events that are possible within the 12 months after the reporting date.

The Group measures impairment loss allowances at an amount equal to lifetime ECLs, except for the following which are measured as 12-month ECLs:

- treasury assets that are determined to have low credit risk at the reporting date. The Group considers a treasury asset to have low credit risk when its credit rating is equivalent to the globally understood definition of 'investment grade'; and
- other financial assets on which credit risk has not increased significantly since their initial recognition (except trade receivables, for which the Group will always recognise lifetime ECLs in accordance with the simplified approach in IFRS 9).

Lifetime ECLs are required where the credit risk on a financial asset has increased significantly since initial recognition (except for investment grade treasury assets, as noted above).

For loan commitments, ECLs are measured by the Group for the percentage of such commitments expected to convert from an outstanding customer offer into a completed customer loan. The conversion factors applied are based on actual trends observed for the Group.

Financial assets that are subject to the impairment requirements of IFRS 9 are described according to their ECL 'stage' as follows:

- 'Stage 1' - Assets for which a 12-month ECL is recognised;
- 'Stage 2' - Assets for which a lifetime ECL is recognised but which are not credit-impaired;
- 'Stage 3' - Assets for which a lifetime ECL is recognised and which are credit-impaired.

IFRS 9 includes specific requirements for financial assets that are credit-impaired when initially purchased or originated (POCI assets). For POCI assets, an entity recognises only the cumulative change in lifetime ECLs since initial recognition, discounted by the credit-adjusted effective interest rate. For POCI assets, interest revenue is calculated using the credit-adjusted effective interest rate. The Group had no POCI assets during the period.

The Group's definitions of 'significant increase in credit risk' and 'credit-impaired' are set out below.

The assessment of impairment requires a number of estimates and assumptions, details of which are included in note 1t).

Forward-looking information

The Group incorporates forward-looking information into both its assessment of whether the credit risk of a financial asset has increased significantly since initial recognition and its measurement of ECLs. The time period over which the Group assesses forward-looking information is the maximum period over which the Group is exposed to credit risk. The Group determines a range of representative scenarios for the possible future direction of key economic variables; this includes forecasts of quarterly movements in these variables for years one to five, followed by a gradual reversion to long-run averages from year eight. The scenarios are derived by reference to external information where this is publicly available and appropriate, together with internally generated views. A probability-weighting, based on management judgement, is assigned to each scenario.

The Group's 'base case' scenario represents a view of the most likely outcome and is aligned with information used by the Group for other purposes such as strategic planning and budgeting. The selection of alternative scenarios is intended to model the non-linear impact of economic factors on ECLs for the Group's financial assets.

For mortgage loan impairment, the Group typically considers a minimum of three scenarios; this includes the base case scenario, together with an upside scenario (more optimistic than the base case) and a downside scenario (more pessimistic than the base case). For treasury asset impairment, the Group typically considers the base case scenario and a downside scenario. Further details are included in note 1t).

Significant increase in credit risk

The Group monitors all financial assets and loan commitments that are subject to IFRS 9's impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition of the asset. IFRS 9 includes a rebuttable presumption that credit risk has significantly increased when contractual payments are more than 30 days past due.

1. Accounting policies *(continued)*

The Group uses internal credit risk metrics that reflect its assessment of the probability of default (PD) of individual counterparties. The credit risk of each exposure is assessed at initial recognition, based on the available information about the counterparty. For loans and advances to customers, the credit risk at initial recognition is typically assessed by reference to information as at the loan drawdown date; this information is not always held by the Group for loans drawn down prior to 2007, in which case the Group uses the earliest available information as a proxy (which is typically January 2007 data for pre-2007 loans that were originated by the Society). All exposures are monitored and the credit risk assessment is updated to reflect current information on an ongoing basis.

For residential mortgages, the Group considers that credit risk has significantly increased if one of the following criteria is met:

- the remaining lifetime PD as at the reporting date, as compared to the remaining lifetime PD for this point in time that was estimated on initial recognition of the asset, exceeds pre-determined thresholds which are set by the Group and reviewed periodically. The thresholds applied will depend on the credit quality at initial recognition, with a lower percentage change in PD being required for higher risk accounts. Further details are included in note 1t);
- the account is in a current state of forbearance (see page 123);
- the account is in arrears (no minimum); or
- the account term has expired.

For commercial mortgages, the Group considers that credit risk has significantly increased when an account is placed on a watchlist or is in arrears.

For residential and commercial mortgages, the above criteria for assessing significant increase in credit risk ensures compliance with IFRS 9's backstop of 30 days past due.

For debt factoring advances, the Group considers that credit risk has significantly increased when an account is placed on a watchlist.

For treasury assets, the Group applies criteria that consider the relative increase in lifetime PD, by reference to external credit ratings where available. The Group considers that credit risk has not increased significantly if the treasury asset is determined to have 'low' credit risk at the reporting date. The Group considers a treasury asset to have low credit risk when its credit rating is equivalent to the globally understood definition of 'investment grade'.

The Society's Statement of Financial Position includes loans to subsidiary undertakings that are repayable on demand. For these loans, the Society considers that credit risk has significantly increased when the subsidiary undertaking no longer has sufficient liquid assets to repay the loan if demanded at the reporting date.

Definition of default

For residential mortgages, the Group's definition of default is aligned with its existing Internal Ratings Based (IRB) definition of default for regulatory capital purposes. For IFRS 9 accounting purposes, stage 3 loans which no longer meet any of the default criteria are subject to a six month probation period before they become eligible for transfer out of stage 3. Default occurs when one or more of the following criteria are met:

- The borrower is 90 days or more past due on their contractual payments.
- The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. The instances are:
  - the loan is in repossession;
  - the borrower has filed for bankruptcy;
  - more than two payments are in arrears and forbearance activity has been applied; or
  - other evidence is available that the customer is not going to be able to meet their loan commitments.

For commercial mortgages, default occurs when one or more of the following criteria are met:

- The borrower is 90 days or more past due on their contractual payments;
- The loan is in repossession;
- A receiver has been appointed;
- The mortgage term has expired; or
- Other evidence is available that the customer is not going to be able to meet their loan commitments.

Credit-impaired financial assets

At each reporting date, the Group assesses whether financial assets (other than those held at FVTPL) are credit-impaired. For those assets that have become credit-impaired, interest revenue is subsequently calculated by applying the effective interest rate to the amortised cost of the asset.

A financial asset is 'credit-impaired' when one or more events have occurred that have a detrimental impact on the estimated future cash flows of the financial asset. Evidence that a financial asset is credit-impaired includes the following:

- a breach of contract such as a default; or
- the disappearance of an active market for a security because of financial difficulties.

For residential and commercial mortgages, the Group considers that a loan that meets the definition of default is credit-impaired. For loans to no longer be considered credit-impaired, consistently good repayments must be demonstrated over a period of time, being not less than six months.

For debt factoring advances, the Group considers that an account is credit-impaired when there is no reasonable expectation of recovery due, typically, to financial difficulties of the customer.

To assess whether sovereign and corporate debt instruments are credit impaired, the Group considers factors such as bond yields, credit ratings and the ability of the borrower to raise funding.

To assess whether trade receivables are credit impaired, the Group considers factors such as the ageing profile, historical default rates and specific case knowledge.

Forbearance

In certain circumstances, the Group renegotiates loans to customers in financial difficulties (referred to as forbearance activities) to maximise collection opportunities and minimise the risk of default whilst ensuring the best outcome for the customer. Under the Group's forbearance policy, loan forbearance is granted on a selective basis if the customer is currently in default on their debt or if there is a high risk of default, there is evidence that the customer made all reasonable efforts to pay under the original contractual terms and the customer is expected to be able to meet the revised terms.

The revised terms typically include extending the maturity of the loan, changing the timing of interest payments or amending the terms of loan covenants. Both retail and commercial loans are subject to the forbearance policy. The Retail Credit Committee regularly reviews reports on forbearance activities.

For the purposes of disclosures in these financial statements, loans with renegotiated terms are defined as loans that have been restructured due to a deterioration in the borrower's financial position, for which the Group has made concessions by agreeing to terms and conditions that are more favourable for the borrower than the Group had provided initially and that it would not otherwise consider.

Write-offs

A financial asset is written off (in full or in part) when the Group judges there to be no reasonable expectation that the asset can be recovered (in full or in part). This is typically the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is performed at the individual asset level. The related impairment loss allowance is also written off once all the necessary procedures have been completed and the loss amount has crystallised. Financial assets that are written off could still be subject to enforcement activities and subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the Income Statement.

Policy applicable for the year ended 31 December 2017

Impairment of loans and advances secured on residential property or land

The Group carried out an assessment of impairment of loans and advances to customers at each reporting date. Individual assessments were made of all mortgage loans where objective evidence indicated losses were likely or the property was in possession or where fraud or negligence had been identified. Objective evidence of impairment may include indications that the borrower or group of borrowers was experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the debt being renegotiated to reduce the burden on the borrower. The key drivers influencing this objective evidence predominantly related to affordability issues driven by unemployment and increased costs of living. Based upon these assessments an individual impairment provision was made in one of two ways.

For properties that were either in possession or where sufficient information was available to calculate a specific provision on an account-by-account basis (for example, accounts that were on a defined 'watchlist') the provision

1. Accounting policies *(continued)*

was calculated as the difference between the existing carrying value and the present value of the estimated future cash flows, discounted at the asset's original effective interest rate. Alternatively, for other individual loans that had reached the point at which an impairment provision was needed but where it was not possible to specifically determine the amount ultimately likely to be received, assumptions were used from groups of loans with similar characteristics, based on historical data including the probability of possession given default and average forced sale discounts, and a provision calculated accordingly against this group of loans.

In addition, a collective impairment provision was made against the remaining portfolio of loans and advances where objective evidence indicated that credit losses had been incurred but not yet identified at the reporting date. The impairment value was calculated by applying various factors to pools within the Group's mortgage portfolio that had similar characteristics. These factors took into account the Group's experience of default rates, loss emergence periods, the effect of regional movements in house prices, as well as adjustments to allow for ultimate forced sales values and realisation costs.

The impairment model also took into account the level of forbearance applied to loans, such as payment reductions, term extensions, conversion to interest only and capitalisation of arrears, and reflected the relative performance of each of these pools.

Impairment provisions were recognised in the Income Statement and reflected in a separate account which was netted against the total carrying value of mortgage assets within the Statement of Financial Position. Interest on the impaired asset continued to be recognised through the unwinding of the discount on an effective interest rate basis. When a subsequent event caused the amount of impairment loss to decrease, the decrease in impairment loss was recognised through the Income Statement.

Where a loan was not recoverable, the related provision for loan impairment was written off once all the necessary procedures had been completed and the amount of the loss had been determined. Subsequent recoveries of amounts previously written off decreased the amount of impairment losses recorded in the Income Statement.

Losses on the equity release portfolio related to the fair value of the 'no negative equity guarantee' provided to the customers of this portfolio. This guarantee was accounted for as an embedded derivative due to its economic characteristics. Losses on the equity release portfolio were recognised in the 'Impairment (losses) / credit on loans and advances to customers' line in the Income Statement.

Forbearance

In certain circumstances, the Group renegotiated loans to customers in financial difficulties (referred to as forbearance activities) to maximise collection opportunities and minimise the risk of default whilst ensuring the best outcome for the customer. Under the Group's forbearance policy, loan forbearance was granted on a selective basis if the customer was currently in default on their debt or if there was a high risk of default, there was evidence that the customer made all reasonable efforts to pay under the original contractual terms and the customer was expected to be able to meet the revised terms.

The revised terms usually included extending the maturity of the loan, changing the timing of interest payments or amending the terms of loan covenants. Both retail and commercial loans were subject to the forbearance policy. The Retail Credit Committee regularly reviewed reports on forbearance activities.

For the purposes of disclosures in these financial statements, loans with renegotiated terms were defined as loans that had been restructured due to a deterioration in the borrower's financial position, for which the Group had made concessions by agreeing to terms and conditions that were more favourable for the borrower than the Group had provided initially and that it would not otherwise have considered.

Impairment of other loans and advances

Individual impairment provisions were made to reduce the value of other impaired loans and advances to the present value of the amount that the Directors considered was likely ultimately to be received, based upon objective evidence. The level of impairment provisions was assessed at each reporting date. Where a loan or advance was not recoverable, the related provision for impairment was written off.

Impairment of other financial assets

At each reporting date the Group assessed, on an individual basis, whether there was objective evidence that other financial assets held by the Group, except those held at fair value through profit or loss, were impaired. Financial assets were impaired when objective evidence demonstrated that a loss event had occurred after the initial recognition of the asset and that the loss event had an impact on the future cash flows of the asset that could be estimated reliably.

Objective evidence that other financial assets were impaired may include default or delinquency by a counterparty, the disappearance of an active market for a security, indications that a counterparty will enter bankruptcy, a significant and prolonged decline in the fair value of a security or evidence of a sovereign debt crisis.

Impairment losses on other financial assets carried at amortised cost were measured as the difference between the carrying value of the asset and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses were recognised in the Income Statement and reflected as a deduction against the carrying value of the asset. When a subsequent event caused the amount of impairment loss to decrease, the decrease in the impairment loss was recognised through the Income Statement.

Where impairment was identified on available-for-sale financial assets, impairment losses were recognised by transferring the cumulative loss that had been recognised directly in equity to the Income Statement. The cumulative loss that was removed from equity and recognised in the Income Statement was measured as the difference between the acquisition cost, net of any principal repayments and amortisation, and the current fair value, less any impairment loss on that asset previously recognised in the Income Statement.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increased and the increase could be objectively related to an event occurring after the impairment loss was recognised in the Income Statement, the impairment loss was reversed through the Income Statement.

Impairment losses on equity instruments classified as available-for-sale could not be reversed through the Income Statement and any increase in the fair value of such an instrument after an impairment loss had been recognised was recognised through Other Comprehensive Income.

h) Financial assets and liabilities – modification, derecognition and offsetting

Modification

The Group sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Group assesses whether or not the new cash flows are substantially different to the original cash flows.

If the cash flows are substantially different, then the contractual rights to cash flows from the original loan are deemed to have expired. In this case, the original loan is derecognised (as discussed below) and a new loan is recognised at fair value. Where impairment is held against the original loan (i.e. the loan is not held at FVTPL), the original loan is derecognised from its existing impairment stage (which may be stage 1, stage 2 or stage 3) and the new loan is initially recognised in stage 1 with its new origination date. Thereafter, the assessment of whether there has been a significant increase in credit risk is made by reference to changes in credit risk for the new loan starting from the new origination date. Examples of loan modification events for which the Group typically applies derecognition include an existing borrower switching to a new mortgage product and an existing borrower porting their loan to a new property.

If the cash flows of a modified loan carried at amortised cost are not substantially different, then the modification does not result in derecognition of the loan. In this case, the Group recalculates the gross carrying amount of the loan and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss. If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented within interest income. The Group assesses whether there has been a significant increase in credit risk by comparing the remaining lifetime PD as at the reporting date (based on the modified contractual terms) to the remaining lifetime PD for this point in time that was estimated at initial recognition (based on the original, unmodified contractual terms). An example of a loan modification event for which the Group typically does not apply derecognition is the application of forbearance strategies.

Derecognition

The Group derecognises a financial asset when the contractual rights to receive the asset's cash flows expire (including deemed expiry arising from a modification with substantially different terms as discussed above), or when the contractual rights have been transferred and either i) the Group transfers substantially all the risks and rewards of ownership, or ii) the Group neither transfers nor retains substantially all the risks and rewards of ownership and the Group has not retained control.

On derecognition of a financial asset, the difference between the carrying amount of the asset and the sum of i) the consideration received (including any new asset obtained less any new liability assumed) and ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

The Society has not derecognised the loans transferred to the Group's special purpose funding vehicles because substantially all the risks and rewards are retained by the Society as detailed in note 1c).

Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

1. Accounting policies *(continued)*

Offsetting

Financial assets and financial liabilities are offset and the net amount presented within the Statement of Financial Position when, and only when, the Group has a legally enforceable right to offset the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously. There are no financial assets or liabilities which are offset within the Statement of Financial Position and all financial assets and liabilities are presented on a gross basis. Income and expenses are presented on a net basis only when permitted under IFRS.

Policy applicable for the year ended 31 December 2017

Financial assets were derecognised when the contractual rights to receive cash flows had expired or where substantially all the risks and rewards of ownership had been transferred. The Society did not derecognise the loans transferred to the Group's special purpose funding vehicles because substantially all the risks and rewards were retained by the Society. Financial liabilities were derecognised only when the obligation was discharged, cancelled or had expired.

Financial assets and financial liabilities were offset and the net amount presented within the Statement of Financial Position when, and only when, the Group had a legally enforceable right to offset the amounts and it intended either to settle them on a net basis or to realise the asset and settle the liability simultaneously. There were no financial assets or liabilities which were offset within the Statement of Financial Position and all financial assets and liabilities were presented on a gross basis. Income and expenses were presented on a net basis only when permitted under IFRS.

i) Foreign currency transactions

Transactions in foreign currencies are translated into the respective functional currencies of Group entities using the exchange rates prevailing at the dates of the transactions. At the reporting date, monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the closing rate of exchange. Exchange differences are taken to the Income Statement as they arise.

On consolidation, the income statements of subsidiary undertakings with non-Sterling functional currencies are translated into Sterling (the Group's presentational currency) at the monthly average rates for the period and their assets and liabilities are translated into Sterling at the closing rate of exchange at the reporting date. Any exchange differences arising on the translation of net assets of overseas subsidiary undertakings are taken to reserves as a separate component of equity and disclosed in the Statement of Comprehensive Income, except to the extent that the translation difference is allocated to the non-controlling interests.

Where a foreign operation is disposed of in its entirety, or partially disposed of such that control is lost, the cumulative amount of translation differences recognised as a separate component of equity is reclassified to the Income Statement as part of the gain or loss on disposal.

j) Taxation

The income tax expense or credit on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity and disclosed in the Statement of Comprehensive Income.

Current tax is the expected tax payable or receivable on the taxable income or expenditure for the year, using tax rates in force during the period, and any adjustments to tax payable in respect of previous years.

Deferred tax is provided using the statement of financial position asset and liability method, which recognises temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor income and expenditure, and differences relating to investments in subsidiary undertakings, associates and joint arrangements to the extent that it is probable they will not reverse in the foreseeable future. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which temporary differences reverse, based on tax rates and laws enacted or substantively enacted at the reporting date.

A deferred tax asset is only recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at least annually and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

k) Leases

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The leased asset is recorded within the Statement of Financial Position as an item of 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. Future instalments under such leases, inclusive of finance charges, are included within other liabilities. Rentals payable are apportioned between the finance element, which is charged to the Income Statement at a constant annual rate, and the amount which reduces the outstanding obligation for future instalments.

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.

Where leasehold premises cease to be occupied by the Group and current market conditions are expected to preclude sub-letting for a rental sufficient to cover the rental costs, a provision is made to cover the present value of the expected deficit.

l) Employee benefits

Defined contribution pension arrangements

Obligations for contributions to defined contribution pension arrangements are recognised as an expense in the Income Statement as incurred.

Defined benefit schemes

The Group operates three defined benefit pension schemes (one of which is a hybrid scheme). The schemes are administered by a corporate Trustee, the funds of which are separate from those of the Group.

Included within the Statement of Financial Position are the Group's net obligations in respect of the defined benefit pension schemes. The obligation of each scheme is calculated separately by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods.

That benefit is discounted to determine its present value, and the fair value of any scheme assets is deducted. The discount rate is based on the average yield available from long-dated AA-rated corporate bonds. The calculation is performed by a qualified actuary using the projected unit credit method.

Net interest income on the defined benefit obligations comprises interest income on plan assets, less the interest cost on the scheme liabilities, and interest on the effect of the asset ceiling. Net interest income relating to the defined benefit pension schemes is recognised in 'Other income' in the Income Statement.

Remeasurements of the retirement benefit obligations, which comprise actuarial gains or losses (arising from the differences between previous actuarial assumptions and actual experience), the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest) are recognised in the Statement of Comprehensive Income.

Service costs are recognised immediately in the Income Statement. When a plan is curtailed, the resulting gain or loss on settlement is also recognised immediately in the Income Statement. The Group recognises gains or losses on the settlement of a retirement benefit obligation when the settlement occurs.

Contributions are transferred to the schemes on a regular basis to secure the benefits provided under the rules of the schemes. Pension contributions are assessed in accordance with the advice of a professionally-qualified actuary.

m) Fees and commissions

The Group recognises fees and commissions in accordance with IFRS 15 *Revenue from Contracts with Customers*. Revenue is measured based on the consideration specified in a contract with a customer.

Financial advice fees and commissions

The recognition of fees and commissions receivable from financial advice is recognised either when the right to consideration has been obtained through fulfilment of performance obligations or when the provision of advice can be demonstrated by the signing of the initial suitability letter by the customer which demonstrates acceptance of the advice provided. A provision for future clawbacks is made for repayment in the event of early termination by the customer.

Estate agency services

Estate agency commissions earned on the sales of properties and land and auction income are recognised on the date contracts are exchanged. Property management income is recognised when the cash is received, which reflects the point at which income is earned and contractual obligations have been fulfilled. Insurance commission is recognised upon fulfilment of contractual obligations with a provision for future clawback repayment in the event of early termination

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

by the customer. Survey and valuation revenue is recognised on the date the survey or valuation report is completed, which reflects the point at which all contractual obligations have been fulfilled. Mortgage origination income is recognised on completion of the mortgage transaction.

Software products and services

Revenue from software licence fees is recognised when access to the software has been made available to the customer to enable implementation. Revenue from implementation and consulting services is recognised in proportion to the stage of completion, typically in accordance with the achievement of contract milestones or days expended. Customer support revenue and systems management revenue are recognised on a straight-line basis over the period of the service rendered. The amount of revenue recognised is adjusted for expected returns.

Fees and commissions payable are generally recognised on an accruals basis as services are received.

Policy applicable for the year ended 31 December 2017

Fees and commissions receivable were generally recognised, net of VAT (where applicable), as the services were provided.

Estate agency commissions earned on the sales of properties and land and auction income were recognised on the date contracts were exchanged. Property management income was recognised when the cash was received, which reflected the point at which income was earned and contractual obligations had been fulfilled. Insurance commission was recognised upon fulfilment of contractual obligations with a provision for future clawback repayment in the event of early termination by the customer. Survey and valuation revenue was recognised on the date the survey or valuation report was completed, which reflected the point at which all contractual obligations had been fulfilled.

The recognition of fees and commissions receivable from financial advice was recognised either when the right to consideration had been obtained through fulfilment of performance obligations or when the provision of advice could be demonstrated by the signing of the initial suitability letter by the customer which demonstrated acceptance of the advice provided. A provision for future clawbacks was made for repayment in the event of early termination by the customer.

Revenue from software licence fees was recognised when access to the software had been made available to the customer to enable implementation. Revenue from implementation and consulting services was recognised in proportion to the stage of completion, typically in accordance with the achievement of contract milestones or days expended. Customer support revenue and systems management revenue were recognised on a straight-line basis over the period of the service rendered.

Fees and commissions payable were generally recognised on an accruals basis as services were received.

n) Property, plant and equipment

Property, plant and equipment is measured at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of those items.

Depreciation is calculated to write down the cost of items of property, plant and equipment to their estimated residual values over their estimated useful lives as set out below on a straight line basis unless stated otherwise.

Freehold and long leasehold buildings	50 to 100 years
Special purpose freehold head office facilities	40 years
Refurbishment of freehold and long leasehold buildings	five to 10 years
Short leasehold buildings	period of lease
Equipment, fixtures and fittings	two to 10 years
Motor vehicles	25% reducing balance

Land is not depreciated. Major items of property, plant and equipment purchased are depreciated on a monthly basis from the date the asset is available for utilisation. Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted where appropriate. In accordance with IAS 36 *Impairment of Assets*, all items of property, plant and equipment are regularly reviewed, at least annually, for indications of impairment. Any impairment identified is charged to the Income Statement.

Subsequent expenditure on items of property, plant and equipment is capitalised only if the subsequent expenditure increases the item's revenue generating capabilities and it is probable that future economic benefits associated with the expenditure will flow to the Group.

Any gain or loss on disposal of an item of property, plant and equipment is recognised in 'Other income' in the Income Statement.

o) Segmental reporting

In accordance with IFRS 8 *Operating Segments*, each operating segment is determined according to distinguishable operating components of the Group for which discrete financial information is available. The chief operating decision maker, the Board, regularly reviews internal reporting for each segment to appropriately allocate resources and assess their performance. The Group does not aggregate any of its operating segments for the purposes of financial reporting.

Information regarding the results of each reportable segment is included in note 38.

p) Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash comprises cash in hand and unrestricted loans and advances to credit institutions repayable on demand, and excludes the mandatory deposit the Society is required to place with the Bank of England. Cash equivalents comprise highly liquid unrestricted investments that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than three months.

The Statements of Cash Flows have been prepared using the indirect method.

q) Investment properties

Properties held by the Group for capital appreciation or which earn rentals are recognised as investment properties at cost less depreciation and impairment losses. The depreciation policy for investment properties is consistent with the policy for property, plant and equipment. Investment properties are regularly reviewed for indications of impairment and any impairment identified is charged to the Income Statement.

Rental income from investment property is recognised over the term of the lease and is included in 'Other income' in the Income Statement.

Any gain or loss on disposal of investment property is also recognised in 'Other income'.

r) Sale and repurchase agreements

Investments and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained within the Statement of Financial Position when substantially all the risks and rewards of ownership remain with the Group and the liability associated with the cash advanced is included separately within the Statement of Financial Position.

The difference between the sale and repurchase price is accrued over the life of the agreement and recognised within net interest income.

s) Provisions for liabilities

Provisions are recognised when the Group has a present obligation 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. Further details can be found in note 27.

t) Critical accounting judgements and estimates in applying accounting policies

Critical judgements

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the financial statements. The key judgements management has made in applying the Group's accounting policies are set out below.

Consolidation of SPVs

Whilst the Society does not have a legal shareholding in the Group's securitisation vehicles, management has judged that the test of control under IFRS 10 is passed. Consequently they are fully consolidated into the Group Accounts. Further details on the consolidation of the securitisation vehicles and the nature of the Society's control over them are found in note 17a).

1. Accounting policies *(continued)*

Transfer of beneficial interest in mortgage loans

Management has judged that the transfer of the beneficial interest in the loans transferred from the Society to the SPVs does not result in a transfer of the risks and rewards in relation to these loans. Therefore the transfer of the beneficial interest is not recognised as a sale by the Society, and the loans continue to be recognised within the Society's Statement of Financial Position, with the proceeds received from the transfer accounted for as a deemed loan repayable to the SPVs.

The Group's accounting policy for its SPVs is outlined in note 1c).

Impairment of mortgage loans and advances

Assessing loan impairment in accordance with IFRS 9 requires the following key judgements:

- determining whether credit risk has significantly increased since the loan was initially recognised; and
- the definition of default.

Residential mortgages

For residential mortgages, management has judged that significant increase in credit risk is determined by reference to certain quantitative and qualitative criteria. The quantitative criteria involve measuring the relative increase in lifetime probability of default for the loan. The qualitative criteria include the loan being in forbearance, in arrears or term expired. Management has further judged that the definition of default should align with the Group's existing IRB definition for regulatory capital purposes. For IFRS 9 accounting purposes, stage 3 loans which no longer meet any of the default criteria are subject to a six month probation period before they become eligible for transfer out of stage 3. Further details are found in note 1g).

Commercial mortgages

For commercial mortgages, management judges that credit risk has significantly increased when an account is placed on a watchlist or is in arrears. Management has further judged that an account is regarded as in default by reference to certain quantitative and qualitative criteria; these criteria include an account being 90 days past due (the IFRS 9 'backstop'). Further details are found in note 1g).

Critical estimates

The Group also makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year.

Estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The key estimates and assumptions are set out below.

Effective interest rate

The carrying value of assets measured at amortised cost is calculated using the effective interest method. This method imputes an interest rate which discounts the forecast future cash flows of an asset over its expected life back to its carrying value. The most critical factor in calculating the amortised cost of assets held by the Group is the expected lives of these assets which are determined on the basis of historical data and management judgement. The impact of a one month increase / (decrease) in the anticipated life of loans and advances to customers would result in the following increase / (decrease) in interest income:

	Group and Society	
	2018	2017
	£m	£m
One month increase / (decrease)	26.5 / (26.0)	22.5 / (17.7)

During the year a charge of £5.8m (2017: £12.5m) for the Group and Society was recognised through interest income, following a reassessment of the expected lives of loans and advances to customers.

Impairment of mortgage loans and advances

The estimation of credit exposures for risk management purposes is complex and requires the use of models, a number of inputs into which are sources of estimation and require the Group to apply judgement. Key sources of estimation the Group uses to measure ECLs include:

- Probability of Default (PD) – the probability at a point in time that a customer will default;
- Exposure at Default (EAD) – the expected outstanding loan amount at the time of default;
- Loss Given Default (LGD) – the loss that is expected to arise on default, taking account of expected recoveries from collateral held;
- Thresholds to determine whether credit risk has significantly increased; and
- Use of forward-looking information.

ECLs are measured by multiplying together the PD, EAD and LGD, and are discounted using the loan's original effective interest rate. EAD is derived by adjusting the current outstanding loan amount for expected cashflows to the date of default. LGD is estimated on a discounted cash flow basis using the effective interest rate. The Group's LGD models consider factors including historical recovery rates and possible future property price changes.

Credit risk information is collected by the Group, based on a range of qualitative and quantitative data considered to be predictive of the risk of default and applying experienced credit judgement. The nature of the exposure and type of borrower are taken into account in the analysis. The Group's PD models use the relevant information to generate estimates of the remaining lifetime PD of exposures and how these are expected to change over time. The PDs are adjusted to take account of expected customer redemptions and also for the impact of forward-looking information.

The following data is typically used to monitor the Group's exposure to credit risk:

- Payment record, including payment ageing analysis;
- Forbearance activity;
- Changes in business, financial and economic conditions;
- Credit reference information supplied by external agencies; and
- Internally generated data of customer behaviour, affordability metrics etc.

For residential mortgages, the assessment of whether credit risk has significantly increased includes assessing the degree by which the remaining lifetime PD at the reporting date has increased compared to initial estimates. The Group determines thresholds for this purpose, expressed as a multiple of the initial PD estimate. The thresholds applied vary according to the credit quality of the loan at initial recognition. They are set with the aim of identifying accounts with significantly increased risk before the borrower misses a payment. The Group periodically reviews the effectiveness of these thresholds in achieving this objective and they have been found to be effective. The thresholds applied by the Group as at 31 December 2018 are set out below:

Lifetime PD band at initial recognition	Multiple by which remaining lifetime PD has increased compared to initial estimate
Low risk	initial estimate x 14
Medium risk	initial estimate x 5
High risk	initial estimate x 2.5

The Group incorporates forward-looking information into both its assessment of whether the credit risk of a financial asset has increased significantly since initial recognition and its measurement of ECLs. The time period over which the Group assesses forward-looking information is the maximum period over which the Group is exposed to credit risk, being the term of the mortgage. In accordance with IFRS 9, the Group's estimate of ECLs is an unbiased and probability-weighted amount that reflects a range of possible outcomes. The Group determines a range of representative scenarios for the possible future direction of key economic variables and a probability-weighting is assigned to each scenario. The Group's 'base case' scenario represents a view of the most likely outcome and is aligned with information used by the Group for other purposes such as strategic planning and budgeting. In addition, the Group incorporates an upside scenario (representing a more optimistic view than the base case) and a downside scenario (representing a more pessimistic view than the base case); the selection of these alternative scenarios is intended to model the non-linear impact of economic factors on ECLs for the Group's mortgage portfolios.

The scenarios applied by the Group as at 31 December 2018 were determined with due consideration to the economic uncertainty surrounding the UK's planned departure from the EU at the end of March 2019. The downside scenario is set in the context of a 'no-deal' Brexit that disrupts the UK economy and the economic indicators used are stressed sufficiently to capture the non-linear impact on ECLs for the Group's mortgage portfolios. The upside scenario is set in the context of a smooth exit from the EU. The relative weightings assigned to each scenario were 60% for the base case, 15% for the upside scenario and 25% for the downside scenario.

The key economic variables considered by the Group when developing the forecast scenarios include:

- Interest rates;
- Unemployment;
- The Retail Price Index;
- House price inflation; and
- Commercial property price growth.

1. Accounting policies *(continued)*

Whilst actual cash flows and losses realised on loans are unaffected by the adoption of IFRS 9, the level of loan impairment accounted for under IFRS 9's expected credit loss approach is expected to be more volatile for the Group than it was under IAS 39's incurred loss approach; this is due to the inherent uncertainty when incorporating forward-looking information for IFRS 9. Going forward, IFRS 9 impairment is expected to vary as expectations of economic conditions become either more pessimistic (which is likely to increase ECLs) or more optimistic (which is likely to reduce ECLs).

The following table outlines the impact on the impairment loss allowance for the residential loan portfolio of possible alternative assumptions of certain estimates used in calculating the ECLs. Each sensitivity shown considers one change in isolation and the combined impact on the impairment loss allowance of more than one sensitivity occurring would not necessarily be the sum of the impact of the individual sensitivities.

Assumption	Change to current assumption	Group 2018 Increase / (decrease) in impairment allowance £m	Society 2018 Increase / (decrease) in impairment allowance £m
Downside scenario weighting (note 1)	Increase from 25% to 35%	0.5	0.1
Downside scenario weighting (note 2)	Increase from 25% to 100%	4.0	1.6
Base case scenario weighting (note 3)	Increase from 60% to 100%	(1.3)	(0.6)
Significant increase in credit risk criteria (note 4)	Relative reduction of 25%	0.1	-
Future house price inflation	+ / - 0.5% pa	(0.4) / 0.4	(0.1) / 0.1

Notes
1. As outlined above, the Group incorporates into its measurement of ECLs multiple economic scenarios, representing a 'base case' view together with a downside and an upside scenario, and relative weightings are assigned to each scenario. This sensitivity shows the impact of an increase of 10% to the probability weighting assigned to the downside scenario, with a relative decrease to the probability weighting assigned to each of the base case and upside scenarios.
2. This sensitivity shows the impact of increasing to 100% the probability weighting assigned to the downside scenario (and therefore zero probability weighting assigned to both the base case and upside scenarios).
3. This sensitivity shows the impact of increasing to 100% the probability weighting assigned to the base case scenario (and therefore zero probability weighting assigned to both the upside and downside scenarios).
4. As outlined above, the assessment of whether credit risk has significantly increased since initial recognition includes the degree by which the remaining lifetime PD at the reporting date has increased compared to initial estimates. This sensitivity shows the impact of simultaneously reducing each multiplier threshold by 25%.

The following table outlines the impact on the impairment loss allowance for the commercial loan portfolio of possible alternative assumptions of certain estimates used in calculating the ECLs. Each sensitivity shown considers one change in isolation and the combined impact on the impairment loss allowance of more than one sensitivity occurring would not necessarily be the sum of the impact of the individual sensitivities.

Assumption	Change to current assumption	Group and Society 2018 Increase / (decrease) in impairment allowance £m
Downside scenario weighting	Increase from 25% to 35%	0.5
Downside scenario weighting	Increase from 25% to 100%	3.4
Base case scenario weighting	Increase from 60% to 100%	(0.8)
Significant increase in credit risk criteria (note 1)	Additional 5% of balances placed on watchlist	2.6
Future commercial property price growth	+ / - 0.5% pa	(0.1) / 0.1

Note
1. As outlined in note 1g), the assessment of whether credit risk has significantly increased since initial recognition is based on accounts being placed on a watchlist or being in arrears. This sensitivity shows the impact of management identifying an additional 5% of gross loan balances to be placed on a watchlist. The impact has been estimated by reference to the average ECL coverage ratios by stage for the commercial loan portfolio as at 31 December 2018.

Impairment of treasury assets

The Group incorporates forward-looking information into its ECL assessment for treasury assets. In addition to the base case view, the Group also considers the impact of an extreme economic downturn such as a two-notch downgrade on the entire portfolio. At 31 December 2018, the relative weightings assigned to each scenario were 95% for the base case and 5% for the downside scenario.

The following table outlines the impact on the impairment loss allowance for treasury assets of possible alternative assumptions of certain estimates used in calculating the ECLs. Each sensitivity shown considers one change in isolation and the combined impact on the impairment loss allowance of more than one sensitivity occurring would not necessarily be the sum of the impact of the individual sensitivities.

Assumption	Change to current assumption	Group 2018 Increase / (decrease) in impairment allowance £m	Society 2018 Increase / (decrease) in impairment allowance £m
Downside scenario weighting	Increase from 5% to 15%	0.1	0.1
Downside scenario weighting	Increase from 5% to 100%	0.8	0.8
Base case scenario weighting	Increase from 95% to 100%	(0.1)	(0.1)

Valuation of equity release portfolio

The valuation of the equity release portfolio relies on the calculation of future cash flows. The size and timing of these can vary depending on a number of different factors. These factors include future expected house prices, future expected inflation, mortality rates, anticipated redemption profiles (arising due to voluntary redemption or a move to long term care) and the level of dilapidation of individual properties on resale.

Some of the factors are based on market expectations (e.g. market-implied RPI swap prices are used to construct a forward-looking inflation curve in order to forecast future expected cash flows receivable from the portfolio), whilst others are derived from historical trends on our portfolio (e.g. anticipated future voluntary redemptions). However, where market prices are not available and historical trends are not deemed to be appropriate the Group uses management judgement; this is the case for future house price index (HPI) growth and volatility.

The Group uses an expectation of HPI growth that is aligned to that used for the central path of the ECL model and corporate planning. This is a somewhat subdued growth assumption in the near term, reverting to a long run expectation of an average of 4%. This is considerably lower than historical levels and reflects management's view. A volatility assumption of 10% is used to allow for an expected range of realised growth around this central figure. This volatility represents solely index volatility. In recognition of the potential for deviation from this index in the case of individual properties, the equity release valuation model also makes an allowance for idiosyncratic factors such as dilapidation upon sale of the property. This is assumed to rise over time, reaching 15% over the lifetime of the portfolio and averaging 7% - 8% at the point of expected peak redemptions.

The following table outlines the impact of reasonably possible alternative assumptions of key inputs which rely on management judgement and are not market observable. Each sensitivity shown considers one change in isolation and the combined impact on the valuation of the portfolio of all sensitivities occurring would not necessarily be the sum of the impact of the individual sensitivities.

Assumption	Change to current assumption	Group and Society 2018 (Decrease) / increase in fair value of portfolio £m
Redemption rates	+ / - 1% pa	(12.3) / 13.7
Discount rate	+ / - 0.2%	(10.8) / 11.2
HPI forecast	+ / - 0.5% pa	10.2 / (11.9)
Impact of property dilapidations	+ / - 5%	(7.8) / 6.6
HPI volatility	+ / - 3% pa	(4.8) / 4.1

For each of the above sensitivities, there would be a corresponding charge / credit to the Income Statement within the 'Fair value losses on equity release portfolio' line arising from the decrease / increase in the fair value of the portfolio.

1. Accounting policies *(continued)*

The Group holds derivative financial instruments to hedge the movements in the equity release portfolio, which offsets to some extent the movements in the valuation of the portfolio, further details of which are found below. The Group's equity release portfolio has been reclassified from amortised cost to FVTPL under IFRS 9. As a consequence, the associated derivatives held to economically hedge the portfolio, and which continue to be held at FVTPL under IFRS 9, no longer qualify to be designated in a hedge relationship for accounting purposes, thus creating greater income statement volatility.

Derivative financial instruments

The Group holds derivatives which are used to hedge the Group's interest rate risk and inflation risk arising from the equity release portfolio. These derivatives are valued using discounted cash flow models using market observable benchmark rates consistent with accepted economic methodologies for pricing financial instruments, and, as the notional values of the derivatives are intended to match the balance of the underlying mortgage assets, also include estimated redemption profiles (arising where a customer voluntarily prepays or moves permanently into long term care) that are based on historical data (reviewed periodically against actuals) and published mortality tables. These redemption profiles are not market observable, therefore an element of management judgement is applied based on historical performance of redemptions.

The effect on the fair value of these derivatives of reasonably possible alternative assumptions regarding the redemption profile of the portfolio is outlined below.

Assumption	Change to current assumption	Group and Society 2018 (Decrease) / increase in liability £m	2017 (Decrease) / increase in liability £m
Redemption rates	+/- 1% pa	(17.0) / 19.3	(20.1) / 23.6

Some of these derivatives hedge not only the interest rate risk but also the inflation risk within the equity release pools. In order to value these derivatives, the Group uses market-implied RPI swap prices to construct a forward looking inflation curve in order to forecast future expected cash flows relating to these derivatives. The model used to value the derivatives incorporates multiple scenarios for RPI in order to take account of the uncertainty and volatility of future RPI rates. The range of multiple scenarios used is based on management judgement and so is not market observable. The Group has control procedures in place regarding the inputs to the valuation that are based on management judgement.

Any change in fair value of the derivative liabilities is offset to some extent by a corresponding but opposite change in the value of the equity release portfolio. The characteristics and the valuation requirements differ slightly between the derivatives and the equity release portfolio resulting in the changes in fair value not offsetting completely.

Subsidiary management incentive scheme

In 2012 and 2014, senior management of Connells Limited purchased equity shares in that company and at the same time the Group issued options to these shareholders which required the Group to purchase these shares at some future dates. In accordance with IFRS 2 *Share-based Payment*, the Group recognises the increase or decrease in the fair value of the liability through the Income Statement, spread over the vesting period, to the estimated dates of exercise. The fair value of this liability is dependent on the following assumptions: an estimate of when the options will be exercised by the non-controlling shareholders, as well as forecasts of EBITDA (i.e. earnings before interest, tax, depreciation and amortisation, and as adjusted under the specific scheme rules) and cash flows of Connells Limited over the period to exercise. The following table outlines the impact of reasonably possible alternative assumptions of certain estimates used in calculating the liability:

Assumption	Change to current assumption	Group 2018 Increase / (decrease) in liability* £m	Group 2017 Increase / (decrease) in liability* £m
Connells Limited EBITDA	10% increase / decrease (note 1)	0.5 / (0.5)	2.4 / (2.4)
Date of exercise of options	Latest possible opportunity (note 2)	(3.0)	3.4

* With a corresponding increase / decrease in the charge to the Income Statement.

Notes

1. As described above, the estimate of the liability is dependent on the assumptions of future EBITDA and cash flows of Connells Limited over the period to exercise. The above sensitivity outlines the increase / decrease to the liability that would result if it was assumed that Connells' forecast EBITDA was 10% higher / lower each year (from 2019 to the period of exercise) than that included in its corporate plans.
2. The fair value of the liability at 31 December 2018 is currently based on the assumption that management will exercise their remaining options at the earliest available opportunity under the terms of the scheme.

Goodwill

The carrying value of goodwill is assessed against value in use calculations. The key assumptions for the value in use calculations are those regarding cash flows, discount rates and growth rates. These assumptions are reviewed on a regular basis, at least at every reporting date, by senior management.

The future cash flows of the cash generating units are based on the latest detailed five year corporate plans available and are sensitive to assumptions regarding the long term growth pattern thereafter. The cash flows reflect management's view of future business prospects at the time of the assessment.

The discount rate used to discount the future expected cash flows is based on the cost of capital assigned to each cash generating unit (see note 20) and can have a significant effect on the valuation of a cash generating unit. The cost of capital is derived from a weighted average cost of capital calculation which incorporates a number of inputs including the risk-free interest rate and a premium to reflect the inherent risk of the business being evaluated. These variables are subject to fluctuations in external markets and economic conditions which are out of management's control and therefore are established on the basis of management judgement.

At 31 December 2018, to the extent that discount rates were to increase by 25%, e.g. from 10% to 12.5%, there would be an increase to the goodwill impairment charge of £1.3m (2017: £1.0m). A reduction in the long term growth rate assumption from 2.5% to 0% would result in an increase to the impairment charge of £0.5m (2017: £nil).

Retirement benefit obligations

The defined benefit pension schemes expose the Group to actuarial risks such as investment risk, interest rate risk, inflation risk and longevity risk. In conjunction with its actuaries the Group makes key financial assumptions that are used in the actuarial valuation of the defined benefit pension obligation and, therefore, changes to these assumptions have an impact on the pension obligation shown within the Statement of Financial Position. These assumptions include inflation and discount rates, life expectancy, commutation allowances and the rate of salary growth; see note 29 for further details on these assumptions.

A decrease in gilt / corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to scheme liabilities. This would impact the Statement of Financial Position adversely and may give rise to increased charges in future years' Income Statements. This effect would be partially offset by an increase in the value of the schemes' gilt and bond holdings and caps on inflationary increases also exist to protect the schemes against high levels of inflation.

Approximate sensitivities of the principal assumptions are set out in the table below which shows the increase or reduction in the scheme liabilities that would result. The methods used for calculating the sensitivities are the same as those used to determine the valuation of the defined benefit obligation as set out in note 29. Each sensitivity shown considers one change in isolation.

Assumption	Change in assumption	Group 2018 (Decrease)/ increase in liabilities £m	Group 2017 (Decrease)/ increase in liabilities £m	Society 2018 (Decrease)/ increase in liabilities £m	Society 2017 (Decrease)/ increase in liabilities £m
Discount rate	+/-0.25% pa	(10.3) / 10.9	(12.4) / 12.4	(5.5) / 5.9	(6.7) / 6.7
Rate of inflation	+/-0.5% pa	9.6 / (8.7)	11.1 / (11.1)	4.6 / (4.2)	5.4 / (5.4)
Rate of salary growth	+/-0.5% pa	-	-	-	-
Commutation allowance	+/-10% pa	2.1 / (2.1)	n/a / (2.4)	1.1 / (1.1)	n/a / (1.1)
Life expectancy	+/-1 year	7.7 / (7.6)	8.1 / (8.1)	4.1 / (4.1)	4.4 / (4.4)

The rate of salary growth has no impact on the pension liabilities as the schemes are closed to future accrual of benefit.

Financial Statements

2. Interest receivable and similar income

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
On financial assets measured at amortised cost:				
On loans fully secured on residential property (note 1)	444.5	445.6	362.8	364.9
On other loans and advances:				
To subsidiary undertakings	-	-	25.3	32.9
Other	12.4	10.7	6.0	5.7
On debt securities	0.2	0.2	0.2	0.2
On other liquid assets	18.9	6.0	18.6	5.9
	476.0	462.5	412.9	409.6
On financial assets at fair value through other comprehensive income:				
On debt securities	12.5	-	11.7	-
On available-for-sale financial assets:				
On debt securities	-	10.0	-	9.6
Interest receivable calculated using the effective interest rate method	488.5	472.5	424.6	419.2
On financial instruments at fair value through profit or loss:				
On equity release portfolio (note 1)	18.5	-	18.5	-
On debt securities	-	-	0.9	-
Net expense on derivative financial instruments held for hedging assets	(33.2)	(72.5)	(32.6)	(72.5)
	(14.7)	(72.5)	(13.2)	(72.5)
	473.8	400.0	411.4	346.7

Note

1. The equity release portfolio was reclassified from financial assets measured at amortised cost to financial assets held at FVTPL on adoption of IFRS 9 on 1 January 2018. As permitted by IFRS 9, the comparative figures have not been restated. Further details are found in note 1b).

Included within interest receivable and similar income is interest accrued on impaired financial assets in the Group of £1.0m (2017: £1.2m) and in the Society of £0.6m (2017: £0.8m).

3. Interest payable and similar charges

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
On financial liabilities measured at amortised cost:				
On shares held by individuals	197.6	174.0	197.6	174.0
On shares held by others	1.3	1.2	1.3	1.2
On subscribed capital	4.5	5.6	4.5	5.6
On deposits and other borrowings:				
Subordinated liabilities	-	1.2	-	1.2
Subsidiary undertakings	-	-	0.8	1.0
Wholesale and other funding	32.9	25.9	12.1	6.5
	236.3	207.9	216.3	189.5
On financial instruments at FVTPL:				
Net income on derivative financial instruments held for hedging liabilities	(3.9)	(28.6)	(8.3)	(35.1)
Finance charge on unwind of put option liability	0.2	0.1	-	-
Deemed loans from Group undertakings	-	-	17.5	16.3
	232.6	179.4	225.5	170.7

4. Fees and commissions

a) Fees and commissions receivable

The tables below provide further information regarding the nature, amount and timing of fees and commissions receivable. As outlined in note 1b), the Group adopted IFRS 15 during the year. IFRS 15 requires that revenue is recognised by the Group in a way that depicts the transfer of goods or services to customers; some revenue is therefore recognised at a point in time and some revenue is recognised over a period of time. Further details as to the revenue recognition policies applied to fees and commissions receivable by the Group are set out in note 1m).

Group	2018			2017
	Products and services transferred at a point in time £m	Products and services transferred over time £m	Total £m	£m
Mortgage origination fees	39.8	13.2	53.0	36.9
Other mortgage related fees	1.8	-	1.8	1.9
General insurance income	52.6	0.6	53.2	51.0
Commissions earned on property sales	152.8	0.4	153.2	163.8
Commissions earned on property lettings	63.5	-	63.5	60.3
Survey and valuation fees	54.6	-	54.6	59.5
Asset management commission	5.6	0.2	5.8	5.9
Conveyancing fees	29.1	-	29.1	31.2
Financial advice fees	31.2	-	31.2	31.6
Software and consultancy fees	0.3	19.3	19.6	20.7
Factoring and invoice discounting services	9.3	-	9.3	9.1
Other fees and commissions	4.9	1.7	6.6	6.0
	445.5	35.4	480.9	477.9

Society	2018			2017
	Products and services transferred at a point in time £m	Products and services transferred over time £m	Total £m	£m
Mortgage related fees	1.6	-	1.6	1.9
General insurance income	-	0.6	0.6	1.1
Financial advice fees	29.6	-	29.6	29.8
Other fees and commissions	1.8	-	1.8	1.6
	33.0	0.6	33.6	34.4

4. Fees and commissions *(continued)*

The table below provides a reconciliation of fees and commissions receivable by the Group to the amounts presented by reportable segment in note 38:

Group 2018	Mortgages and Savings £m	Estate Agency £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
Mortgage origination fees	-	54.2	-	(1.2)	53.0
Other mortgage related fees	1.8	-	-	-	1.8
General insurance income	0.6	52.6	-	-	53.2
Commissions earned on property sales	-	153.2	-	-	153.2
Commissions earned on property lettings	-	63.5	-	-	63.5
Survey and valuation fees	-	64.7	-	(10.1)	54.6
Asset management commission	-	5.8	-	-	5.8
Conveyancing fees	-	29.1	-	-	29.1
Financial advice fees	31.2	-	-	-	31.2
Software and consultancy fees	-	-	20.4	(0.8)	19.6
Factoring and invoice discounting services	-	-	9.3	-	9.3
Other fees and commissions	1.8	5.4	1.2	(1.8)	6.6
Fees and commissions receivable	35.4	428.5	30.9	(13.9)	480.9
Other	(3.5)	-	(0.6)	0.2	(3.9)
Net non-interest income	31.9	428.5	30.3	(13.7)	477.0

Group 2017	Mortgages and Savings £m	Estate Agency £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
Mortgage origination fees	0.2	37.4	-	(0.7)	36.9
Other mortgage related fees	1.9	-	-	-	1.9
General insurance income	1.1	49.9	-	-	51.0
Commissions earned on property sales	-	163.8	-	-	163.8
Commissions earned on property lettings	-	60.3	-	-	60.3
Survey and valuation fees	-	64.2	-	(4.7)	59.5
Asset management commission	-	5.9	-	-	5.9
Conveyancing fees	-	31.2	-	-	31.2
Financial advice fees	31.6	-	-	-	31.6
Software and consultancy fees	-	-	22.0	(1.3)	20.7
Factoring and invoice discounting services	-	-	9.1	-	9.1
Other fees and commissions	1.6	6.4	-	(2.0)	6.0
Fees and commissions receivable	36.4	419.1	31.1	(8.7)	477.9
Other	(3.4)	(1.7)	(0.5)	0.2	(5.4)
Net non-interest income	33.0	417.4	30.6	(8.5)	472.5

b) Fees and commissions payable

The total shown in the Income Statement for fees and commissions payable includes £2.6m for the Group (2017: £3.2m) and £nil for the Society (2017: £nil) relating to financial assets not measured at FVTPL. These figures exclude amounts which are incorporated in determining the effective interest rate on such financial assets.

5. Administrative expenses

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Employee costs:				
Wages and salaries	316.8	311.2	74.7	72.1
Social security costs	30.3	29.9	7.3	7.2
Pension costs:				
Defined contribution arrangements (note 29)	10.0	8.3	5.2	5.0
Past service costs (note 29)	3.0	-	1.3	-
	360.1	349.4	88.5	84.3
Other administrative expenses	160.9	173.7	54.9	52.4
Central administrative costs recharged to Group undertakings	-	-	(4.7)	(4.6)
	521.0	523.1	138.7	132.1
Other administrative expenses comprise:				
Depreciation and amortisation (notes 18, 19 and 20)	21.1	21.0	5.5	5.2
Impairment of property, plant and equipment and investment property (notes 18 and 19)	2.3	0.1	2.3	0.1
Impairment of goodwill (note 20)	2.5	-	-	-
Impairment losses on trade receivables (note 36c))	0.8	0.6	-	-
Amounts payable under operating leases	18.3	19.2	4.4	5.2
Other property and establishment costs	18.3	17.9	5.1	5.1
Postage and communications	15.0	15.9	5.5	5.7
IT costs	14.3	11.9	8.5	7.4
Marketing and advertising	21.5	25.0	6.3	7.4
Insurance	5.3	5.4	2.3	2.2
Legal, professional and consultancy	16.1	13.1	9.9	8.8
Training, recruitment and other employee related costs	16.5	16.9	4.0	4.2
Costs of Connells' management incentive scheme (note 26)	(4.2)	9.7	-	-
Other	13.1	17.0	1.1	1.1
	160.9	173.7	54.9	52.4

The remuneration of the external auditor, which is included within legal, professional and consultancy costs above, is set out below (excluding VAT):

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Audit of the Society and Group Annual Accounts	0.2	0.2	0.2	0.2
Audit of the Group's subsidiary undertakings' accounts pursuant to legislation	0.5	0.4	-	-
Audit of the transition to new accounting standards	0.3	0.1	0.3	0.1
Audit-related assurance services	0.1	0.1	0.1	0.1
Other non-audit services	0.3	0.5	0.3	0.4
	1.4	1.3	0.9	0.8

6. Employee numbers

The average number of full and part-time persons employed during the year (including Executive Directors) was as follows:

	Group 2018	Group 2017	Society 2018	Society 2017
Principal office	1,399	1,363	1,399	1,363
Society branches	769	784	769	784
Subsidiary undertakings	7,346	7,405	-	-
	9,514	9,552	2,168	2,147

7. Directors' emoluments

Directors' emoluments are set out within the Directors' Remuneration Report on pages 70 to 87.

Total Directors' emoluments for 2018 amounted to £3.0m (2017: £3.4m).

8. Related party transactions

A number of transactions are entered into with related parties in the normal course of business; these are detailed below.

Key management personnel

For the purposes of these disclosures, the definition of key management personnel has been updated by the Group during the year. Previously, key management personnel comprised the Executive Directors and Non-Executive Directors of the Society. The definition has been expanded this year to also include other members of the Society's Executive Committee who, in addition to the Executive and Non-Executive Directors, are responsible for ensuring the Society meets its strategic and operational objectives.

The information presented below regarding the Group's key management personnel, and persons connected to key management personnel, including information for the year ended 31 December 2017, has been updated accordingly.

The table below summarises the benefits paid to key management personnel in the year:

Group and Society	2018 £m	2017 £m
Salary, benefits and annual performance pay	3.9	4.3
Employer pension contributions	0.3	0.3
	4.2	4.6

The table below sets out the outstanding balances in relation to related party transactions with key management personnel and persons who are connected with key management personnel:

	2018 £m	2017 £m
Mortgage loans outstanding at 31 December	0.1	0.1
Savings balances at 31 December	1.7	1.6

Interest receivable and payable on the above accounts during the year was as follows:

	2018 £000	2017 £000
Interest receivable	2	3
Interest payable	15	12

Loans and savings of key management personnel are at normal commercial rates. There are no provisions for impairment against these loans.

Key management personnel loans and transactions

At 31 December 2018 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £89,371 (2017: £142,936) to two (2017: three) key management personnel or persons who are connected with key management personnel. These mortgages are provided at market interest rates and are subject to repayment under normal lending terms. No amounts have been waived or written off.

A register is maintained at the Principal Office of the Society which shows details of all loans, transactions and arrangements with Directors and connected persons. A statement for the current financial year of the appropriate details contained in the register will be available for inspection at the Principal Office for a period of 15 days up to and including the Annual General Meeting.

Contributions to pension schemes

During the year, the Group and Society paid contributions of £19.2m (2017: £11.6m) and £8.7m (2017: £5.6m) respectively to pension schemes, which are classified as related parties.

Related party transactions

During the year the Society had the following related party transactions with subsidiary undertakings:

	2018 £m	2017 £m
Rendering and receiving of services	0.3	0.4
Recharges of central costs	4.7	4.6
Interest receivable	26.2	32.9
Interest payable	(18.3)	(17.3)
Mortgage referral, valuation and legal fees (note 1)	(12.1)	(10.3)
Other income	2.8	1.6
Collateral transferred to funding vehicles	489.5	986.3
Repayment of debt securities	(9.1)	(142.1)

Note

1. These are fees payable by the Society to Connells for the above services, which are amortised through net interest receivable in the Society's books on an effective interest basis.

All the above transactions were entered into on an arm's-length basis. For details of the relationship between the Society and its principal subsidiary undertakings see note 17a).

At 31 December 2018 the Society owed £560.3m (2017: £667.9m) to subsidiary undertakings and was owed £854.4m (2017: £965.4m) by subsidiary undertakings. Interest on intra-Group borrowings is charged at an appropriate market rate. As at 31 December 2018 the Society recognised no impairment loss allowance in respect of loans to subsidiary undertakings on the grounds of immateriality (2017: £nil).

During the year the Group had the following related party transactions with joint ventures and associates:

	2018 £m	2017 £m
Services provided to the Group	4.0	2.4
Services provided by the Group	4.0	3.6

At 31 December 2018 the Group was owed £0.2m (2017: £nil) by joint ventures, and owed £nil (2017: £nil) to joint ventures.

There were no provisions in respect of sales of goods and services or in respect of outstanding loans to or from related parties as at 31 December 2018 or 31 December 2017.

9. Tax expense

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Current tax	40.0	41.9	21.1	17.0
Deferred tax (note 28)	0.6	-	1.5	(1.8)
	40.6	41.9	22.6	15.2

9. Tax expense *(continued)*

A reconciliation of the tax expense on profit before tax at the standard UK corporation tax rate to the actual tax expense is as follows:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Profit before tax	188.2	200.1	167.1	133.8
Share of profits from joint ventures, net of tax	(0.8)	(2.0)	-	-
	187.4	198.1	167.1	133.8
Tax calculated at standard UK corporation tax rate of 19.00% (2017: 19.25%)	35.6	38.1	31.7	25.8
Effects of:				
Expenses not deductible for tax purposes	2.2	4.6	0.7	2.3
Adjustment to tax expense in respect of prior periods	0.9	(1.9)	0.9	(3.8)
Non-taxable income	(1.1)	(1.0)	(15.8)	(11.7)
Corporation tax rate change	-	(0.6)	(0.1)	(0.2)
Higher tax rates on overseas earnings	0.3	-	-	-
Effects of lower tax rates in other jurisdictions (see below)	(1.8)	(1.7)	-	-
Banking surcharge	5.2	4.5	5.2	4.5
Recognition of tax losses not previously recognised	(0.9)	(0.2)	-	-
Other	0.2	0.1	-	(1.7)
Tax expense	40.6	41.9	22.6	15.2

The effective tax rate for the Group for the year ended 31 December 2018 is 21.66% (2017: 21.15%) compared with the standard rate of UK corporation tax of 19.00% (2017: 19.25%). The rate is higher than the standard rate due to the impact of the 8% surcharge on bank profits introduced by the Finance (No. 2) Act 2015 which is charged on the Society's taxable profits above £25m. The rate for the year is also increased by expenditure disallowable for tax purposes and reduced by the lower tax rate in Guernsey which applies to the taxable profits of Skipton International Limited.

The effective tax rate for the Society for the year ended 31 December 2018 is 13.52% (2017: 11.36%). The major impact on the effective rate of tax is the non-taxable dividend income received of £82.9m (2017: £60.5m). This is partially offset by the impact of the 8% surcharge on taxable profits above £25m.

10. Loans and advances to credit institutions held at amortised cost

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Gross carrying amount	422.8	345.3	349.5	260.8
Loss allowance	(0.1)	-	-	-
Net carrying amount	422.7	345.3	349.5	260.8

The table below provides information on movements in the gross carrying amount of loans and advances to credit institutions during the year.

	Group Stage 1 £m	Group Stage 2 £m	Group Total £m	Society Stage 1 £m	Society Total £m
Gross carrying amount as at 31 December 2017	342.3	3.0	345.3	260.8	260.8
Impact of adopting IFRS 9 at 1 January 2018	-	-	-	-	-
Gross carrying amount as at 1 January 2018	342.3	3.0	345.3	260.8	260.8
Increases due to origination, acquisition and additions	75.0	2.5	77.5	88.7	88.7
Gross carrying amount as at 31 December 2018	417.3	5.5	422.8	349.5	349.5

The table below provides information on movements in the loss allowance for loans and advances to credit institutions during the year.

	Group Stage 1 £m	Group Stage 2 £m	Group Total £m	Society Stage 1 £m	Society Total £m
Loss allowance as at 31 December 2017	-	-	-	-	-
Impact of adopting IFRS 9 at 1 January 2018 (note 1b))	0.1	-	0.1	-	-
Loss allowance as at 1 January 2018 and 31 December 2018	0.1	-	0.1	-	-

No amounts were written off during the year in either the Group or the Society.

For further details on the assessment of ECLs on liquid assets, see note 1g).

The table below provides maturity information for the net carrying amounts.

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Repayable on demand:				
Cash and cash equivalents	71.3	84.4	-	-
Cash pledged as collateral	299.4	259.7	299.4	259.7
	370.7	344.1	299.4	259.7
In not more than three months:				
Cash and cash equivalents	1.8	-	-	-
Other loans and advances to credit institutions	50.2	0.1	50.1	-
	52.0	0.1	50.1	-
In more than one year but not more than five years:				
Cash pledged as collateral	-	1.1	-	1.1
	-	1.1	-	1.1
Total loans and advances to credit institutions	422.7	345.3	349.5	260.8
Total included within cash and cash equivalents	73.1	84.4	-	-

Collateral

Cash is pledged and received as collateral against derivative contracts which are used by the Group to manage its exposure to market risk. Collateral is pledged to derivative contract counterparties where there is a net amount outstanding to the counterparty and collateral is received from derivative contract counterparties where there is a net amount due to the Group.

Non-standardised and some legacy derivatives are collateralised based on bilateral Credit Support Annex (CSA) agreements. Under the terms of a CSA, collateral is passed between parties to mitigate the credit risk of counterparties which is inherent in the outstanding derivative contracts. Standardised derivatives are cleared with a central clearing counterparty in accordance with the European Market Infrastructure Regulation (EMIR). Under the arrangements for cleared derivatives, additional collateral is required to protect the central clearing house against credit risk of the counterparties and to cover intra-day market movements and variations in valuation of the derivative contracts. At 31 December 2018 the Group and Society pledged £102.7m (2017: £45.0m) of this additional collateral, which is included in the figures in the table below.

Collateral pledged and received is ring-fenced by all parties to the derivative contract for the sole purpose of collateralisation of the contracts. All derivatives are marked to market on a daily basis, with collateral being either returned or pledged based on the market valuation of the derivatives.

The Group's derivative contracts have an outstanding contractual period of up to 38 years (2017: 39 years).

In addition, cash collateral can be pledged or received as repurchase agreement contracts. Repurchase agreements are funding arrangements which allow a party to sell a financial asset as security to raise funds and the borrower agrees to

10. Loans and advances to credit institutions held at amortised cost *(continued)*

repurchase the financial asset at a later agreed date. Where there is a movement in valuation of the underlying financial asset used as security, the borrower is required to pledge cash (known as 'valuation margin') to make up the shortfall in the value of the security. This valuation margin protects the counterparty against the risk that the security changes in value over time. Cash pledged in this way is ring-fenced for the sole purpose of collateralisation and it is separate to the funds raised as part of the underlying repurchase agreement.

The table below provides further detail on the cash the Group has pledged against financial contracts.

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Cash pledged against derivative contracts	299.4	260.8	299.4	260.8
Total on-balance sheet cash pledged as collateral	299.4	260.8	299.4	260.8

The table below provides further detail on the cash the Group holds against financial contracts.

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Cash held against derivative contracts	9.8	37.2	10.1	40.6
Total off-balance sheet cash held as collateral	9.8	37.2	10.1	40.6

11. Debt securities

The majority of debt securities held are highly liquid assets which are used on a continuing basis in the Group's activities.

	Group 2018 FVOCI and Total £m	2017 £m
Gilts	219.0	153.2
Certificates of deposit	316.5	55.1
Fixed rate bonds	242.6	178.6
Floating rate notes	20.0	24.0
Treasury bills	169.0	94.0
Covered bonds	208.6	87.4
Residential mortgage backed securities	207.4	198.8
	1,383.1	791.1
Debt securities have remaining maturities as follows:		
In not more than one year	657.3	299.4
In more than one year	725.8	491.7
	1,383.1	791.1
Transferable debt securities comprise:		
Listed on a recognised investment exchange	1,066.6	640.3
Unlisted	316.5	150.8
	1,383.1	791.1
Market value of listed transferable debt securities	1,066.6	640.3

	Society 2018 FVOCI £m	Society 2018 FVTPL £m	Society 2018 Total £m	2017 £m
Gilts	203.8	-	203.8	153.2
Certificates of deposit	301.5	-	301.5	20.0
Fixed rate bonds	242.6	-	242.6	178.6
Floating rate notes	20.0	-	20.0	-
Treasury bills	49.8	-	49.8	-
Covered bonds	208.6	-	208.6	87.4
Residential mortgage backed securities	236.6	82.0	318.6	321.1
	1,262.9	82.0	1,344.9	760.3
Debt securities have remaining maturities as follows:				
In not more than one year	507.9	46.9	554.8	146.4
In more than one year	755.0	35.1	790.1	613.9
	1,262.9	82.0	1,344.9	760.3
Transferable debt securities comprise:				
Listed on a recognised investment exchange	961.4	82.0	1,043.4	738.6
Unlisted	301.5	-	301.5	21.7
	1,262.9	82.0	1,344.9	760.3
Market value of listed transferable debt securities	961.4	82.0	1,043.4	730.4

The table below provides further detail on the movement in debt securities during the year.

The balances as at 1 January 2018 in the tables below represent the balances following adoption of IFRS 9 on 1 January 2018. For further details see note 1b).

	Group 2018 Amortised cost £m	Group 2018 FVOCI £m	Group 2018 FVTPL £m	Group 2018 Total £m	2017 £m
At 1 January	1.7	789.4	-	791.1	1,055.1
Additions	-	1,763.2	-	1,763.2	666.5
Disposals	(1.7)	(1,165.2)	-	(1,166.9)	(920.0)
Changes in fair value	-	(4.3)	-	(4.3)	(10.5)
At 31 December	-	1,383.1	-	1,383.1	791.1

	Society 2018 Amortised cost £m	Society 2018 FVOCI £m	Society 2018 FVTPL £m	Society 2018 Total £m	2017 £m
At 1 January	1.7	674.8	81.1	757.6	1,262.0
Additions	-	1,313.9	-	1,313.9	419.4
Disposals	(1.7)	(721.4)	-	(723.1)	(910.6)
Changes in fair value	-	(4.4)	0.9	(3.5)	(10.5)
At 31 December	-	1,262.9	82.0	1,344.9	760.3

The tables below provide further detail on the movement in the impairment loss allowance held in respect of debt securities during the year. The loss allowances as at 1 January in the tables below represent the balances following adoption of IFRS 9 on 1 January 2018 (for further details see note 1b)).

With respect to debt securities held at FVOCI, there were no stage 2 allowances or stage 3 allowances during the year. With respect to debt securities held at amortised cost, there were no impairment loss allowances during the year. There were no amounts written off by the Group or Society during the year in respect of debt securities.

11. Debt securities *(continued)*

	2018			
	Group		Society	
	FVOCI Stage 1	Total	FVOCI Stage 1	Total
	£m	£m	£m	£m
Loss allowance at 1 January	0.1	0.1	0.1	0.1
Increases due to origination, acquisition and additions	0.2	0.2	0.2	0.2
Decrease due to derecognition, repayments and disposals	(0.1)	(0.1)	-	-
Loss allowance at 31 December	0.2	0.2	0.3	0.3

The Group's accounting policies for the derecognition of financial assets held at amortised cost are set out in note 1h).

In December 2018, some debt securities that were held by the Group and Society were repaid and therefore derecognised. These securities were previously held at amortised cost and had a carrying amount of £1.7m (net of an impairment allowance of less than £0.1m). No gain / loss arose on derecognition of these securities.

Collateral

At 31 December 2018, £0.2m (2017: £0.4m) of debt securities have been pledged by the Group, and £121.8m (2017: £94.4m) have been pledged by the Society, as collateral in repurchase transactions. These transactions are used to either obtain liquidity or to test the liquidity of the assets pledged as collateral. Where debt securities are pledged as collateral in repurchase transactions, the debt securities are not derecognised from the balance sheet and the transaction is accounted for as a secured loan.

Further detail on debt securities that have been pledged as collateral is found in the table below.

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Gilts	-	-	98.7	94.0
T-Bills	-	-	22.9	-
Fixed Rate Bonds	0.2	0.4	0.2	0.4
Total on-balance sheet debt securities pledged as collateral	0.2	0.4	121.8	94.4

The collateral is pledged for the duration of the repurchase agreement, and is returned on maturity of the agreement, subject to the repayment of the amount raised. The securities cannot be pledged again by the Group until maturity of the repurchase agreement, however the recipient of the collateral is free to sell or further repurchase the assets. As at 31 December 2018, the Group's repurchase agreements have a contractual period of up to two months (2017: one month).

There were no debt securities held by the Group or the Society at the end of 2018 or 2017 that were pledged as collateral by counterparties (known as 'reverse repurchase agreements').

Residential mortgage backed securities

The Group's investments in residential mortgage backed securities represent investments in unconsolidated structured entities, as described in note 1c).

The maximum exposure to losses from unconsolidated structured entities is equivalent to the book value plus accrued interest, determined by the carrying value of these investments plus any unrealised losses / minus any unrealised gains recognised within the fair value reserve (2017: available-for-sale reserve) as shown below.

Group and Society	2018 £m	2017 £m
Carrying value of assets	207.4	198.8
Cumulative unrealised gains recognised in available-for-sale reserve	-	(0.6)
Cumulative unrealised losses recognised in fair value reserve	1.4	-
Maximum exposure to loss at 31 December	208.8	198.2

During the year, the Group and Society received interest income of £2.5m (2017: £1.8m) from its investments in unconsolidated structured entities and incurred impairment charges of £nil (2017: £nil). In addition, £2.0m of unrealised losses were recognised through the fair value reserve (2017: £0.1m of unrealised profits recognised through the available-for-sale reserve).

No collateral has been received by the Group in respect of the above third party funding entities. The total size of unconsolidated structured entities as shown in the table above is determined by reference to the Group's total notional exposure to the unconsolidated structured entities in question.

The Group did not provide any non-contractual support, nor any contractual guarantees, during the year to unconsolidated structured entities and currently has no intentions to provide any such support. The Group is not required to absorb losses of any unconsolidated structured entities before other parties and the Group did not act as a sponsor to any unconsolidated structured entities during the year. The Group would, in general, be regarded as a sponsor of an unconsolidated structured entity if market participants would reasonably associate the entity with the Group.

At 31 December 2018 the Society also held £29.2m of residential mortgage backed securities held at FVOCI and £82.0m of residential mortgage backed securities held at FVTPL that were issued by the Group's securitisation vehicles, Darrowby No. 3 plc and Darrowby No. 4 plc.

12. Loans and advances to customers held at amortised cost

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Loans fully secured on residential property*	17,715.8	16,318.6	15,747.7	14,375.9
Other loans:				
Loans fully secured on land	259.7	285.8	259.7	285.8
Other loans and advances	159.9	141.0	-	0.1
Fair value adjustment for hedged risk	(8.4)	227.3	(8.2)	224.8
	18,127.0	16,972.7	15,999.2	14,886.6
The remaining maturity of loans and advances to customers from the reporting date is as follows:				
On call and at short notice	95.9	83.0	1.8	3.1
In not more than three months	35.1	39.5	22.6	26.4
In more than three months but not more than one year	50.8	45.2	23.4	37.3
In more than one year but not more than five years	595.1	441.7	405.4	357.2
In more than five years	17,368.7	16,405.1	15,558.3	14,500.8
	18,145.6	17,014.5	16,011.5	14,924.8
Less: Impairment (note 14)	(18.6)	(41.8)	(12.3)	(38.2)
	18,127.0	16,972.7	15,999.2	14,886.6

* The equity release portfolio was reclassified from financial assets measured at amortised cost to financial assets held at FVTPL on adoption of IFRS 9 on 1 January 2018. As permitted by IFRS 9, the comparative figures have not been restated. Further details are set out in note 1b).

Included in loans fully secured on residential property is a £30.0m asset (2017: £25.5m) that arises as a result of applying the effective interest method of accounting for these mortgages. A critical factor in calculating this asset, which determines the overall carrying value of these mortgages and associated interest income recognised, is the expected life of the mortgages in question as the total interest income expected to be received is spread over this expected life using the effective interest method. Further details can be found in note 1t).

13. Transfers of financial assets

As outlined in note 1c) the Society has transferred the beneficial interest in certain portfolios of loans and advances to customers to the Group's special purpose vehicles (SPVs) Darrowby No. 3 plc, Darrowby No. 4 plc and Skipton Covered Bonds LLP, to enable the subsequent raising of debt to investors who gain the security of the underlying mortgage loans as collateral.

The proceeds received from the transfer of mortgage loans are accounted for as a deemed loan repayable to the SPVs, which is included in 'Amounts owed to other customers' within the Society's Statement of Financial Position.

The transfers of the beneficial interest in the mortgage loans to the SPVs are not treated as sales by the Society and are not derecognised. The Society continues to recognise these assets within its own Statement of Financial Position because it substantially retains the risks and rewards of these mortgage portfolios. The Society continues to operationally manage these mortgage loans in the same manner as the remainder of its mortgage portfolio and is exposed to the rewards of these assets, primarily through the receipt of interest income, and is exposed to the risks of these assets, which is primarily exposure to the credit risk associated with these mortgage loans.

The underlying mortgage loans are ring-fenced and cannot be used for any purpose by the Society or the SPV other than as security for the debt raised.

At 31 December 2018, loans and advances to customers held at amortised cost include £1,484.8m (2017: £1,312.9m) of balances for both the Group and Society which have been used in these secured funding arrangements, resulting in the beneficial interest in these loans being transferred to Darrowby No. 3 plc (£129.8m; 2017: £173.1m), Darrowby No. 4 plc (£195.1m; 2017: £241.7m) and Skipton Covered Bonds LLP (£1,159.9m; 2017: £898.1m). These loans secure £1,065.9m (2017: £306.4m) of funding for the Group.

The carrying value of the mortgage loans at the date the beneficial interest was transferred was £2,409.8m (2017: £1,920.3m).

At 31 December 2018 the balance on the deemed loans repayable to Darrowby No. 3 plc and Darrowby No. 4 plc, which represent the proceeds received for the transferred financial assets, included in 'Amounts owed to other customers' in the Society was £324.9m (2017: £414.8m).

At 31 December 2018, the deemed loan repayable to Skipton Covered Bonds LLP, which represents the proceeds received for the transferred financial assets, was included within 'Loans to subsidiary undertakings' and netted against the term advance between the Society and the LLP. The balance on the deemed loan at 31 December 2018 was £821.0m (2017: £nil).

The Group's accounting policies for the derecognition of financial assets held at amortised cost are set out in note 1h). During the year, no gains or losses arose in respect of loans and advances to customers held at amortised cost that were derecognised by the Group or Society.

14. Impairment losses on loans and advances to customers

Group	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans and advances £m	Fair value of embedded derivatives on equity release portfolio £m	Total £m
Loss allowance at 31 December 2017	7.3	8.0	0.8	25.7	41.8
Adjustments on initial adoption of IFRS 9 (note 1b))	2.7	(1.1)	-	(25.7)	(24.1)
Adjusted loss allowance at 1 January 2018	10.0	6.9	0.8	-	17.7
Amounts written off during the year, net of recoveries	(1.5)	-	(0.2)	-	(1.7)
Income statement charge for the year	1.3	1.0	0.2	-	2.5
Transfer of engagements	0.1	-	-	-	0.1
Loss allowance at 31 December 2018	9.9	7.9	0.8	-	18.6

Group	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans and advances £m	Fair value of embedded derivatives on equity release portfolio £m	Total £m
At 1 January 2017					
Individual impairment	11.9	8.4	0.6	-	20.9
Collective impairment	7.3	0.9	-	27.7	35.9
	19.2	9.3	0.6	27.7	56.8
Amounts written off during the year, net of recoveries					
Individual impairment	(1.7)	(0.2)	-	-	(1.9)
Collective impairment	(0.2)	-	-	(0.2)	(0.4)
	(1.9)	(0.2)	-	(0.2)	(2.3)
Amounts disposed of during the year					
Individual impairment	(6.0)	-	-	-	(6.0)
Collective impairment	(2.7)	-	-	-	(2.7)
	(8.7)	-	-	-	(8.7)
Income Statement					
Impairment losses on loans and advances					
Individual impairment	0.3	(0.5)	0.2	-	-
Collective impairment	(0.6)	(0.6)	-	(1.8)	(3.0)
	(0.3)	(1.1)	0.2	(1.8)	(3.0)
Adjustment to impairment losses on loans and advances resulting from recoveries during the year					
Individual impairment	(1.0)	-	-	-	(1.0)
(Credit) / charge for the year	(1.3)	(1.1)	0.2	(1.8)	(4.0)
At 31 December 2017					
Individual impairment	3.5	7.7	0.8	-	12.0
Collective impairment	3.8	0.3	-	25.7	29.8
	7.3	8.0	0.8	25.7	41.8

14. Impairment losses on loans and advances to customers *(continued)*

Society	Loans fully secured on residential property £m	Loans fully secured on land £m	Fair value of embedded derivatives on equity release portfolio £m	Total £m
Loss allowance at 31 December 2017	4.5	8.0	25.7	38.2
Adjustments on initial adoption of IFRS 9 (note 1b))	0.2	(1.1)	(25.7)	(26.6)
Adjusted loss allowance at 1 January 2018	4.7	6.9	-	11.6
Amounts written off during the year, net of recoveries	(0.5)	-	-	(0.5)
Income statement charge for the year	0.1	1.0	-	1.1
Transfer of engagements	0.1	-	-	0.1
Loss allowance at 31 December 2018	4.4	7.9	-	12.3

Society	Loans fully secured on residential property £m	Loans fully secured on land £m	Fair value of embedded derivatives on equity release portfolio £m	Total £m
At 1 January 2017				
Individual impairment	2.9	8.4	-	11.3
Collective impairment	2.1	0.9	27.7	30.7
	5.0	9.3	27.7	42.0
Amounts written off during the year, net of recoveries				
Individual impairment	(0.4)	(0.2)	-	(0.6)
Collective impairment	-	-	(0.2)	(0.2)
	(0.4)	(0.2)	(0.2)	(0.8)
Income Statement				
Impairment losses on loans and advances				
Individual impairment	(0.4)	(0.5)	-	(0.9)
Collective impairment	0.6	(0.6)	(1.8)	(1.8)
	0.2	(1.1)	(1.8)	(2.7)
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.3)	-	-	(0.3)
Credit for the year	(0.1)	(1.1)	(1.8)	(3.0)
At 31 December 2017				
Individual impairment	1.8	7.7	-	9.5
Collective impairment	2.7	0.3	25.7	28.7
	4.5	8.0	25.7	38.2

15. Equity release portfolio held at FVTPL

Movements during the year in the equity release portfolio are outlined below.

	Group and Society 2018 £m
At 1 January	426.6
Redemptions	(6.2)
Further advances	0.3
Movements in fair value	(17.1)
Realised losses on redemption	(0.7)
Accrued interest	8.0
At 31 December	410.9

On 1 January 2018 the equity release portfolio was reclassified from financial assets measured at amortised cost to financial assets held at FVTPL following the adoption of IFRS 9, further details of which can be found in note 1b). The above opening position of £426.6m is the position immediately following the reclassification.

Further details on how the valuation of the equity release portfolio is derived including the key inputs into the calculation are found in note 1b), note 1e) and note 1t).

The Group holds derivative financial instruments to economically hedge the movements in fair value of the equity release portfolio, as outlined in note 1b). The gain in fair value of the derivatives held to hedge the equity release portfolio during the year was £18.1m and is included in the Income Statement line 'Fair value gains on other derivatives' (2017: £14.4m gain included in the Income Statement line 'Fair value gains on hedging instruments and hedged items').

The equity release portfolio comprises loans which are secured against property to a value as at 31 December 2018 of £581.4m.

16. Loans and advances to customers held at FVTPL

Movements during the year are outlined below.

	Group and Society 2018 £m
At 1 January	-
Transfer of engagements	1.7
Repayments	(0.7)
Other movements	0.9
At 31 December	1.9

As outlined in note 1e), the above loans consist mainly of certain lifetime mortgages that are required, under IFRS 9, to be held at FVTPL.

Collateral is held against the above loans in the form of property in the UK and is valued as at 31 December 2018 at £20.2m.

17. Investments in Group undertakings

a) Subsidiary undertakings

The net movement in investments in subsidiary undertakings during the year was as follows:

Society	Shares in subsidiary undertakings 2018 £m	2017 £m	Loans to subsidiary undertakings 2018 £m	2017 £m	Total 2018 £m	2017 £m
Cost						
At 1 January	186.0	186.0	965.4	1,189.1	1,151.4	1,375.1
Additions	-	-	11.6	73.9	11.6	73.9
Repayments	-	-	(122.6)	(297.6)	(122.6)	(297.6)
Written off	(2.5)	-	-	-	(2.5)	-
At 31 December	183.5	186.0	854.4	965.4	1,037.9	1,151.4
Provisions						
At 1 January	65.4	55.5	-	-	65.4	55.5
Provided in the year	-	9.9	-	-	-	9.9
Written off	(2.5)	-	-	-	(2.5)	-
At 31 December	62.9	65.4	-	-	62.9	65.4
Net book value at 31 December	120.6	120.6	854.4	965.4	975.0	1,086.0

The balance of loans to subsidiary undertakings at 1 January 2018 in the table above represents the balance following adoption of IFRS 9 on 1 January 2018. For further details see note 1b).

In respect of loans provided by the Society to its subsidiary undertakings, limits in place define the maximum amount that can be advanced to each subsidiary and any changes to these limits are required to be pre-approved by the Group Wholesale Credit Committee.

The Society reviews the carrying value of its investments in subsidiary undertakings at each reporting date. During the year the Society recognised £nil impairment against the carrying value of its shares in subsidiary undertakings and recognised £nil impairment against loans to subsidiary undertakings on the grounds of immateriality. In 2017 the Society recognised total impairment of £9.9m against the carrying value of its shares in Amber Homeloans Limited and North Yorkshire Mortgages Limited.

At the end of the current and preceding financial year the Group held a controlling interest in the following principal trading subsidiary undertakings:

Name of subsidiary undertaking	Principal business activity	Registered office	Percentage of ownership interest 2018	2017
Amber Homeloans Limited	Lending body	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Connells Limited and subsidiary undertakings*	Estate agency and related businesses	The Bailey, Skipton, North Yorkshire, BD23 1DN	99.9	99.8
Darrowby No. 3 plc	Funding vehicle	35 Great St. Helen's, London, EC3A 6AP	(See below)	(See below)
Darrowby No. 4 plc	Funding vehicle	35 Great St. Helen's, London, EC3A 6AP	(See below)	(See below)
Jade Software Corporation Limited and subsidiary undertakings	Provider of software development services	5 Sir Gil Simpson Drive, Christchurch, New Zealand	99.98	99.92
North Yorkshire Mortgages Limited	Lending body	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Northwest Investments NZ Limited	Provider of software development services	C/- Bell Gully, Level 22 Vero Centre, 48 Shortland Street, Auckland, New Zealand	100.0	100.0
Skipton Business Finance Limited	Provider of debt factoring services	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Skipton Covered Bonds Limited Liability Partnership	Mortgage acquisition and guarantor of covered bonds	The Bailey, Skipton, North Yorkshire, BD23 1DN	(See below)	(See below)
Skipton Financial Services Limited	Financial adviser	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Skipton Group Holdings Limited (SGHL)	Intermediate holding company	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Skipton International Limited (SIL)	Offshore deposit taker and lender	Tudor House, Le Bordage, St Peter Port, Guernsey, GY1 6DS	100.0	100.0
Skipton Trustees Limited	Provider of will writing services	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0

* Indicates where an option to purchase non-controlling interests in the future exists.

All the above entities are incorporated, registered and operate in the United Kingdom except for SIL, which is incorporated and registered in Guernsey and operates in Guernsey, Jersey and the UK; Northwest Investments NZ Limited, which is incorporated, registered and operates in New Zealand; and Jade Software Corporation Limited, which is incorporated and registered in New Zealand and operates worldwide.

Consolidation of Group undertakings

The special purpose vehicles (SPVs) Darrowby No. 3 plc and Darrowby No. 4 plc were formed with only nominal share capital. Skipton Covered Bonds LLP, of which the Society is a member, was formed to guarantee payments on covered bonds that the Society issues to the wholesale market. The SPVs and Skipton Covered Bonds LLP are funded through loans from the Society and their activities are carried out under the direction of the Society, in line with the transaction documentation. The Society is exposed to variable returns from these entities and has the ability to affect those returns in line with the transaction documentation and therefore these SPVs pass the test of control under IFRS 10. Consequently they are fully consolidated into the Group Accounts.

The Society has no contractual arrangements or intention to provide additional financial or other support to these SPVs.

b) Acquisitions

During 2018 Connells Limited acquired a further 2.25% shareholding in Gascoigne Halman Group Limited for cash consideration of £0.3m, increasing the Group's shareholding to 77.25%. Connells also purchased the trade and assets of a number of small businesses for total consideration of £0.6m (with a further £0.1m deferred consideration), generating goodwill of £0.1m.

In June 2017 the Jade group was subject to a group restructure, which resulted in the Skipton Group purchasing further shares in Jade for cash consideration of £6.6m, increasing its shareholding from 56.4% to 99.9%. At the same time, as part of the restructure, a small group of companies was disposed of, as outlined below in section c) *Disposals*.

In the prior year the Connells group purchased a number of small businesses for cash consideration of £1.7m (with a further £0.3m deferred consideration), generating goodwill of £0.8m.

c) Disposals

The profit on disposal of subsidiary undertakings for the year was £3.3m for the Group (2017: £11.3m) and £nil for the Society (2017: £nil).

During 2014, the Group sold its then subsidiary Homeloan Management Limited (HML). The sale of HML to Computershare included contingent consideration dependent on HML's performance over a period following the disposal and this resulted in amounts being receivable by the Group between 2018 and 2022.

During the year the contingent consideration receivable by the Group was finalised with the purchaser at £32.5m, being £2.3m higher (undiscounted and before costs) than the amount estimated by the Group as at 31 December 2017. The first instalment of £6.9m (before costs) was received by the Group in May 2018 and the contingent consideration asset stands at £23.0m at 31 December 2018 (2017: £25.1m). The profit recognised in the Income Statement in relation to the

Financial Statements

17. Investments in Group undertakings *(continued)*

HML disposal during the year of £3.3m (2017: £15.2m) is included in the 'Profit on disposal of subsidiary undertakings' line in the Income Statement.

Profits on disposal for the Group in 2017 also include amounts released from provisions no longer required, being £0.7m profit in respect of the HML disposal and £0.3m profit in respect of the 2015 disposal of Pearson Jones plc.

In 2017 the Group disposed of a small group of companies, Jade Logistics Holding Company and its subsidiary undertakings which were previously part of the Jade group, resulting in a loss on disposal for the Group in 2017 of £4.9m.

d) Joint ventures

At 31 December 2018, the Group held interests in the following companies that are classed as joint ventures:

Name of investment	Principal business activity	Registered office	Class of shares held	Percentage of ownership interest 2018	2017
TM Group (UK) Limited	Property search services	1200 Delta Business Park, Swindon, Wiltshire, SN5 7XZ	Ordinary	33.3	33.3
Cybele Solutions Holdings Limited	Conveyancing services	Bickerton House, Lloyd Drive, Ellesmere Port, Cheshire, CH65 9HQ	Ordinary	50.0	50.0
Vibrant Energy Matters Limited	Home energy, property and eco services	2 Foxes Lane, Oakdale Business Park, Blackwood, Gwent, NP12 4AB	Ordinary	46.1	46.1

The Group's combined share of net assets and the Group's combined share of profit after tax for the above joint ventures are as shown within the Statement of Financial Position and Income Statement respectively.

e) Equity share investments

At 31 December 2018, the Group held interests in the following companies:

		Percentage of ownership interest		Carrying value	
		2018	2017	2018	2017
Name of investment	Principal business activity	%	%	£m	£m
Hearthstone Investments plc	Property fund management	17.1	13.9	-	-
OnTheMarket plc	Property search provider	0.1	-	0.1	-
Viewber Limited	Property viewings services	2.7	-	0.3	-
Tactile Limited	Software application provider	8.7	8.7	0.4	0.4
Wynyard Group Limited	Provider of software development services	17.7	17.7	-	-
				0.8	0.4

On adoption of IFRS 9 on 1 January 2018, the Group's investments in equity shares were reclassified from available-for-sale financial assets to financial assets mandatorily held at FVTPL. There was no adjustment to carrying value as a result of this reclassification. For further details see note 1b).

The movement in the Group's equity share investments during the year is analysed below:

	Group 2018 £m	Group 2017 £m
At 1 January	0.4	36.4
Additions	0.7	0.1
Disposals	-	(41.0)
Impairment recognised in Income Statement	-	(0.1)
Gain recognised in Other Comprehensive Income	-	5.0
Fair value losses recognised in Income Statement	(0.3)	-
At 31 December	0.8	0.4

Listed investments

The carrying value of the Group's investment in OnTheMarket plc is determined by reference to that company's share price, resulting in a fair value loss of £0.1m being recognised in the year.

In 2017 the Group sold its entire shareholding in ZPG Plc, generating a profit of £38.5m.

Unlisted investments

The carrying values of the Group's investments in Tactile (trading as Fixflo) and Viewber are the cost of the amounts invested by the Group. The Directors have reviewed both these investments and consider that their respective carrying values represent the best indication of fair value.

Connells invested a further £0.2m in Hearthstone during the year. The Directors have reviewed the carrying value of this investment, based on recent trading performance, outlook and expectations of the value of the business, and have concluded that the carrying value of £nil (2017: £nil) is the best indication of its fair value. This resulted in a fair value loss of £0.2m being recognised in the year.

The Group's investment in Wynyard Group Limited was written down to £nil in previous periods. Wynyard entered voluntary administration in October 2016 and subsequently went into liquidation in February 2017.

18. Property, plant and equipment

Group	2018 Land and buildings £m	2018 Equipment, fixtures and fittings £m	2018 Total £m	2017 Land and buildings £m	2017 Equipment, fixtures and fittings £m	2017 Total £m
Cost						
At 1 January	95.0	91.6	186.6	91.3	85.6	176.9
Additions	4.6	9.9	14.5	7.5	10.0	17.5
Disposals	(1.0)	(7.1)	(8.1)	(2.8)	(3.7)	(6.5)
Transfer of engagements	0.9	-	0.9	-	-	-
Foreign exchange movements on translation	-	-	-	-	(0.3)	(0.3)
Transfer from / (to) investment property	0.2	-	0.2	(1.0)	-	(1.0)
At 31 December	99.7	94.4	194.1	95.0	91.6	186.6
Depreciation						
At 1 January	42.1	66.3	108.4	38.7	60.4	99.1
Charge for the year	5.3	8.9	14.2	5.0	8.7	13.7
Impairment charge	-	0.4	0.4	0.1	-	0.1
Disposals	(0.8)	(6.1)	(6.9)	(1.3)	(2.7)	(4.0)
Foreign exchange movements on translation	-	-	-	-	(0.1)	(0.1)
Transfer from / (to) investment property	0.1	-	0.1	(0.4)	-	(0.4)
At 31 December	46.7	69.5	116.2	42.1	66.3	108.4
Net book value at 1 January	52.9	25.3	78.2	52.6	25.2	77.8
Net book value at 31 December	53.0	24.9	77.9	52.9	25.3	78.2

18. Property, plant and equipment *(continued)*

Society	2018			2017		
	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Cost						
At 1 January	50.3	34.4	84.7	49.7	30.8	80.5
Additions	2.3	3.7	6.0	2.7	3.8	6.5
Disposals	(0.3)	-	(0.3)	(1.1)	(0.2)	(1.3)
Transfer of engagements	0.9	-	0.9	-	-	-
Transfer to investment property	-	-	-	(1.0)	-	(1.0)
At 31 December	53.2	38.1	91.3	50.3	34.4	84.7
Depreciation						
At 1 January	21.4	29.4	50.8	20.3	28.0	48.3
Charge for the year	2.1	1.8	3.9	2.1	1.5	3.6
Impairment charge	-	0.4	0.4	0.1	-	0.1
Disposals	(0.3)	-	(0.3)	(0.7)	(0.1)	(0.8)
Transfer to investment property	-	-	-	(0.4)	-	(0.4)
At 31 December	23.2	31.6	54.8	21.4	29.4	50.8
Net book value at 1 January	28.9	5.0	33.9	29.4	2.8	32.2
Net book value at 31 December	30.0	6.5	36.5	28.9	5.0	33.9

The net book value of land and buildings comprises:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Freehold	39.0	38.9	24.8	24.2
Long leasehold	1.1	1.8	1.1	0.9
Short leasehold	12.9	12.2	4.1	3.8
	53.0	52.9	30.0	28.9

19. Investment property

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Cost				
At 1 January	28.1	28.2	27.8	27.9
Transfer of engagements	0.3	-	0.3	-
Disposals	(0.1)	(1.1)	(0.1)	(1.1)
Transfer (to) / from property, plant and equipment	(0.2)	1.0	-	1.0
At 31 December	28.1	28.1	28.0	27.8
Depreciation				
At 1 January	13.7	13.2	13.5	13.0
Charge for the year	0.7	0.6	0.7	0.6
Impairment charge	1.9	-	1.9	-
Disposals	(0.1)	(0.5)	(0.1)	(0.5)
Transfer (to) / from property, plant and equipment	(0.1)	0.4	-	0.4
At 31 December	16.1	13.7	16.0	13.5
Net book value at 1 January	14.4	15.0	14.3	14.9
Net book value at 31 December	12.0	14.4	12.0	14.3

All investment property relates to property purchased by the Group or Society and is either unoccupied by the Group or Society, or relates to branches where part of the property is sub-leased.

The amount of rental income from investment property recognised in the Income Statement during the year was £2.5m (2017: £2.3m) for the Group and £1.9m (2017: £1.6m) for the Society.

The aggregate estimated market value of investment properties is set out in the table below:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Market value of investment property	15.1	16.6	15.1	16.3

The estimated market value of the investment properties has been determined by an appropriately qualified internal valuer, supported by external valuations where appropriate, in accordance with RICS Appraisal and Valuation Standards and is an indication of fair value. This fair value measurement is categorised as a Level 3 fair value measurement, as described in note 37b).

For the majority of the Group's investment properties, fair value is estimated using the market valuation approach which uses prices and other relevant information generated by market transactions involving comparable properties. Where comparable transactions may not be available, the Group may also consider a discounted cash flow technique which considers the present value of the net cash flows to be generated from the property, taking into account expected rental growth, void periods and rent-free periods. The expected net cash flows are discounted using risk-adjusted discount rates.

The Directors have assessed the carrying value of the investment properties compared to their fair value and have concluded that impairment of £1.9m should be recognised during the year (2017: £nil).

20. Intangible assets

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Goodwill	137.3	139.7	-	-
Other intangible assets	24.1	24.7	2.5	2.6
	161.4	164.4	2.5	2.6

Goodwill	Group 2018 £m	Group 2017 £m
Cost, less amortisation to 1 January 2004*		
At 1 January	147.3	146.5
Acquisitions of subsidiary undertakings and business units	0.1	0.8
At 31 December	147.4	147.3
Impairment losses		
At 1 January	7.6	7.6
Impairment loss during the year	2.5	-
At 31 December	10.1	7.6
Net book value at 1 January	139.7	138.9
Net book value at 31 December	137.3	139.7

* Prior to the transition to IFRS on 1 January 2005 goodwill was held at cost less accumulated amortisation in line with UK GAAP. Goodwill arising on acquisitions before the transition to IFRS on 1 January 2005 has been retained at its previous UK GAAP amount, as described in note 1d).

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating unit (operating segment) that is expected to benefit from that business combination. The carrying value of goodwill has been allocated as follows:

Operating segment	Group 2018			Group 2017		
	Cost of goodwill £m	Accumulated impairment £m	Carrying value £m	Cost of goodwill £m	Accumulated impairment £m	Carrying value £m
Mortgages and Savings	2.9	0.1	2.8	2.9	0.1	2.8
Estate Agency	135.7	4.7	131.0	135.6	2.2	133.4
Investment Portfolio	8.8	5.3	3.5	8.8	5.3	3.5
Total goodwill	147.4	10.1	137.3	147.3	7.6	139.7

Based upon the Directors' assessment of recoverable amounts, the Directors have concluded that impairment of £2.5m is required to be recognised in respect of goodwill within the Estate Agency division in 2018 (2017: £nil).

The recoverable amounts of the operating segments are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding cash flows, discount rates and growth rates.

The cash flows are derived from the most recent corporate plans for the next five years, which take into account the risks inherent in each of the businesses. The cash flows are extrapolated for subsequent years (up to an additional 10 years, to reflect that the subsidiary undertakings are held for long term investment, or a specific number of years where circumstances dictate) based on a long term growth rate of 2.5% (2017: 2.5%) or specific growth rates where circumstances dictate.

The cash flows from the corporate plans are based upon the following key drivers:

Operating segment	Key drivers
Mortgages and Savings	Volume of new business, recurring income and FTSE levels
Estate Agency	Volume of UK property transactions, house price inflation, level of unemployment and interest rates
Investment Portfolio	Volume of new business, level of unemployment and interest rates

The Group estimates discount rates based upon the weighted average cost of capital which is adjusted to take account of the market risks associated with each cash generating unit.

The pre-tax discount rates are as follows:

Operating segment	Group 2018 %	Group 2017 %
Mortgages and Savings	14	11
Estate Agency	11	11
Investment Portfolio	11	11

Other intangible assets	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Cost				
At 1 January	86.5	86.9	18.9	17.9
Acquisition of subsidiary undertakings	-	0.5	-	-
Acquisition of other business assets	0.7	0.8	-	-
Additions	4.9	6.0	0.8	1.0
Foreign exchange movements on translation	-	(1.4)	-	-
Disposals	(0.1)	(0.2)	-	-
Disposal of subsidiary undertakings	-	(6.1)	-	-
At 31 December	92.0	86.5	19.7	18.9
Amortisation and impairment				
At 1 January	61.8	61.0	16.3	15.3
Charge for the year	6.2	6.7	0.9	1.0
Foreign exchange movements on translation	-	(1.4)	-	-
Disposals	(0.1)	(0.1)	-	-
Disposal of subsidiary undertakings	-	(4.4)	-	-
At 31 December	67.9	61.8	17.2	16.3
Net book value at 1 January	24.7	25.9	2.6	2.6
Net book value at 31 December	24.1	24.7	2.5	2.6

The net book value of other intangible assets comprises:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Brands	6.5	6.5	-	-
Customer contracts and relationships	6.5	7.6	-	-
Computer software and databases	11.1	10.6	2.5	2.6
	24.1	24.7	2.5	2.6

21. Other assets

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Trade receivables	31.3	30.8	1.8	1.1
Prepayments	17.6	16.9	11.8	10.9
Accrued income	6.4	5.7	-	-
Undrawn advances to debt factoring clients (note 1)	-	39.7	-	-
Contingent consideration	23.0	25.1	-	-
Other	6.6	4.6	1.4	1.1
	84.9	122.8	15.0	13.1

Note

1. In prior periods, undrawn advances to debt factoring clients were included within other assets and a corresponding liability was included within other liabilities (see note 26). With effect from 1 January 2018, these balances are presented on a net basis.

Further details regarding trade receivables are included in Note 36c).

22. Shares

	Group and Society 2018 £m	Group and Society 2017 £m
Held by individuals	15,986.4	14,840.1
Other shares	142.1	134.2
Fair value adjustment for hedged risk	(15.0)	11.5
	16,113.5	14,985.8

A maturity analysis of shares is included in note 34.

23. Amounts owed to credit institutions

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Amounts owed to subsidiary undertakings	-	-	122.1	97.2
Other	1,878.0	1,483.2	1,877.8	1,482.9
	1,878.0	1,483.2	1,999.9	1,580.1

A maturity analysis of amounts owed to credit institutions is included in note 34.

24. Amounts owed to other customers

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Amounts owed to subsidiary undertakings	-	-	438.2	570.7
Other	1,691.3	1,805.7	91.0	354.0
Fair value adjustment for hedged risk	(0.9)	(0.6)	-	-
	1,690.4	1,805.1	529.2	924.7

A maturity analysis of amounts owed to other customers is included in note 34.

Amounts owed to other customers by the Group relate primarily to retail deposits accepted through the Group's Channel Islands based subsidiary, Skipton International Limited. At 31 December 2018 the amount of such deposits included above, net of fair value adjustment for hedged risk, is £1,524.3m (2017: £1,387.6m).

Amounts owed to subsidiary undertakings by the Society include £324.9m in respect of deemed loans from Darrowby No. 3 plc (£129.8m) and Darrowby No. 4 plc (£195.1m) which have been designated as at FVTPL, in line with the accounting policy outlined in note 1f). During the year, and cumulatively to the reporting date, there has been no change in the fair value of these liabilities that is attributable to changes in the Society's own credit risk; the Group has determined this on the grounds that the credit risk within these deemed loans is very low as only customer receipts are owed under the terms of the loans.

The difference between the amount the Society would be contractually obliged to pay at maturity in order to discharge these liabilities and the carrying value as at 31 December 2018 is £0.8m (2017: £0.6m). There have been no transfers of the cumulative gain or loss within equity during the year (2017: none).

25. Debt securities in issue

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Certificates of deposit	4.0	15.7	4.0	15.7
Senior unsecured debt	348.8	348.5	348.8	348.5
Covered bonds	846.3	-	846.3	-
Securitisation	219.6	306.4	-	-
Fair value adjustment for hedged risk	1.6	(4.2)	(4.7)	(4.2)
	1,420.3	666.4	1,194.4	360.0

A maturity analysis of debt securities in issue is included in note 34.

In April 2018 the Society issued a Sterling covered bond transaction, raising £400m of funding over a five year term. In October 2018 the Society issued a Euro denominated covered bond transaction, which raised €500m of five year funding. The amounts outstanding at 31 December 2018 are included in 'Covered bonds' above.

Group debt securities in issue include £1,065.9m (2017: £306.4m) of funding secured on certain loans and advances to customers through the Group's securitisation vehicles Darrowby No. 3 plc, Darrowby No. 4 plc and the special purpose vehicle Skipton Covered Bonds LLP.

26. Other liabilities

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Trade payables	5.4	4.4	1.8	1.5
Fair value of put option obligation	8.3	9.9	-	-
Fair value of liability of subsidiary management incentive scheme	10.6	24.6	-	-
Debt factoring liabilities (note 1)	-	39.7	-	-
VAT and employment taxes	15.2	16.3	2.0	2.1
Other	17.4	15.5	6.7	4.2
	56.9	110.4	10.5	7.8

Note

1. In prior periods, undrawn advances to debt factoring clients were included within other assets (see note 21) and a corresponding liability was included within other liabilities. With effect from 1 January 2018, these balances are presented on a net basis.

Put option obligation

The movement in the fair value of the put option obligation is summarised below:

	Group 2018 £m	Group 2017 £m
At 1 January	9.9	11.7
Unwind of the discount factor	0.2	0.3
Exercise of put options by non-controlling shareholders	(0.3)	-
Revaluation of market values and changes to future exercise dates	(1.5)	(2.1)
At 31 December	8.3	9.9

Financial Statements

26. Other liabilities *(continued)*

Subsidiary management incentive scheme

Six members of Connells Limited senior management purchased equity shares in that company in 2012 and 2014. At the same time, the Group issued options to these shareholders to require SGHL to purchase their shareholdings in Connells Limited at some future dates. Four of the six options remain outstanding at the 2018 year end (2017: four of six), with the maximum option length being four years from 31 December 2018. In accordance with IFRS 2 Share-based Payment, this is a cash-settled scheme in the Group Accounts, with the fair value of the liability being spread over the period to exercise. The fair value of the liability is subsequently remeasured at each reporting date with any changes in fair value recognised in the Income Statement.

The movement in the fair value of the liability of the subsidiary management incentive scheme is summarised below:

	Group 2018 £m	Group 2017 £m
At 1 January	24.6	21.4
Exercise of share options during the year	(9.8)	(6.5)
Movement in fair value of the liability recognised in the Income Statement	(4.2)	9.7
At 31 December	10.6	24.6

27. Provisions for liabilities

The movements in provisions for liabilities during the year were as follows:

Group 2018	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks £m	Survey and valuation claims £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	3.7	1.2	8.2	4.2	8.5	0.3	26.1
Charge / (credit) for the year	0.2	(0.6)	12.7	-	(0.3)	-	12.0
Utilised during the year	(0.2)	(0.6)	(10.2)	(0.5)	(2.3)	-	(13.8)
At 31 December	3.7	-	10.7	3.7	5.9	0.3	24.3

Group 2017	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks £m	Survey and valuation claims £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	4.3	2.3	5.4	6.7	4.2	0.4	23.3
(Credit) / charge for the year	(0.3)	1.2	11.5	(1.7)	5.7	(0.1)	16.3
Utilised during the year	(0.3)	(2.3)	(8.7)	(0.8)	(1.4)	-	(13.5)
At 31 December	3.7	1.2	8.2	4.2	8.5	0.3	26.1

Society 2018	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	0.4	1.2	0.6	4.7	0.2	7.1
(Credit) / charge for the year	-	(0.6)	(0.1)	0.3	-	(0.4)
Utilised during the year	(0.1)	(0.6)	(0.1)	(1.5)	-	(2.3)
At 31 December	0.3	-	0.4	3.5	0.2	4.4

Society 2017	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	0.5	2.3	0.5	3.6	0.2	7.1
Charge for the year	-	1.2	0.1	2.4	-	3.7
Utilised during the year	(0.1)	(2.3)	-	(1.3)	-	(3.7)
At 31 December	0.4	1.2	0.6	4.7	0.2	7.1

Provision for the costs of surplus properties

The provision for the costs of surplus properties is expected to reverse over the remaining life of the leases or period to anticipated date of disposal, if sooner.

Financial Services Compensation Scheme

The Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. The Society's provision does not include capital levies which may arise from future claims made under the scheme.

Commission clawbacks

The commission clawback provision represents an estimate of the repayment of commission to suppliers as a result of cancelled policies sold by the Estate Agency division and the financial advice activities of the Group. These are estimated based upon anticipated cancellation rates.

Survey and valuation claims

Provision is made for professional indemnity claims and potential claims that arise during the normal course of business in relation to surveys and valuations carried out by the Connells group. The provision is based upon the expected level of future professional indemnity claims relating to services already provided and the value provided on each claim is the lower of the professional indemnity insurance excess per claim or the estimated exposure. To assess the level of future claims, analysis is performed on the number of preliminary notifications expected to turn into future claims and on historical claim trends to forecast the number of future claims where a notification is yet to be received. Historical data on claims success frequency and value is also used to estimate the size of the liability.

The professional indemnity claim provision is stated at the Directors' best estimate of the eventual liability, based on the information available at the time. Whilst the level of future claims is uncertain, the Group has robust processes in place that aim to restrict the number and magnitude of these.

Due to the nature of the professional indemnity claims it is difficult to indicate approximate payment timescales or claims received in future years. The provision will be utilised as individual claims are settled.

Customer compensation

The customer compensation provision includes provisions for potential claims on payment protection insurance (PPI) of £2.4m (2017: £3.3m). This includes provisions made, mainly in 2016, following rules and guidance issued in 2016 and 2017 by the FCA following the Supreme Court's decision in the case of *Plevin v Paragon Personal Finance Limited*.

The Group has continued to experience an increase in PPI complaint levels during the year following the introduction of a deadline, by the FCA, for making PPI complaints (the deadline is 29 August 2019). A number of cases are referred to the Financial Ombudsman Service (FOS), each incurring a £550 fee. These provisions are expected to be utilised within the next twelve to eighteen months.

In addition the customer compensation provision includes £3.1m (2017: £3.8m) for potential future redress payable following an evaluation during 2017 of some historical terms and conditions of a small number of mortgages, mainly within our specialist mortgage lenders Amber and NYM, which have been closed to new business since 2008.

28. Deferred tax

Deferred tax is calculated on temporary differences under the statement of financial position asset and liability method, using the enacted tax rate expected to apply in the relevant tax jurisdiction when these differences reverse, which is 25% (2017: 25%) for the Society and 17% (2017: 17%) for most other Group companies.

The movement in deferred tax during the year was as follows:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
At 1 January prior to impact of IFRS 9 adoption	23.0	18.2	13.1	10.7
Impact of IFRS 9 adoption	12.9	-	13.3	-
At 1 January including impact of IFRS 9 adoption	35.9	18.2	26.4	10.7
Income Statement (charge) / credit (note 9)	(0.6)	-	(1.5)	1.8
Items taken directly to other comprehensive income	1.0	5.0	1.1	0.6
Acquired on acquisition of subsidiaries	(0.1)	(0.2)	-	-
Transfer of engagements	(0.1)	-	(0.1)	-
At 31 December	36.1	23.0	25.9	13.1

The adoption of IFRS 9 resulted in an adjustment to the deferred tax asset in the Group of £12.9m and in the Society of £13.3m, which will be released to the Income Statement over a 10 year period as permitted by the standard.

Deferred tax assets and liabilities are attributable to the following items:

Deferred tax assets	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Fixed asset temporary differences	0.7	1.2	0.1	0.3
Pension obligations	21.1	21.0	13.0	12.8
Provisions	2.4	2.2	0.9	0.8
Corporation tax losses	0.1	0.1	-	-
Derivatives and loans	11.8	-	12.3	-
Other	5.5	5.9	-	-
	41.6	30.4	26.3	13.9

Deferred tax liabilities	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Fixed asset temporary differences	0.7	1.5	-	-
Derivatives and loans	0.2	0.3	0.1	-
Available-for-sale financial assets	-	0.8	-	0.8
Financial assets held at FVOCI	0.3	-	0.3	-
Contingent consideration	3.3	3.6	-	-
Other	1.0	1.2	-	-
	5.5	7.4	0.4	0.8
Net deferred tax asset	36.1	23.0	25.9	13.1

The deferred tax charge / (credit) in the Income Statement comprises the following:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Fixed asset temporary differences	(0.4)	(0.7)	0.2	(0.3)
Provisions	(0.2)	(0.7)	(0.1)	(0.6)
Contingent consideration	(0.3)	2.6	-	-
Other	1.5	(1.2)	1.4	(0.9)
	0.6	-	1.5	(1.8)

Unrecognised deferred tax relating to trading losses carried forward at 31 December 2018 amounts to £3.4m (2017: £4.7m) for the Group and £nil for the Society (2017: £nil).

The majority of deferred tax assets are anticipated to be recoverable after one year. The Group's plans indicate that the Group and Society will generate sufficient taxable profits over its five year planning period to absorb the corporation tax losses included within deferred tax at the reporting date, together with those other temporary differences that are expected to reverse during that period.

29. Pensions

Defined contribution schemes

The amount charged to the Income Statement in respect of contributions to the Group's defined contribution and stakeholder pension arrangements is the contribution payable in the year. The total pension cost charged to the Income Statement amounted to £10.0m for the Group (2017: £8.3m) and £5.2m for the Society (2017: £5.0m).

Defined benefit schemes

The Group sponsors two funded defined benefit arrangements and one hybrid arrangement (with a funded defined benefit element). Skipton Pension Trustees Limited, a company that acts as the sole Trustee of each scheme, has been appointed to manage all three schemes:

- The Skipton (2015) Group Pension Scheme (the 'Skipton (2015) Scheme').
- The Connells (2014) Group Pension Scheme (the 'Connells (2014) Scheme').
- The Holmesdale Building Society Pension Scheme (the 'Holmesdale Scheme').

These are separate trustee administered funds holding the pension scheme assets to meet long term liabilities for current and past employees as follows:

- Skipton (2015) Scheme – 747 members
- Connells (2014) Scheme – 1,009 members
- Holmesdale Scheme – 7 members

The level of retirement benefit in each scheme is principally based on salary and is linked to changes in inflation up to retirement. For all three schemes the level of retirement benefit is based on salary earned in each year of employment prior to leaving active service as follows:

- Skipton (2015) Scheme. There are two separate benefits sections within the scheme, as a result of the merger of the two former pension schemes into the Skipton (2015) Scheme, where members' benefits in the former pension schemes were preserved. The benefits are as follows:
  - Old Skipton Scheme - the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service or, for members previously employed by Skipton Financial Services, the annual average salary earned in the last five years of employment prior to leaving active service;
  - Scarborough Scheme - the highest (prior to 2003) or the average (post 2003) annual salary earned in the last three years of employment prior to leaving active service.

Financial Statements

29. Pensions *(continued)*

- Connells (2014) Scheme. There are three separate benefit sections within the scheme, as the Connells (2014) Scheme is a result of three previous schemes merged into one scheme in 2014. The benefits are as follows:
  - Scheme 1 - the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service;
  - Scheme 2 - the annual average salary earned in the last three years of employment prior to leaving active service;
  - Scheme 3 - the greater of the annual average salary earned in the last three years and the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service.
- Holmesdale Scheme - the highest pensionable salary in the last five years immediately preceding 5 April 2004, or if earlier the highest pensionable salary in the last five years immediately preceding normal retirement date or the last date of employment prior to leaving active service.

The schemes are all closed to new members and to the future accrual of benefits, with the exception of the Scarborough section of the Skipton (2015) Scheme where active members retain a link to salary (capped at 5% per annum). The Scarborough Scheme closed to the future accrual of benefits, subject to the exception noted above, on 1 May 2007, the Connells (2014) Scheme on 1 January 2009, the Skipton (2015) Scheme on 31 December 2009 and the Holmesdale Scheme on 31 March 2004. Following the closure of all the schemes, all active members left pensionable service and became entitled to deferred benefits.

The schemes are subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator and guidance notes adopted by the Financial Reporting Council, sets out the framework for funding defined benefit occupational pension schemes in the UK.

The Trustee of each scheme is required to act in the best interests of the scheme's beneficiaries. The appointment of the Trustee is determined by the scheme's trust documentation.

Full actuarial valuations were carried out as at the dates set out below in accordance with the scheme funding requirements of the Pensions Act 2004 and the funding of each scheme is agreed between the Group and the Trustee in line with those requirements. This legislation requires the deficit to be calculated using prudent, as opposed to best estimate, actuarial assumptions. The most recent actuarial valuations for each of the schemes showed the following:

Scheme	Valuation date	Deficit £m	Recovery period	Annual contribution £m
Skipton (2015)	31 December 2016	43.6	7 years	4.5
Connells (2014)	30 April 2017	44.9	7 years	2.8
Holmesdale	31 December 2017	0.2	5 years	0.0

The actuarial valuations of each scheme showed deficits and the Group has agreed with the Trustees that it will aim to eliminate the deficit over a specified period by the payment of annual contributions as agreed by the Group and the Trustees. The current best estimate of contributions to be paid by the Group to the schemes for the year commencing 1 January 2019 is £14.6m, which includes an expected lump sum payment of £7.2m, for further details of which see page 171.

The pension obligations are valued separately for accounting and funding purposes. For the purposes of IAS 19 *Employee Benefits*, the actuarial valuations, which were carried out by a qualified independent actuary, have been updated on an approximate basis to 31 December 2018. The actuarial valuation deficits shown in the table above will always be different to the IAS 19 accounting deficit of £99.5m (2017: £100.2m) as, in addition to the different dates of each valuation, accounting standards require best estimate assumptions to be used whereas the funding valuation uses more prudent assumptions. There have been no changes in the valuation methodology adopted for this year's disclosures compared to the previous year's disclosures.

Scheme expenses and levies to the Pension Protection Fund are payable by the Group as and when they are due and are accounted for within the Group's administrative expenses.

The aggregate costs of the three schemes are recognised in accordance with IAS 19.

The main financial assumptions used in the actuarial valuation are as follows:

	Group and Society 2018 %	2017 %
Retail price inflation (RPI)	3.25	3.25
Consumer price inflation (CPI)	2.25	2.25
Discount rate	2.85	2.55
Increases to pension payment:		
in line with RPI, subject to a max of 5% pa	3.17	3.17
in line with RPI, subject to a min of 3% and max of 5% pa	3.63	3.63
in line with RPI, subject to a max of 2.5% pa	2.23	2.23
in line with CPI, subject to a max of 5% pa	2.27	2.27
in line with CPI, subject to a min of 3% and max of 5% pa	3.26	3.26
in line with CPI, subject to a max of 2.5% pa	1.83	1.83
Rate of increase for deferred pensions (in line with CPI, subject to a max of 5% pa)	2.25	2.25
Allowance for commutation of pension for cash at retirement	82% of post A day maximum	100% of post A day maximum

All the schemes' deferred pensions accrue inflationary increases based on CPI rather than RPI, unless the scheme rules specifically refer to RPI.

The most significant non-financial assumption is the assumed rate of longevity. For the year ended 31 December 2018, this has been based on mortality rates that are 100% of the S2PMA_L or S2PFA_L tables for males and females respectively, with an allowance for projected improvements in mortality in line with CMI 2017 improvements with a 1% per annum long term rate of convergence. The tables adopted imply the following life expectancy:

	Life expectancy at age 65 (years) 2018	2017
Male retiring in the current year	22.9	23.0
Female retiring in the current year	23.9	24.0
Male retiring in 15 years' time	23.9	23.8
Female retiring in 15 years' time	25.1	24.9

The table below shows the net pension liability recognised within the Statement of Financial Position:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Fair value of plan assets	149.0	165.3	80.0	91.0
Present value of defined benefit obligations	(248.4)	(265.5)	(132.1)	(142.7)
Impact of asset ceiling	(0.1)	-	(0.1)	-
Net pension liability	(99.5)	(100.2)	(52.2)	(51.7)

The present value of scheme liabilities is measured by discounting the best estimate of future cash flows to be paid out by the schemes using the projected unit credit method. The value calculated in this way is reflected in the net liability within the Statement of Financial Position as shown above.

The projected unit credit method is a valuation method in which each potential cash flow from the schemes (for example, annual pension payment or potential lump sum payment on death) is multiplied by an assumed probability of payment and discounted between the valuation date and the time the payment is needed.

All remeasurements are recognised in the year in which they occur in the Statement of Comprehensive Income. As all remeasurements and assets are recognised, the deficits shown above are those recognised within the Statement of Financial Position.

29. Pensions *(continued)*

IAS 19 allows an employer to recognise a surplus as an asset to the extent that it is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme, even if the refunds may only be available at some distant time in the future, such as after the last benefit has been paid. The Holmesdale scheme is in surplus, therefore the amount recognised in the Statement of Financial Position is limited to the asset ceiling. The asset ceiling is the present value of any economic benefits available to the entity in the form of a refund or a reduction in future contributions.

In respect of the Skipton and Connells schemes, the Group has reviewed the guidance provided by IFRIC 14 and has concluded that it is not necessary to make any adjustments to the IAS 19 figures in respect of an asset ceiling or minimum funding requirement as at 31 December 2018. As these schemes are in deficit, the asset ceiling has no impact and therefore no reconciliation is required.

The table below sets out a reconciliation of the present value of the defined benefit obligation for the year:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
At 1 January	265.5	279.8	142.7	147.8
Interest expense	6.6	7.2	3.6	3.8
Remeasurement losses / (gains) arising from changes in:				
Scheme experience	0.4	(4.8)	(0.2)	(0.1)
Demographic assumptions	(1.8)	(3.1)	(1.2)	(1.7)
Financial assumptions	(13.6)	2.7	(7.2)	1.7
Actual benefit payments	(12.5)	(16.3)	(7.7)	(8.8)
Past service costs	3.0	-	1.3	-
Liabilities assumed on merger	0.8	-	0.8	-
At 31 December	248.4	265.5	132.1	142.7

The English High Court ruling in *Lloyds Banking Group Pension Trustees Limited v Lloyds Bank plc and others* was published on 26 October 2018, and held that UK pension schemes with Guaranteed Minimum Pensions (GMPs) accrued from 17 May 1990 must equalise for the different effects of these GMPs between men and women. The case also gave some guidance on related matters, including the various methods which are available to achieve equalisation.

The estimated impact on the Group's pension obligation as at 31 December 2018 has been calculated by the Group and this has been determined using method "C2" which, as part of the above ruling, was determined by the court to be lawful in principle and meet the minimum requirements to achieve equality. The Trustees have subsequently determined that method C2 will be adopted by the Group and there will be an associated impact on the Group's past and future benefit payments.

The impact has been estimated as £3.0m for the Group and £1.3m for the Society, and this is included in 'Past service costs' in the table above. The estimated impact has been accounted for as a plan amendment, the effect of which impacts the Income Statement and these amounts are included within 'Administrative expenses'.

There have been no settlements, plan amendments or curtailments in the year.

The estimated average duration of the defined benefit obligation as at 31 December 2018 is 18 years (2017: 18 years).

The table below sets out the reconciliation of the fair value of scheme assets for the year:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
At 1 January	165.3	168.9	91.0	94.0
Interest income	4.2	4.4	2.3	2.4
Return on plan assets (excluding amounts included in interest income)	(18.0)	5.0	(9.9)	2.8
Contributions by employer	9.2	3.3	3.5	0.6
Benefits paid	(12.5)	(16.3)	(7.7)	(8.8)
Assets acquired on merger	0.8	-	0.8	-
At 31 December	149.0	165.3	80.0	91.0

The actual return on the scheme assets, including interest income on plan assets, over the year ended 31 December 2018 was as follows:

- Group £(13.8)m (2017: £9.4m)
- Society £(7.6)m (2017: £5.2m)

The table below sets out the fair value of the scheme assets by each major category:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Diversified growth fund (note 1)	96.6	139.3	55.4	76.8
Liability driven instruments (note 2)	28.4	25.3	15.8	13.9
Equities	22.8	-	8.3	-
Cash	1.0	0.7	0.3	0.3
Corporate bonds	0.2	-	0.2	-
	149.0	165.3	80.0	91.0

Notes
1. Diversified growth funds (DGF) target equity-like returns with lower volatility which is achieved through dynamic diversification. Funds are invested in a diversified range of assets, including equities, bonds, property and cash and the allocation between these asset classes is actively managed by a fund manager reflecting the changing correlations and risk characteristics.
2. Liability driven investments (LDI) are investments in assets which are expected to behave in a similar manner to liabilities and therefore aim to provide a better match against liability movements than conventional bonds or gilts.

Each of the schemes invests in an LDI fund which aims to provide protection against interest rate and inflation movements. The LDI funds aim to cover 50% of the interest rate sensitivity and 100% of the inflation sensitivity of the funded liabilities of each scheme on the scheme funding basis.

None of the fair values of the assets shown above include any of the Group's own financial instruments or any property occupied by, or other assets used by, the Group. All of the schemes' assets have a quoted market price with the exception of the Trustee's bank account balance.

It is the policy of the Trustee and the Group to review the investment strategy at the time of each funding valuation. The Trustee's investment objectives and the processes undertaken to measure and manage the risks inherent in the scheme investment strategy are documented in the scheme's Statement of Investment Principles.

The schemes are exposed to the following investment risks:

Credit risk: this is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Market risk: this comprises currency risk, interest rate risk and other price risk.

- Currency risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates.
- Interest rate risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market interest rates.
- Other price risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The main investment objective for the Trustee of the scheme is to maintain a portfolio of suitable assets to meet, together with future contributions, the benefits payable under the Trust Deed and Rules as they fall due. The scheme has exposure to investment risks because of the investments it makes to implement its investment strategy, as detailed in the Statement of Investment Principles.

The Trustee manages investment risks, including credit risk and market risk, within agreed risk limits which are set taking into account the scheme's strategic investment objectives. These investment objectives and risk limits are implemented through the investment management agreements in place with the scheme's investment managers and are monitored by the Trustee by regular reviews of the investment portfolios.

29. Pensions (continued)

Credit risk

The schemes invest in pooled investment vehicles and are therefore directly exposed to credit risk in relation to the pooled investment vehicles and are indirectly exposed to credit risks arising on the financial instruments held by the vehicles.

The schemes' holdings in pooled investment vehicles are unrated. Direct credit risk arising from pooled investment vehicles is mitigated by the underlying assets of the pooled arrangements being ring-fenced from the pooled manager, the regulatory environments in which the pooled managers operate and diversification of investments amongst a number of pooled arrangements. The investment manager carries out its own due diligence checks before a new pooled fund is invested in, and on an ongoing basis monitors any changes to the regulatory and operating environment of the underlying pooled investment managers.

Indirect credit risk arises in relation to underlying investments held in the LDI pooled investment vehicles, as well as DGF pooled investment vehicles due to the bond holdings within these funds.

The LDI funds use robust collateralisation management procedures so as to mitigate the impact of credit risk.

Market risk

Currency risk

The schemes do not take explicit unhedged positions in overseas investments through their investment strategy, either directly or indirectly via pooled investment vehicles.

The DGF managers' default position is that any investment in overseas assets is hedged back to Sterling in order to reduce currency risk. The DGF managers may from time to time take unhedged overseas investment positions in pursuit of growth opportunities or to reduce overall fund risk. Overall however, their neutral position is considered to be 100% Sterling.

Interest rate risk

The schemes' assets are subject to indirect interest rate risk through their LDI pooled investment vehicles, as well as DGF pooled investment vehicles due to the bond holdings within these funds.

The schemes' liabilities are exposed to a significant level of interest rate movement and for this reason it is desirable for the assets to also be exposed to interest rate risk. The schemes manage interest rate risk by considering the net risk when taking account of the liabilities valued.

Other price risk

Other price risk arises principally in relation to the schemes' return seeking portfolio which includes DGFs held in pooled investment vehicles, as well as the LDI pooled investment vehicles due to the inflation sensitive elements of the fund. The scheme manages this exposure to other price risk by constructing a diverse portfolio of investments across various markets.

The table below sets out the amounts which have been recognised within the Income Statement. The service costs are recognised in 'Administrative expenses', whilst the net interest expense is recognised in 'Other income'.

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Service cost				
Past service costs and loss	3.0	-	1.3	-
Net interest expense	2.4	2.8	1.3	1.4
Total recognised in Income Statement	5.4	2.8	2.6	1.4

The table below sets out the remeasurements of retirement benefit obligations which have been recognised within the Statement of Comprehensive Income:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Remeasurements of retirement benefit obligations:				
Actuarial (losses) / gains arising from:				
Experience adjustments	(0.4)	4.8	0.2	0.1
Demographic assumptions	1.8	3.1	1.2	1.7
Financial assumptions	13.6	(2.7)	7.2	(1.7)
Impact of asset ceiling	(0.1)	-	(0.1)	-
Return on plan assets (excluding amounts included in net interest cost)	(18.0)	5.0	(9.9)	2.8
Total amount recognised in Other Comprehensive Income	(3.1)	10.2	(1.4)	2.9

The table below sets out the Group's estimate of the aggregate contributions expected to be paid to the schemes during the year ending 31 December 2019, based on the most recent actuarial valuations.

	Group 2019 £m	Society 2019 £m
Estimated employer contributions		
Ongoing	7.4	4.5
Lump sum contribution	7.2	-
Estimated employee contributions	-	-
Estimated total contributions	14.6	4.5

In line with UK pensions legislation, a formal actuarial valuation ('triennial valuation') of the assets and liabilities of the Schemes is carried out at least every three years by an independent actuary. The results of the most recent triennial valuations are set out on page 166. On completion of the actuarial valuations, a new schedule of deficit contributions payable by the Group was agreed with the Trustees, and the Group agreed to pay £10.0m in lump sums into the Connells Scheme (£2.8m during 2018 and £7.2m during 2019) and increase its ongoing deficit contributions to £2.9m per annum into that scheme and to £4.5m into the Society schemes.

30. Subscribed capital

	Group and Society 2018 £m	2017 £m
8.500% Sterling Permanent Interest Bearing Shares	15.3	15.3
12.875% Sterling Permanent Interest Bearing Shares	26.3	26.3
	41.6	41.6

All Permanent Interest Bearing Shares are unsecured and rank pari passu with each other. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated note holders, depositors, payables and investing members of the Society. These shares are measured at amortised cost.

30. Subscribed capital *(continued)*

The table below shows the movement during the year in the Group and Society's financing activity liabilities, namely subscribed capital.

	Group and Society 2018 £m	2017 £m
Balance at 1 January	41.6	92.6
Changes from financing cash flow:		
Repayment	-	(50.0)
Interest paid	(4.5)	(6.3)
Total changes from financing cash flow	(4.5)	(56.3)
Changes in fair value	-	(0.7)
Liability-related changes:		
Interest expense	4.5	5.6
Total liability-related changes	4.5	5.6
Other changes:		
Unwind of merger fair value adjustments	-	0.4
Total other changes	-	0.4
Balance at 31 December	41.6	41.6

31. Tax effects relating to each component of other comprehensive income

Group

	2018 Before-tax amount £m	2018 Tax benefit £m	2018 Net-of-tax amount £m	2017 Before-tax amount £m	2017 Tax benefit / (expense) £m	2017 Net-of-tax amount £m
Financial assets held at FVOCI	(2.2)	0.6	(1.6)	-	-	-
Available-for-sale financial assets	-	-	-	(34.9)	6.0	(28.9)
Cash flow hedges	(0.3)	-	(0.3)	(4.3)	1.1	(3.2)
Cost of hedging reserve	(0.5)	-	(0.5)	-	-	-
Remeasurements of defined benefit obligations	(3.1)	1.0	(2.1)	10.2	(1.9)	8.3
Translation of foreign operations	-	-	-	(0.4)	-	(0.4)
Other comprehensive income	(6.1)	1.6	(4.5)	(29.4)	5.2	(24.2)

Society

	2018 Before-tax amount £m	2018 Tax benefit £m	2018 Net-of-tax amount £m	2017 Before-tax amount £m	2017 Tax benefit / (expense) £m	2017 Net-of-tax amount £m
Financial assets held at FVOCI	(2.3)	0.5	(1.8)	-	-	-
Available-for-sale financial assets	-	-	-	(1.2)	0.3	(0.9)
Cash flow hedges	(1.0)	0.3	(0.7)	(4.3)	1.1	(3.2)
Remeasurements of defined benefit obligations	(1.4)	0.5	(0.9)	2.9	(0.7)	2.2
Other comprehensive income	(4.7)	1.3	(3.4)	(2.6)	0.7	(1.9)

32. Other financial commitments and contingent liabilities

a) The Society has confirmed it will provide continuing support to its subsidiary undertakings that have net liabilities or which rely on it for ongoing funding.

b) Total commitments under non-cancellable operating leases are as follows:

Group	2018 Land and buildings £m	2018 Other £m	2017 Land and buildings £m	2017 Other £m
Amounts falling due:				
Within one year	18.9	0.2	13.1	2.3
Within two to five years inclusive	31.5	0.1	33.5	0.5
Over five years	18.8	-	21.6	-
	69.2	0.3	68.2	2.8

Society	2018 Land and buildings £m	2018 Other £m	2017 Land and buildings £m	2017 Other £m
Amounts falling due:				
Within one year	3.5	0.1	3.6	0.3
Within two to five years inclusive	8.5	-	8.4	0.1
Over five years	4.2	-	4.4	-
	16.2	0.1	16.4	0.4

At 31 December 2018, the Group's commitments under non-cancellable operating leases for land and buildings includes £67.7m (2017: £65.6m) relating to properties occupied by the Group used in the ordinary course of business, £1.4m (2017: £1.7m) relating to properties occupied by sub-tenants and £0.1m (2017: £0.9m) relating to buildings that were unoccupied.

The total commitments for the Society relates to branches used in the ordinary course of business, or former branches, £0.1m of which relates to former branches that were unoccupied at 31 December 2018 (2017: £0.8m).

A provision is made in respect of unoccupied properties where the total commitment amount is not expected to be recovered through a sub-lease arrangement, which is included in 'Provision for the cost of surplus properties' in note 27.

33. Derivative financial instruments

The Group uses derivative financial instruments (derivatives) to manage the risks arising from its operations.

The Board has authorised the use of derivatives by the Group to reduce the risk of loss arising from changes in market risks in accordance with Section 9A (4) of the Building Societies Act 1986 and derivatives are used by the Group for economic hedging purposes only. The Group does not run a trading book.

The principal derivatives used by the Group are interest rate swaps, index swaps and cross currency swaps that are used to hedge Group Statement of Financial Position (SOFP) exposures. The accounting policies for derivatives are described in note 1e) to the Accounts.

For the purpose of assessing hedge effectiveness, the Group determines the economic relationship between the hedged item and the hedging instrument by comparing the terms of each item, including reference rate, notional amount and maturity.

Risk management strategy

The Group has a formal structure for managing risk, including established risk limits, reporting requirements, mandates and other control procedures. This structure is reviewed regularly by the Asset & Liability Committee (ALCO).

33. Derivative financial instruments *(continued)*

Interest rate risk

The main market risk faced by the Group is interest rate risk. Interest rate risk is the risk that the fair values of financial assets or financial liabilities, or future cash flows receivable or payable on financial assets or financial liabilities, fluctuate as a result of changes in market interest rates.

Interest rate risk predominantly arises on the fixed rate mortgages and savings products offered by the Group. Further detail on the Group's exposure to interest rate risk is found in note 35.

The Group uses the following derivatives to hedge its exposure to interest rate risk:

Fair value hedges of interest rate risk

Portfolio hedging

The Group manages the interest rate risk arising from fixed rate mortgages and savings by entering into swaps on a frequent basis. The level of exposure from the mortgage portfolio frequently changes due to new loans being originated, contractual customer repayments and early customer repayments. As a result the Group adopts a dynamic hedging strategy to hedge the exposure profile by entering into new swap agreements each month. The Group uses a portfolio of fair value hedges of interest rate risk to recognise fair value changes related to changes in interest rate risk on fixed rate mortgages and savings products, to therefore reduce the profit or loss volatility that would otherwise occur from changes in the fair value of the interest rate swaps alone.

The hedge relationship is reassessed prospectively each month in order that the ratio between the notional value of the hedged items and the notional value of the hedging instruments is recalibrated to be close to 100%.

Occasionally hedge ineffectiveness can arise, i.e. the derivative fails to hedge the interest rate risk to the extent that is expected. The Group assesses hedge ineffectiveness on an ongoing basis and where it assesses that the hedging instrument is ineffective the hedging relationship would be rebalanced.

The main sources of ineffectiveness in fair value hedges of interest rate risk are:

- Differences between the expected and actual volume of customer prepayments, as the Group hedges to the expected repayment date taking into account expected prepayments based on past experience;
- Differences in the timing of cash flows from monthly mortgage redemptions and cash flows from quarterly or annual interest payments or receipts on interest rate swaps; and
- Differences in the maturities of the interest rate swap and the mortgage loans.

Micro hedging

Additionally, fair value hedge relationships are designated for interest rate risk arising from the Group's liquidity portfolio and Medium Term Note (MTN) liabilities. For these items, a hedge is taken out specifically for the individual asset or liability, and therefore critical terms of the hedged item and hedging instrument match. Where critical terms match, the fair value adjustment on the hedged item offsets exactly the change in fair value of the hedging instrument.

Fair value gains or losses on derivatives held in qualifying fair value hedging relationships and the hedging gain or loss on the hedged item are included in the 'Fair value gains on hedging instruments and hedged items' line in the Income Statement.

The Group assesses all of its micro fair value hedges of interest rate risk to have a hedge effectiveness ratio of 100%, as all derivatives hedge an amount of underlying instrument equal to the notional amount.

Hedge ineffectiveness could potentially arise if amendments are made to either the hedged item or the hedging instrument, or if there are significant changes in the credit rating of the hedged item or hedging instrument's counterparties; the Group has assessed the likelihood of this to be low.

Cash flow hedges of interest rate risk

The Group also has exposure to interest rate risk arising from its free reserves portfolio, which is composed of reserves held in excess of required reserves. The Group uses derivatives to hedge this risk and accounts for these derivatives as cash flow hedges against variable rate liabilities. The aim of cash flow hedging is to reduce the exposure to variability in cash flows arising from a financial asset or liability. The variable rate on the hedging instrument, or swap, offsets the hedged items, which are LIBOR-linked financial assets or liabilities.

Hedge ineffectiveness for cash flow hedges is assessed using the 'hypothetical derivative' method and ineffectiveness has been assessed as £nil (2017: £nil) for the Group's cash flow hedges.

Hedge ineffectiveness could potentially arise if amendments are made to either the hedged item or the hedging instrument, or if there are significant changes in the credit rating of the hedged item or hedging instrument's counterparties; the Group has assessed the likelihood of this to be low.

Currency risk

The Group's exposure to foreign currency risk arises predominantly as a result of issuing Euro-denominated regulated covered bonds to the wholesale funding market.

Fair value hedges of currency risk

The Group has entered into a cross-currency swap agreement to hedge the foreign currency risk arising from the Society's Euro covered bond issuance. Fixed rate Euro-denominated receipts are swapped to floating rate Sterling payments through these derivatives. The derivative is entered into by the LLP, with the hedged item being the term advance from the Society to the LLP, which mirrors the bond issued by the Society. Foreign currency basis spread is priced into the derivative but is excluded from the hedging relationship as permitted by IFRS 9. Any gain or loss caused by this is recognised directly in reserves in the cost of hedging reserve.

Equity release portfolio

In addition to the above, the Group holds derivative financial instruments to economically hedge the equity release portfolio which do not qualify as being in a designated hedging relationship for accounting purposes. As the derivatives held to hedge the equity release portfolio are not in a hedge accounting relationship, they are not included in the tables below. Further information on the derivatives held to hedge this portfolio can be found on pages 109, 110 and 151.

Other derivatives not held in an accounting hedge

Certain other derivatives cannot be accounted for in a fair value or cash flow hedge as the economic hedging relationship does not meet the criteria set out by IFRS 9. These derivatives are held at FVTPL and their change in fair value is included in the 'Fair value gains on hedging instruments and hedged items' line in the Income Statement.

Hedging instruments

The following table sets out the maturity profile and average price and rate of the hedging instruments used in the Group's hedge accounting strategies:

Group	2018			
	Up to 3 months	3-12 months	1-5 years	Over 5 years
Cash flow hedges				
Interest rate swaps				
Notional amount (£m)	-	44.0	145.6	-
Average fixed interest rate (%)	-	2.1%	1.6%	-
Fair value hedges				
Interest rate swaps				
Notional amount (£m)	1,739.4	6,699.1	10,298.7	315.5
Average fixed interest rate (%)	0.7%	0.8%	0.9%	1.2%
Cross currency swaps				
Notional amount (£m)	-	-	448.1	-
Average fixed interest rate (%)	-	-	0.5%	-

Society	2018			
	Up to 3 months	3-12 months	1-5 years	Over 5 years
Cash flow hedges				
Interest rate swaps				
Notional amount (£m)	-	44.0	223.7	-
Average fixed interest rate (%)	-	2.1%	1.4%	-
Fair value hedges				
Interest rate swaps				
Notional amount (£m)	1,804.0	6,749.1	10,921.7	315.5
Average fixed interest rate (%)	0.7%	0.8%	0.9%	1.2%

33. Derivative financial instruments *(continued)*

The table below provides further detail on the Group's fair value hedges used in hedge accounting relationships:

		2018					
		Carrying amount			Change in fair value credit / (charge) (note 1)	Hedge ineffectiveness credit / (charge) (note 2)	Income Statement line
	Notional	Assets	Liabilities				
Group	£m	£m	£m	SOFP line	£m	£m	
Interest rate swaps	19,052.7	61.0	(57.4)	note 3	1.9	5.4	note 4
Cross currency swaps	448.1	5.9	-	note 3	6.4	-	note 4
Society							
Interest rate swaps	19,790.3	63.3	(58.9)	note 3	(1.8)	5.3	note 4

Notes
1. The change in fair value during the period that was used as the basis for calculating hedge ineffectiveness and which was recognised in the Income Statement during the period.
2. The amount of hedge ineffectiveness recognised in the Income Statement during the period.
3. The Statement of Financial Position line that includes these items is 'Derivative financial instruments'.
4. The Income Statement line that includes the hedge ineffectiveness recognised during the period is 'Fair value gains on hedging instruments and hedged items'.

The table below provides further detail on the Group's cash flow hedges used in hedge accounting relationships:

		2018							
		Carrying amount			Change in fair value (charge) / credit (note 1)	Change in fair value recognised in OCI (charge) / credit	Hedge ineffective-ness (note 2)	Income Statement line	Amount reclassified from OCI to Income Statement
	Notional	Assets	Liabilities	SOFP line					
Group	£m	£m	£m		£m	£m	£m		£m
Interest rate swaps	189.6	3.1	(0.3)	note 3	(2.5)	(2.5)	-	note 4	-
Society									
Interest rate swaps	267.7	3.1	(1.0)	note 3	(2.9)	(2.9)	-	note 4	-

Notes
1. The change in fair value during the period that was used as the basis for calculating hedge ineffectiveness.
2. The amount of hedge ineffectiveness recognised in the Income Statement during the period.
3. The Statement of Financial Position line that includes these items is 'Derivative financial instruments'.
4. The Income Statement line that would include any hedge ineffectiveness recognised during the period is 'Fair value gains on hedging instruments and hedged items'.

Hedged items

The tables below provide further detail on the Group's hedged items:

	2018					
	Carrying amount		Fair value adjustments on hedged item: positive / (negative)		Change in fair value (charge) / credit (note 1)	Amount remaining on items de-designated from hedge relationship (note 2)
	Assets	Liabilities				
Group	£m	£m	£m	SOFP line	£m	£m
Cash flow hedges						
Floating rate assets	189.6	-	n/a	note 3	n/a	0.6
Floating rate liabilities	-	-	n/a	note 4	n/a	1.0
Fair value hedges						
Fixed rate mortgages	11,240.0	-	(7.3)	note 5	(10.0)	-
Debt securities	417.6	-	3.1	note 3	(2.0)	-
Fixed rate savings	-	6,426.5	(16.3)	note 6	24.3	-
Covered bonds	-	454.7	6.3	note 4	(6.3)	-
Debt securities in issue	-	345.2	(4.7)	note 4	0.5	-
Society						
Cash flow hedges						
Floating rate assets	267.7	-	n/a	note 3	n/a	0.6
Floating rate liabilities	-	-	n/a	note 4	n/a	1.0
Fair value hedges						
Fixed rate mortgages	11,384.1	-	(7.5)	note 5	(11.0)	-
Debt securities	417.6	-	3.1	note 3	(2.0)	-
Fixed rate savings	-	7,020.0	(16.0)	note 6	25.6	-
Debt securities in issue	-	345.2	(4.7)	note 4	0.5	-

Notes
1. The change in fair value during the period that is used as the basis for calculating hedge ineffectiveness.
2. The accumulated amount of fair value hedge adjustments remaining (in the Statement of Financial Position for fair value hedges; in the cash flow hedging reserve for cash flow hedges) for any hedged items that have ceased to be adjusted for hedging gains and losses.
3. The Statement of Financial Position line that includes these items is 'Debt securities'.
4. The Statement of Financial Position line that includes these items is 'Debt securities in issue'.
5. The Statement of Financial Position line that includes these items is 'Loans and advances to customers'.
6. The Statement of Financial Position line that includes these items is 'Shares'.

		2018			
		Carrying amount			
	Notional	Assets	Liabilities	Change in fair value recognised in OCI	Amount reclassified from OCI to Income Statement
Group	£m	£m	£m	£m	£m
Cross currency swaps	448.1	5.9	-	(0.5)	-

33. Derivative financial instruments *(continued)*

The table below provides an analysis of amounts recognised in other comprehensive income resulting from hedge accounting during the period:

	Group			Society	
	Cash flow hedging reserve £m	Cost of hedging reserve £m	Total £m	Cash flow hedging reserve £m	Total £m
Balance at 1 January 2018	0.1	-	**0.1**	0.1	**0.1**
Change in fair value of derivatives in effective hedging relationships:					
Held to hedge interest rate risk	(2.2)	(0.5)	**(2.7)**	(2.9)	**(2.9)**
Net amounts previously reclassified to profit or loss:					
Held to hedge interest rate risk	1.9	-	**1.9**	1.9	**1.9**
Tax on movements in reserves during the period	-	-	**-**	0.3	**0.3**
Balance at 31 December 2018	**(0.2)**	**(0.5)**	**(0.7)**	**(0.6)**	**(0.6)**

34. Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost. It is an inherent part of the Group's business as long term mortgages are funded mainly by shorter term retail customer balances. Mortgages can have a contractual maturity date of, for example, 25 years but in practice are frequently repaid early; conversely retail deposits, nominally repayable on demand or with short notice periods, frequently remain with the Group beyond their contractual notice. It is this mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity policy is designed to ensure the maintenance of sufficient liquid assets to cover statutory, regulatory and operational requirements. This is achieved through maintaining a sufficient level of liquid 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. ALCO manages liquidity under delegated authority, within risk appetite limits established by the Board, and also monitors the composition of liquidity in line with risk management objectives.

The Group's liquidity is managed as follows:

- the Board establishes limits over the quantity and quality of the Group's portfolio of liquid assets. The portfolio is managed by the Treasury function, monitored by the Market & Liquidity Risk function and overseen by ALCO under a series of delegated authorities;
- the Group's Market & Liquidity Risk function conducts a series of daily, weekly and monthly stress tests that are designed to ensure that the Group's liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding; and
- under the Regulatory liquidity regime, the Group is required to hold highly liquid assets (such as government and supranational debt securities and cash) to satisfy the Liquidity Coverage Ratio (LCR).

There are two key measures that the Group considers key to monitoring its liquidity position:

- LCR – which analyses daily the amount of high quality liquidity that it is necessary to hold; and
- liquidity stress tests – whereby, as noted above, the Group models how far its liquid asset holdings would fall under a number of different stress scenarios.

The tables below analyse the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining maturity period at the reporting date to the contractual maturity. In practice, customer deposits, i.e. shares, amounts owed to credit institutions and amounts owed to other customers, are likely to be repaid later than on the earliest date on which repayment can be required.

Group	2018					
	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets						
Cash in hand and balances with the Bank of England	2,395.7	-	-	-	-	**2,395.7**
Loans and advances to credit institutions	370.7	52.0	-	-	-	**422.7**
Debt securities	-	195.8	461.5	537.8	188.0	**1,383.1**
Derivative financial instruments	-	7.2	19.9	42.9	2.3	**72.3**
Loans and advances to customers held at amortised cost	95.8	35.1	50.7	594.5	17,350.9	**18,127.0**
Loans and advances to customers held at FVTPL	1.9	-	-	-	-	**1.9**
Equity release portfolio at FVTPL	-	2.1	9.7	52.9	346.2	**410.9**
Equity share investments	-	-	-	-	0.8	**0.8**
Trade receivables	18.2	13.1	-	-	-	**31.3**
Contingent consideration	-	-	6.1	16.9	-	**23.0**
Total financial assets	**2,882.3**	**305.3**	**547.9**	**1,245.0**	**17,888.2**	**22,868.7**
Liabilities						
Shares	3,865.5	9,654.5	1,378.8	1,214.3	0.4	**16,113.5**
Amounts owed to credit institutions	1.6	16.9	0.8	1,858.7	-	**1,878.0**
Amounts owed to other customers	413.5	366.8	682.6	227.5	-	**1,690.4**
Debt securities in issue	-	87.3	0.5	1,332.5	-	**1,420.3**
Derivative financial instruments	-	5.0	15.9	86.9	171.6	**279.4**
Trade payables	-	5.4	-	-	-	**5.4**
Fair value of put option obligation	-	-	7.0	1.3	-	**8.3**
Subscribed capital	-	-	-	-	41.6	**41.6**
Total financial liabilities	**4,280.6**	**10,135.9**	**2,085.6**	**4,721.2**	**213.6**	**21,436.9**
Net liquidity gap	**(1,398.3)**	**(9,830.6)**	**(1,537.7)**	**(3,476.2)**	**17,674.6**	**1,431.8**

Notes to the Accounts *(continued)*

34. Liquidity risk *(continued)*

Group	2017					
	Repayable on demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Assets						
Cash in hand and balances with the Bank of England	2,396.9	-	-	-	-	2,396.9
Loans and advances to credit institutions	344.1	0.1	-	1.1	-	345.3
Debt securities	-	105.6	193.8	436.1	55.6	791.1
Derivative financial instruments	-	4.0	12.6	74.5	3.1	94.2
Loans and advances to customers	82.8	39.4	45.1	440.6	16,364.8	16,972.7
Equity share investments	-	-	-	-	0.4	0.4
Trade receivables	17.7	13.1	-	-	-	30.8
Contingent consideration	-	4.9	-	20.2	-	25.1
Total financial assets	2,841.5	167.1	251.5	972.5	16,423.9	20,656.5
Liabilities						
Shares	3,801.9	8,328.9	1,335.9	1,518.8	0.3	14,985.8
Amounts owed to credit institutions	15.9	37.4	26.0	1,403.9	-	1,483.2
Amounts owed to other customers	402.4	368.1	815.3	219.3	-	1,805.1
Debt securities in issue	-	3.3	12.7	650.4	-	666.4
Derivative financial instruments	-	5.7	16.4	58.5	237.9	318.5
Trade payables	-	4.4	-	-	-	4.4
Fair value of put option obligation	-	-	5.6	4.3	-	9.9
Subscribed capital	-	-	-	-	41.6	41.6
Total financial liabilities	4,220.2	8,747.8	2,211.9	3,855.2	279.8	19,314.9
Net liquidity gap	(1,378.7)	(8,580.7)	(1,960.4)	(2,882.7)	16,144.1	1,341.6

Society	2018					
	Repayable on demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Assets						
Cash in hand and balances with the Bank of England	2,395.7	-	-	-	-	**2,395.7**
Loans and advances to credit institutions	299.4	50.1	-	-	-	**349.5**
Debt securities	-	212.8	342.0	602.1	188.0	**1,344.9**
Derivative financial instruments	-	7.3	20.3	39.2	1.4	**68.2**
Loans and advances to customers held at amortised cost	1.8	22.6	23.4	405.1	15,546.3	**15,999.2**
Loans and advances to customers held at FVTPL	1.9	-	-	-	-	**1.9**
Equity release portfolio at FVTPL	-	2.1	9.7	52.9	346.2	**410.9**
Loans to subsidiary undertakings	854.4	-	-	-	-	**854.4**
Trade receivables	1.3	0.5	-	-	-	**1.8**
Total financial assets	**3,554.5**	**295.4**	**395.4**	**1,099.3**	**16,081.9**	**21,426.5**
Liabilities						
Shares	3,865.5	9,654.5	1,378.8	1,214.3	0.4	**16,113.5**
Amounts owed to credit institutions	1.8	138.6	0.8	1,858.7	-	**1,999.9**
Amounts owed to other customers	154.3	165.0	25.7	184.2	-	**529.2**
Debt securities in issue	-	3.5	0.5	1,190.4	-	**1,194.4**
Derivative financial instruments	-	5.0	16.0	89.7	171.6	**282.3**
Trade payables	-	1.8	-	-	-	**1.8**
Subscribed capital	-	-	-	-	41.6	**41.6**
Total financial liabilities	**4,021.6**	**9,968.4**	**1,421.8**	**4,537.3**	**213.6**	**20,162.7**
Net liquidity gap	**(467.1)**	**(9,673.0)**	**(1,026.4)**	**(3,438.0)**	**15,868.3**	**1,263.8**

Financial Statements

34. Liquidity risk (continued)

Society 2017	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets						
Cash in hand and balances with the Bank of England	2,396.9	-	-	-	-	2,396.9
Loans and advances to credit institutions	259.7	-	-	1.1	-	260.8
Debt securities	-	55.9	90.5	558.3	55.6	760.3
Derivative financial instruments	-	4.0	13.2	78.2	2.8	98.2
Loans and advances to customers	3.1	26.3	37.2	356.3	14,463.7	14,886.6
Loans to subsidiary undertakings	965.4	-	-	-	-	965.4
Trade receivables	0.7	0.4	-	-	-	1.1
Total financial assets	3,625.8	86.6	140.9	993.9	14,522.1	19,369.3
Liabilities						
Shares	3,801.9	8,328.9	1,335.9	1,518.8	0.3	14,985.8
Amounts owed to credit institutions	112.8	37.4	26.0	1,403.9	-	1,580.1
Amounts owed to other customers	180.6	177.4	160.0	406.7	-	924.7
Debt securities in issue	-	3.0	12.7	344.3	-	360.0
Derivative financial instruments	-	5.8	16.4	59.8	236.9	318.9
Trade payables	-	1.5	-	-	-	1.5
Subscribed capital	-	-	-	-	41.6	41.6
Total financial liabilities	4,095.3	8,554.0	1,551.0	3,733.5	278.8	18,212.6
Net liquidity gap	(469.5)	(8,467.4)	(1,410.1)	(2,739.6)	14,243.3	1,156.7

Loans and advances to customers classified as repayable on demand represent those loans and advances that are on call and at short notice.

Debt securities in issue include £219.6m (2017: £306.4m) of funding obtained through the Group's securitisation issuances carried out through Darrowby No. 3 plc and Darrowby No. 4 plc. The final maturity dates of the securitisation notes are significantly out into the future, however the Group can exercise call options to repurchase the outstanding notes at dates within the next 5 years and these are expected to be exercised. As a result all such amounts have been shown within less than 5 years in the tables above.

The following table is an analysis of undiscounted gross contractual cash flows payable on financial liabilities:

Group 2018 Liabilities	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	13,521.1	1,391.2	1,262.2	0.4	**16,174.9**
Amounts owed to credit institutions, other customers and debt securities in issue	890.2	716.7	3,497.7	-	**5,104.6**
Derivative financial instruments	8.8	38.6	159.3	173.7	**380.4**
Trade payables	5.4	-	-	-	**5.4**
Fair value of put option obligation	-	7.0	1.4	-	**8.4**
Subscribed capital	1.6	2.9	18.0	44.9	**67.4**
	14,427.1	**2,156.4**	**4,938.6**	**219.0**	**21,741.1**

Group 2017 Liabilities	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	12,131.5	1,348.6	1,580.7	0.3	15,061.1
Amounts owed to credit institutions, other customers and debt securities in issue	829.1	868.2	2,332.5	-	4,029.8
Derivative financial instruments	11.6	34.9	93.8	217.2	357.5
Trade payables	4.4	-	-	-	4.4
Fair value of put option obligation	-	5.6	4.5	-	10.1
Subscribed capital	1.6	2.9	18.0	44.9	67.4
	12,978.2	2,260.2	4,029.5	262.4	19,530.3

The undiscounted gross contractual cash flows of debt securities in issue that have been issued as securitisation funding in the tables above have been calculated on the assumption that the call options referred to on page 182 are exercised.

Society 2018 Liabilities	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	13,521.1	1,391.2	1,262.2	0.4	**16,174.9**
Amounts owed to credit institutions, other customers and debt securities in issue	468.0	49.4	3,306.2	-	**3,823.6**
Derivative financial instruments	9.4	39.8	161.9	173.7	**384.8**
Trade payables	1.8	-	-	-	**1.8**
Subscribed capital	1.6	2.9	18.0	44.9	**67.4**
	14,001.9	**1,483.3**	**4,748.3**	**219.0**	**20,452.5**

Society 2017 Liabilities	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	12,131.5	1,348.6	1,580.7	0.3	15,061.1
Amounts owed to credit institutions, other customers and debt securities in issue	512.9	209.8	2,188.8	-	2,911.5
Derivative financial instruments	12.2	36.7	95.5	217.2	361.6
Trade payables	1.5	-	-	-	1.5
Subscribed capital	1.6	2.9	18.0	44.9	67.4
	12,659.7	1,598.0	3,883.0	262.4	18,403.1

Amounts owed to other customers in the Society tables above include deemed loans from the Group's securitisation vehicles Darrowby No. 3 plc and Darrowby No. 4 plc, which arise from the funding transactions carried out through these entities. The undiscounted gross contractual cash flows arising on these loans have been calculated on the assumption that the call options referred to on page 182 are exercised.

35. Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk (including the use of derivatives) and foreign currency risk.

The Group's Treasury function is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's Treasury policy, which is reviewed and recommended by ALCO and approved by the Board. The Group's Market & Liquidity Risk function measures and monitors adherence to the Treasury policy and reports regularly on all aspects of market risk exposure, including interest rate risk and foreign currency risk.

35. Market risk *(continued)*

a) Interest rate risk

The main market risk faced by the Group is interest rate risk.

The Group uses a number of different metrics to monitor interest rate risk and details of these are set out below.

The Group monitors interest rate risk exposure against limits by determining the effect on the Group's current net notional value of assets and liabilities for a parallel shift in interest rates equivalent to 2% for all maturities, in line with regulatory requirements. These results are compared to the Board limit and operational trigger at least weekly, and are formally reported to ALCO and the Board monthly.

Other interest rate risk metrics employed by the Group incorporate earnings-at-risk and market value methodologies. The market value exposure position is calculated using at least 250 monthly yield curve movements from, approximately, the last seven years. The earnings-at-risk methodology is calculated using at least 100 stochastically (randomly) generated rate paths. Both of these approaches employ 95% confidence intervals. The outputs of these interest rate risk measurement methodologies are compared to their respective Board limits and operational triggers at least weekly and are reported to ALCO and the Board monthly. All these measures are used to guide interest rate risk management decisions.

The levels of Group interest rate risk exposures throughout the reporting period, based on measures taken at each month end, were as follows:

	As at 31 December 2018 £m	Average 2018 £m	High 2018 £m	Low 2018 £m	As at 31 December 2017 £m
Static earnings-at-risk	7.4	7.0	7.8	6.0	5.2
Historical value-at-risk	0.1	1.2	2.4	0.1	2.2
2% parallel interest rate shift	0.1	6.6	14.0	0.1	13.2

Although these measures provide valuable insights into the market risk to which the Group is exposed, they need to be viewed in the context of the following limitations:

- Historical data is not necessarily the best guide to future events, but is a reasonable proxy;
- The use of 95% confidence levels, by definition, does not take account of changes that may occur beyond this level of confidence and therefore may not fully take into account the most extreme events; and
- Exposures are calculated on static Statement of Financial Position positions and therefore future changes in the structure of the Statement of Financial Position are ignored.

Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics, for example LIBOR and Bank of England Base Rate), are also monitored closely and regularly reported to ALCO.

b) Currency risk

The currency risk appetite of the Group is low and any funding issues denominated in foreign currency are immediately swapped into Sterling.

During the year the Group issued a €500m regulated covered bond, however the exposure to foreign currency fluctuations is fully hedged as a derivative contract was taken out to swap the Euros into Sterling on issuance of the covered bond.

The Group has investments in its subsidiary undertakings Jade Software Corporation Limited and Northwest Investments NZ Limited, which are denominated in New Zealand Dollars. The foreign currency fluctuations in relation to these investments are not hedged, and are recognised in the Group's translation reserve.

In addition, a number of the Group's businesses undertake transactions denominated in foreign currency as part of their normal business. Any amounts outstanding at 31 December 2018 are not material.

c) Other price risk

The Group also has exposure to market risk arising from the movement in the Retail Price Index and house price indices. In particular, movements in these indices impact on the valuation of the equity release portfolio, as outlined further on page 133.

36. Credit risk

Credit risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group.

The Group faces this risk from its lending to:

- individual customers (retail mortgages);
- businesses (through past commercial lending and current debt factoring / invoice discounting); and
- wholesale counterparties (including other financial institutions). Credit risk within our treasury portfolio arises from the investments held by the Group in order to meet liquidity requirements and for general business purposes.

Changes in the credit quality and the recoverability of loans and amounts due from counterparties influence the Group's exposure to credit risk. The Group's strategy is to maintain a cautious approach to credit risk and new lending. Adverse changes in the credit quality of counterparties, collateral values or deterioration in the wider economy, including rising unemployment, changes in interest rates, deterioration in household finances and any contraction in the UK property market leading to falling property values, could affect the recoverability and value of the Group's assets and influence its financial performance. An economic downturn and falls in house prices and commercial property values would affect the level of impairment losses.

The Group has embedded a comprehensive risk management framework with clear lines of accountability and oversight as part of its overall governance framework.

The Group has processes and policies to monitor, control, mitigate and manage credit risk within the Group's credit risk appetite. The Retail Credit Committee and the Group Wholesale Credit Committee provide oversight to the effectiveness of all credit management across the Group and the controls in place ensure lending is within the Board approved credit risk appetite. The reporting structure ensures timely and accurate reporting of all substantive risk matters to the Board and the Board Risk Committee. The Board receives monthly updates on the credit risk profile of the Group.

As part of the Group's preparations for the implementation of IFRS 9 on 1 January 2018, the Group's credit risk management strategy was reviewed and, where appropriate, its policies and processes were enhanced. As the Group already applied an IRB 'expected loss' model for regulatory capital purposes, the introduction of IFRS 9 did not result in significant changes to the Group's credit risk management practices.

Management makes use of the Group's IFRS 9 ECL information for purposes that include regulatory capital management, certain product pricing models and credit risk forecasting.

The maximum exposure to credit risk for financial assets is represented by the carrying amount of each financial asset, except for the following:

- A fair value adjustment for hedged risk of £(8.4)m (2017: £227.3m) is included within loans and advances to customers. This is indirectly exposed to credit risk through the relationship with the underlying loans covered by the Group's hedging strategy.
- The Group has credit risk exposure from commitments to lend where a mortgage has been offered but not yet completed, which leads to the recognition of a financial asset (within loans and advances to customers) on completion of the mortgage. As outlined in note 1g), an impairment loss allowance is held against these commitments in accordance with IFRS 9. The total amount of such loan commitments at 31 December 2018 is £1,068.6m (2017: £828.8m) and the impairment loss allowance held is less than £0.1m (2017: £nil).

With respect to collateral held by the Group at 31 December 2018, the Group considers that the quality of that collateral has not significantly changed as a result of deterioration in collateral or changes in the collateral policies of the Group during the year.

Retail mortgage lending to customers

The Group currently lends in the prime residential UK mortgage market, including buy-to-let, through the Society, whilst SIL lends in the Channel Islands and in the UK. The Board's credit risk appetite defines a number of limits regarding customer and collateral credit quality to which all lending activity must adhere.

The credit decision process utilises automated credit scoring and policy rules with lending policy criteria supporting manual underwriting. All aspects of the credit decision process are subject to regular independent review and development ensuring they support decisions in line with the Board's credit risk appetite.

The Group also has credit exposures through Amber Homeloans Limited (Amber) and North Yorkshire Mortgages Limited (NYM) which comprise residential UK mortgages, including buy-to-let, across prime and non-prime lending markets. These portfolios closed to new customer origination and lending in 2008 and are managed by adherence to clear policies in relation to mortgage servicing and credit management.

36. Credit risk *(continued)*

As outlined in note 1b), following IFRS 9 adoption on 1 January 2018 the equity release portfolio is no longer included within amounts presented by the Group for residential loans and advances to customers held at amortised cost. For further details of the equity release portfolio, see note 15.

Commercial lending to customers and businesses

The Society's commercial mortgage portfolio was closed to new lending in November 2008.

Other loans and advances

These include advances made by our factored debt and invoice discounting business, Skipton Business Finance Limited, which continue to be managed by appropriately skilled teams. In addition other loans and advances include advances made to residential mortgage customers in Guernsey and Jersey by SIL; these are secured on shares in a property management company which owns the building in which the properties are located. These loans are monitored by appropriately skilled teams in SIL.

Wholesale lending to other financial institutions

Wholesale credit risk arises from the wholesale investments held by the Society's Treasury function which is responsible for managing this aspect of credit risk in line with the Board approved credit risk appetite and wholesale credit policies. Wholesale counterparty limits are reviewed monthly by the Group Wholesale Credit Committee based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within our risk appetite. We regularly review and closely monitor the number of counterparties to whom we will lend and, for those counterparties to whom we have lent, we review both the amount and duration of any limits.

A deterioration in wholesale credit markets could lead to volatility in the value of the Group's portfolio of treasury assets together with the risk of further impairment within our treasury investments portfolio.

ALCO provides oversight to the effectiveness of wholesale credit risk management.

a) Credit risk - loans and advances to customers held at amortised cost

The table below shows the mix of the Group and Society's loans and advances to customers at the reporting date:

2018	Gross carrying amount	ECL allowance (note 14)	Fair value adjustment for hedged risk	Carrying amount	
Group	£m	£m	£m	£m	%
Residential mortgages*	17,725.7	(9.9)	(8.4)	**17,707.4**	**97.7**
Loans fully secured on land^	267.6	(7.9)	-	**259.7**	**1.4**
Other lending:					
Debt factoring advances	91.4	(0.8)	-	**90.6**	**0.5**
Other loans	69.3	-	-	**69.3**	**0.4**
	18,154.0	(18.6)	(8.4)	**18,127.0**	**100.0**
Society					
Residential mortgages*	15,752.1	(4.4)	(8.2)	**15,739.5**	**98.4**
Loans fully secured on land^	267.6	(7.9)	-	**259.7**	**1.6**
	16,019.7	(12.3)	(8.2)	**15,999.2**	**100.0**

* The equity release portfolio was reclassified from financial assets held at amortised cost to financial assets held at FVTPL on adoption of IFRS 9 on 1 January 2018. As permitted by IFRS 9, the comparative figures have not been restated. Further details are found in note 1b).
^ Also known as commercial mortgages.

2017	Group £m	%	Society £m	%
Total residential mortgages	16,351.6	97.3	14,406.1	98.0
Commercial mortgages	293.8	1.8	293.8	2.0
Other lending:				
Debt factoring loans	79.9	0.5	-	-
Other loans and advances	61.9	0.4	0.1	-
Gross balances	16,787.2	100.0	14,700.0	100.0
Impairment provisions	(41.8)		(38.2)	
Fair value adjustment for hedged risk	227.3		224.8	
	16,972.7		14,886.6	

i) Residential mortgages

The majority of loans and advances to customers are secured on UK residential properties and are geographically diverse.

The tables below provide information on residential loans and advances by payment due status:

2018	Group Stage 1 £m	Group Stage 2 £m	Group Stage 3 £m	Group Total £m	Society Stage 1 £m	Society Stage 2 £m	Society Stage 3 £m	Society Total £m
Not past due	17,304.2	198.8	12.9	**17,515.9**	15,530.4	99.5	9.6	**15,639.5**
Up to 30 days past due	-	84.1	3.1	**87.2**	-	33.8	1.7	**35.5**
31 to 60 days past due	-	41.4	7.3	**48.7**	-	25.9	4.7	**30.6**
61 to 90 days past due	-	13.6	8.8	**22.4**	-	6.1	4.9	**11.0**
Over 90 days past due	-	-	51.5	**51.5**	-	-	35.5	**35.5**
	17,304.2	**337.9**	**83.6**	**17,725.7**	**15,530.4**	**165.3**	**56.4**	**15,752.1**

2017	Group £m	%	Society £m	%
Neither past due nor individually impaired	16,229.0	99.3	14,331.3	99.5
Past due but not individually impaired:				
Up to 3 months	63.2	0.4	35.5	0.2
	16,292.2	99.7	14,366.8	99.7
Individually impaired:				
Low risk	37.9	0.2	26.3	0.2
High risk	18.5	0.1	10.5	0.1
Possessions	3.0	-	2.5	-
	16,351.6	100.0	14,406.1	100.0

For details on how the Group assesses ECLs see note 1g).

Financial Statements

36. Credit risk *(continued)*

The table below provides information on movements in the gross carrying amount of residential loans and advances to customers during the year:

	2018							
	Group				Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross carrying amount as at 1 January	15,636.5	349.4	86.7	**16,072.6**	13,913.8	155.8	57.5	**14,127.1**
Transfers due to changes in credit risk:								
From stage 1 to stage 2	(80.2)	78.4	-	**(1.8)**	(58.2)	56.6	-	**(1.6)**
From stage 1 to stage 3	(10.0)	-	10.1	**0.1**	(6.6)	-	6.7	**0.1**
From stage 2 to stage 1	51.7	(53.4)	-	**(1.7)**	31.7	(33.3)	-	**(1.6)**
From stage 2 to stage 3	-	(11.0)	11.0	**-**	-	(5.3)	5.3	**-**
From stage 3 to stage 2	-	11.8	(12.1)	**(0.3)**	-	5.8	(6.0)	**(0.2)**
From stage 3 to stage 1	4.2	-	(4.3)	**(0.1)**	2.5	-	(2.6)	**(0.1)**
Modification of contractual cashflows	(11.5)	3.8	3.4	**(4.3)**	(9.9)	3.2	2.8	**(3.9)**
Transfer of engagements	123.2	3.2	1.6	**128.0**	123.2	3.2	1.6	**128.0**
Increases due to origination	4,208.4	2.4	0.2	**4,211.0**	3,940.7	2.4	0.2	**3,943.3**
Decrease due to derecognition and repayments	(2,624.4)	(45.4)	(6.9)	**(2,676.7)**	(2,412.8)	(22.7)	(4.5)	**(2,440.0)**
Write-offs	(0.3)	(1.6)	(6.2)	**(8.1)**	-	(0.5)	(4.6)	**(5.1)**
Other movements	6.6	0.3	0.1	**7.0**	6.0	0.1	-	**6.1**
Gross carrying amount as at 31 December	**17,304.2**	**337.9**	**83.6**	**17,725.7**	**15,530.4**	**165.3**	**56.4**	**15,752.1**

The amounts included in the table above represent the movement in the gross carrying amount between each reporting period end and not the balance as at the date of the movement. The amounts presented above as at 1 January 2018 reflect the opening balances following adoption of IFRS 9; the opening balances above therefore exclude £279.0m relating to the Group's equity release portfolio that was reclassified out of this financial asset category at 1 January 2018 (see note 1b) for further details).

Gains and losses arising during the year from loan modifications that did not result in derecognition were not significant. Amounts written off are in accordance with the Group's accounting policy for write-offs (see note 1g)). Amounts presented within 'other movements' in the table above include movements in the Group's effective interest rate asset as described in note 1e).

The table below provides information on movements in the impairment loss allowance for residential loans and advances to customers during the year:

	2018							
	Group				Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Loss allowance as at 1 January	3.3	3.3	3.4	**10.0**	2.3	0.6	1.8	**4.7**
Transfers due to changes in credit risk:								
From stage 1 to stage 2	-	0.9	-	**0.9**	-	0.4	-	**0.4**
From stage 1 to stage 3	-	-	0.5	**0.5**	-	-	0.2	**0.2**
From stage 2 to stage 1	-	(0.4)	-	**(0.4)**	-	(0.1)	-	**(0.1)**
From stage 2 to stage 3	-	(0.2)	0.6	**0.4**	-	-	0.2	**0.2**
From stage 3 to stage 2	-	0.2	(0.2)	**-**	-	0.1	(0.1)	**-**
Remeasurements within existing stage	(0.6)	0.4	0.1	**(0.1)**	(0.7)	0.1	-	**(0.6)**
Transfer of engagements	-	-	0.1	**0.1**	-	-	0.1	**0.1**
Increases due to origination	0.2	-	-	**0.2**	0.2	-	-	**0.2**
Decrease due to derecognition and repayments	(0.1)	-	(0.1)	**(0.2)**	(0.1)	-	(0.1)	**(0.2)**
Write-offs	-	(0.4)	(1.1)	**(1.5)**	-	-	(0.5)	**(0.5)**
Loss allowance as at 31 December	**2.8**	**3.8**	**3.3**	**9.9**	**1.7**	**1.1**	**1.6**	**4.4**

The loss allowances as at 1 January 2018 in the table above represent the balances following adoption of IFRS 9 on 1 January 2018. For further details see note 1b).

The tables below provide information on residential loans and advances to customers grouped by credit risk rating (probability of default). For further details on how the probability of default affects the Group's assessment of ECLs, see note 1g) and note 1t). ECL coverage shows the level of loss allowance expressed as a percentage of the gross carrying amount.

Group	2018								
	Gross carrying amount				Loss allowance				
Probability of default	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	ECL coverage %
<0.15%	4,315.0	2.5	-	**4,317.5**	0.2	-	-	**0.2**	-
0.15% - <0.25%	7,846.5	0.1	-	**7,846.6**	0.7	-	-	**0.7**	-
0.25% - <0.5%	4,286.9	0.2	-	**4,287.1**	0.9	-	-	**0.9**	-
0.5% - <0.75%	562.4	1.6	-	**564.0**	0.2	-	-	**0.2**	-
0.75% - <2.5%	269.6	16.4	-	**286.0**	0.6	-	-	**0.6**	0.2%
2.5% - <10%	23.1	49.3	-	**72.4**	0.2	-	-	**0.2**	0.3%
10% - <100%	0.7	267.8	-	**268.5**	-	3.8	-	**3.8**	1.4%
Default	-	-	83.6	**83.6**	-	-	3.3	**3.3**	3.9%
	17,304.2	**337.9**	**83.6**	**17,725.7**	**2.8**	**3.8**	**3.3**	**9.9**	**0.1%**

ECL coverage by stage (%)					**0.02%**	**1.12%**	**3.95%**	**0.06%**

36. Credit risk *(continued)*

Society				2018					
	Gross carrying amount				**Loss allowance**				
Probability of default	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**ECL coverage %**
<0.15%	4,310.5	1.7	-	**4,312.2**	0.2	-	-	**0.2**	-
0.15% - <0.25%	6,554.1	0.1	-	**6,554.2**	0.7	-	-	**0.7**	-
0.25% - <0.5%	4,075.3	0.2	-	**4,075.5**	0.6	-	-	**0.6**	-
0.5% - <0.75%	446.6	0.8	-	**447.4**	0.1	-	-	**0.1**	-
0.75% - <2.5%	133.1	13.6	-	**146.7**	0.1	-	-	**0.1**	0.1%
2.5% - <10%	10.2	30.8	-	**41.0**	-	-	-	**-**	-
10% - <100%	0.6	118.1	-	**118.7**	-	1.1	-	**1.1**	0.9%
Default	-	-	56.4	**56.4**	-	-	1.6	**1.6**	2.8%
	15,530.4	**165.3**	**56.4**	**15,752.1**	**1.7**	**1.1**	**1.6**	**4.4**	**-**
ECL coverage by stage (%)					**0.01%**	**0.67%**	**2.84%**	**0.03%**	

The tables below provide further information on the types of lending and geographical split:

	Group					**Society**				
	2018				2017	**2018**				2017
	Stage 1 £m	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	Total £m	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	Total £m
Prime:										
Residential	13,412.8	162.4	53.0	**13,628.2**	12,431.1	12,489.5	130.4	47.8	**12,667.7**	11,475.1
Buy-to-let	3,505.3	46.3	9.6	**3,561.2**	3,034.4	2,997.8	31.3	7.8	**3,036.9**	2,592.8
Self-build	30.1	9.5	1.7	**41.3**	46.8	9.2	2.0	0.2	**11.4**	13.3
Fast track	33.9	1.6	0.6	**36.1**	45.9	33.9	1.6	0.6	**36.1**	45.9
Self-certified	243.1	77.7	11.8	**332.6**	371.1	-	-	-	**-**	-
Sub-prime*:										
Residential	14.6	8.4	1.1	**24.1**	28.0	-	-	-	**-**	-
Buy-to-let	24.9	1.6	0.1	**26.6**	30.1	-	-	-	**-**	-
Self-build	0.2	-	0.3	**0.5**	0.5	-	-	-	**-**	-
Self-certified	39.3	30.4	5.4	**75.1**	84.7	-	-	-	**-**	-
Equity release^	-	-	-	**-**	279.0	-	-	-	**-**	279.0
	17,304.2	**337.9**	**83.6**	**17,725.7**	16,351.6	**15,530.4**	**165.3**	**56.4**	**15,752.1**	14,406.1

* Sub-prime mortgages are defined as loans to borrowers that typically had weakened credit histories at the time the loan was advanced.

^ The equity release portfolio was reclassified from financial assets held at amortised cost to financial assets held at FVTPL on adoption of IFRS 9 on 1 January 2018. As permitted by IFRS 9, the comparative figures have not been restated. Further details are found in note 1b).

	Group					**Society**				
	2018				2017	**2018**				2017
Region	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	Total £m	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	Total £m
North	698.9	11.7	5.3	**715.9**	650.1	680.0	6.0	3.6	**689.6**	621.9
Yorkshire	1,669.2	34.6	9.9	**1,713.7**	1,581.8	1,618.6	22.4	8.1	**1,649.1**	1,510.5
East Midlands	1,245.6	23.9	5.1	**1,274.6**	1,166.7	1,203.7	12.3	3.2	**1,219.2**	1,103.7
East Anglia	518.0	9.9	2.3	**530.2**	520.8	489.8	5.8	1.8	**497.4**	485.5
London	2,450.0	46.7	11.8	**2,508.5**	2,253.7	2,137.8	13.5	5.3	**2,156.6**	1,949.1
South East	3,189.2	67.3	12.9	**3,269.4**	3,078.7	3,030.1	28.0	7.6	**3,065.7**	2,873.1
South West	1,731.0	27.3	9.9	**1,768.2**	1,626.6	1,668.9	16.5	7.7	**1,693.1**	1,547.1
West Midlands	1,285.7	27.2	6.4	**1,319.3**	1,183.9	1,242.7	12.5	4.3	**1,259.5**	1,120.9
North West	1,621.8	41.7	9.8	**1,673.3**	1,528.6	1,544.0	23.3	7.3	**1,574.6**	1,424.0
Wales	622.0	17.4	3.3	**642.7**	582.7	588.3	7.0	2.3	**597.6**	532.8
Scotland	1,337.1	24.2	5.8	**1,367.1**	1,253.5	1,309.8	16.6	4.7	**1,331.1**	1,216.5
Northern Ireland	23.6	5.1	1.1	**29.8**	32.8	16.7	1.4	0.5	**18.6**	21.0
Channel Islands	912.1	0.9	-	**913.0**	891.7	-	-	-	**-**	-
	17,304.2	**337.9**	**83.6**	**17,725.7**	16,351.6	**15,530.4**	**165.3**	**56.4**	**15,752.1**	14,406.1

Indexed loan-to-value information on the Group's residential loan portfolio is set out below:

	Group					**Society**				
	2018				2017	**2018**				2017
Loan-to-value	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	Total £m	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	Total £m
<40%	2,824.7	49.9	11.7	**2,886.3**	2,536.2	2,624.6	38.7	9.9	**2,673.2**	2,364.9
40% - 50%	2,416.1	46.4	11.9	**2,474.4**	2,126.5	2,205.8	27.8	8.7	**2,242.3**	1,940.4
50% - 60%	3,353.2	62.8	15.8	**3,431.8**	3,121.3	2,999.2	28.4	10.4	**3,038.0**	2,763.3
60% - 70%	3,398.8	78.7	15.8	**3,493.3**	3,382.8	2,992.8	33.0	9.7	**3,035.5**	2,918.0
70% - 80%	2,897.2	52.4	12.3	**2,961.9**	2,843.0	2,531.6	22.5	8.7	**2,562.8**	2,441.0
80% - 90%	2,068.8	31.8	5.7	**2,106.3**	2,063.3	1,889.3	9.3	1.9	**1,900.5**	1,786.3
90% - 100%	319.4	9.9	6.6	**335.9**	235.3	277.2	2.4	5.0	**284.6**	172.7
>100%	26.0	6.0	3.8	**35.8**	43.2	9.9	3.2	2.1	**15.2**	19.5
	17,304.2	**337.9**	**83.6**	**17,725.7**	16,351.6	**15,530.4**	**165.3**	**56.4**	**15,752.1**	14,406.1

The Group indexes property prices using the quarterly Halifax regional non-seasonally adjusted index. The new lending policy is currently a maximum loan-to-value ratio of 95% for residential mortgages and 75% for buy-to-let lending. In addition SIL lend up to 100% on their 'Next Generation' mortgages whereby 15% is required to be guaranteed by a guarantor.

At 31 December 2018, the average indexed loan-to-value of Group residential mortgages on a valuation weighted basis (calculated as the total outstanding balance divided by the total value of collateral held), was 46.1% (2017: 47.2%) and for Society residential mortgages was 45.2% (2017: 46.4%).

Forbearance

Where appropriate for customers, the Group applies a policy of forbearance. This may be applied where the actual or apparent financial stress of the customer is considered to be short term with a potential to be recovered. Forbearance may involve arrears capitalisation, a reduction in the monthly payment (known as a concession), a conversion to interest only or a mortgage term extension. Forbearance is undertaken in order to achieve the best outcome for both the customer and the business through dealing with repayment difficulties at an early stage.

36. Credit risk *(continued)*

Possession is generally considered only as a last resort, once all other options for the customer have been exhausted. Possession balances represent loans against which the Group has taken ownership of properties pending their sale. The Group does not occupy repossessed properties for business use or use assets acquired in its operations. All customer accounts are monitored to ensure that these strategies remain appropriate.

For the Group, at 31 December 2018 the balance of residential loans where the property has been taken into possession was £3.6m and represents less than 0.1% of total outstanding loans (2017: £3.0m; less than 0.1%). For the Society, at 31 December 2018 the balance of residential loans where the property has been taken into possession was £1.8m and represents less than 0.1% of total outstanding loans (2017: £2.5m; less than 0.1%). All possessions balances are classified as stage 3.

The tables below provide further information on residential mortgages regarded as being in forbearance as at 31 December 2018, showing the type of account renegotiations applied. For the purpose of these forbearance tables, the Group applies the European Banking Authority (EBA) definition of forbearance. Under the EBA definition, loans are required to meet certain payment and arrears criteria before they are deemed to exit forbearance; this includes a minimum two year probation period following the forbearance event (extended to three years in certain situations).

For the purpose of the tables below, the following loans are therefore regarded as being in forbearance as at 31 December 2018:

- any loan to which forbearance measures were applied within the two years prior to the reporting date (regardless of whether the loan remains on renegotiated terms at 31 December 2018); and
- any loan to which forbearance measures were applied and which remains on renegotiated terms at 31 December 2018 (even if the forbearance event was more than two years prior to the reporting date).

For the purpose of the tables below, loans are presented according to the ECL stage in which they were held as at the reporting date.

For the avoidance of doubt, the Group does not, and is not required to, apply the EBA definition of forbearance in its accounting policies; the Group's accounting policy for forbearance does not therefore include the minimum two year probation period that is included in the EBA definition (for full details of the Group's accounting policies for forbearance and the measurement of impairment losses, see note 1g)).

Group 2018	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Stage 1							
Not past due	17,304.2	-	11.8	10.8	0.2	22.8	0.1
	17,304.2	**-**	**11.8**	**10.8**	**0.2**	**22.8**	**0.1**
Stage 2							
Not past due	198.8	0.4	11.4	6.8	6.2	24.8	12.5
Up to 30 days past due	84.1	-	11.2	1.1	0.4	12.7	15.1
Over 30 days past due	55.0	0.1	7.5	0.7	0.4	8.7	15.8
	17,642.1	**0.5**	**41.9**	**19.4**	**7.2**	**69.0**	**0.4**
Stage 3							
Not past due	12.9	-	2.1	0.7	0.3	3.1	24.0
Up to 90 days past due	19.2	-	5.7	0.8	0.1	6.6	34.4
Over 90 days past due	51.5	-	18.6	3.3	1.3	23.2	45.0
	17,725.7	**0.5**	**68.3**	**24.2**	**8.9**	**101.9**	**0.6**
Loss allowance	**(9.9)**	**-**	**(1.0)**	**(0.1)**	**(0.1)**	**(1.2)**	**12.1**
	17,715.8	**0.5**	**67.3**	**24.1**	**8.8**	**100.7**	**0.6**

Group 2017	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	16,229.0	1.8	40.0	24.6	9.1	75.5	0.5
Past due but not individually impaired:							
Up to 3 months	63.2	0.1	13.9	1.4	0.3	15.7	24.8
	16,292.2	1.9	53.9	26.0	9.4	91.2	0.6
Individually impaired:							
Low risk	37.9	-	12.8	2.1	0.9	15.8	41.7
High risk	18.5	-	5.7	0.5	0.5	6.7	36.2
Possessions	3.0	-	0.5	0.2	-	0.7	23.3
	16,351.6	1.9	72.9	28.8	10.8	114.4	0.7
Collective impairment	(29.5)	-	(0.1)	-	-	(0.1)	0.3
Individual impairment	(3.5)	-	(0.8)	(0.1)	-	(0.9)	25.7
	16,318.6	1.9	72.0	28.7	10.8	113.4	0.7

Society 2018	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Stage 1							
Not past due	15,530.4	-	10.6	6.7	0.2	17.5	0.1
	15,530.4	**-**	**10.6**	**6.7**	**0.2**	**17.5**	**0.1**
Stage 2							
Not past due	99.5	0.4	10.0	6.8	3.4	20.6	20.7
Up to 30 days past due	33.8	-	9.1	1.1	0.3	10.5	31.1
Over 30 days past due	32.0	0.1	4.4	0.5	0.4	5.4	16.9
	15,695.7	**0.5**	**34.1**	**15.1**	**4.3**	**54.0**	**0.3**
Stage 3							
Not past due	9.6	-	1.4	0.7	0.3	2.4	25.0
Up to 90 days past due	11.3	-	4.3	0.7	0.1	5.1	45.1
Over 90 days past due	35.5	-	15.3	3.2	1.3	19.8	55.8
	15,752.1	**0.5**	**55.1**	**19.7**	**6.0**	**81.3**	**0.5**
Loss allowance	**(4.4)**	**-**	**(0.7)**	**(0.1)**	**(0.1)**	**(0.9)**	**20.5**
	15,747.7	**0.5**	**54.4**	**19.6**	**5.9**	**80.4**	**0.5**

36. Credit risk *(continued)*

Society 2017	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	14,331.3	1.1	34.1	13.3	4.2	52.7	0.4
Past due but not individually impaired:							
Up to 3 months	35.5	0.1	11.4	0.8	0.3	12.6	35.5
	14,366.8	1.2	45.5	14.1	4.5	65.3	0.5
Individually impaired:							
Low risk	26.3	-	10.6	2.1	0.9	13.6	51.7
High risk	10.5	-	4.2	0.5	0.5	5.2	49.5
Possessions	2.5	-	0.5	0.2	-	0.7	28.0
	14,406.1	1.2	60.8	16.9	5.9	84.8	0.6
Collective impairment	(28.4)	-	(0.1)	-	-	(0.1)	0.4
Individual impairment	(1.8)	-	(0.5)	(0.1)	-	(0.6)	33.3
	14,375.9	1.2	60.2	16.8	5.9	84.1	0.6

Collateral

Collateral held consists predominantly of residential properties. The use of such collateral is in line with terms that are usual and customary to standard lending activities.

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated by reference to market prices or indices of similar assets.

Some properties in the Group's mortgage book are in negative equity, which increases the possibility of the Group incurring a loss if the property is taken into possession.

Fair value of capped collateral held	Group 2018 £m	Society 2018 £m
Stage 1	17,300.0	15,528.5
Stage 2	337.7	165.3
Stage 3	82.9	56.0
	17,720.6	15,749.8
Gross loan balances	17,725.7	15,752.1
Negative equity	5.1	2.3
Capped collateral held in respect of possessions (included within Stage 3 above)	3.1	1.5

	Group 2017 £m	Society 2017 £m
Not individually impaired	16,286.7	14,363.6
Impaired	56.1	36.8
Possessions	2.8	2.3
	16,345.6	14,402.7
Gross loan balances	16,351.6	14,406.1
Negative equity	6.0	3.4

The fair value of residential property used to derive the figures in the table above is determined by reference to a recognised house price index. Movements in this index to the reporting date are applied to all properties in the portfolio on a regional basis. For the majority of the Group's loans, the Group holds excess collateral however this cannot be used to offset those instances where the loan amount exceeds the collateral held. The fair value of capped collateral in the table above therefore represents, on an individual loan basis, the lower of the value of the property and the outstanding loan amount. It does not reflect the overall value of properties against which the loans are secured. The total fair value of collateral held in respect of residential mortgages for the Group at 31 December 2018 is £38,479.8m (2017: £34,646.2m) and for the Society is £34,813.1m (2017: £31,068.5m).

At 31 December 2018 the contractual amount outstanding on loans written off during the year due to there being no reasonable expectation of recovery, but which remain subject to enforcement activity, is £2.1m for the Group and £0.8m for the Society.

ii) Commercial mortgages

The commercial mortgage portfolio (also known as loans fully secured on land) is currently closed to new business.

The tables below provide information on commercial loans by payment due status.

Group and Society 2018	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Not past due	236.3	22.2	2.7	261.2
Up to 30 days past due	-	1.0	-	1.0
31 to 60 days past due	-	0.8	-	0.8
61 to 90 days past due	-	1.9	-	1.9
Over 90 days past due	-	-	2.7	2.7
	236.3	25.9	5.4	267.6

Group and Society 2017	£m	%
Neither past due nor individually impaired	288.1	98.0
Past due but not individually impaired:		
Up to 3 months	2.8	1.0
	290.9	99.0
Individually impaired:		
Low risk	0.2	0.1
High risk	2.1	0.7
Possessions	0.6	0.2
	293.8	100.0

The table below provides information on movements in the gross carrying amount of commercial loans during the year.

Group and Society 2018	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross carrying amount as at 1 January	262.6	26.0	5.2	293.8
Transfers due to changes in credit risk:				
From stage 1 to stage 2	(0.9)	0.9	-	-
From stage 1 to stage 3	(0.7)	-	0.7	-
From stage 2 to stage 1	1.8	(2.0)	-	(0.2)
From stage 3 to stage 1	0.3	-	(0.3)	-
Modification of contractual cashflows	(2.5)	1.2	0.8	(0.5)
Transfer of engagements	2.1	-	0.4	2.5
Decrease due to derecognition and repayments	(26.2)	(0.2)	(0.8)	(27.2)
Write-offs	-	-	(0.6)	(0.6)
Other movements	(0.2)	-	-	(0.2)
Gross carrying amount as at 31 December	236.3	25.9	5.4	267.6

36. Credit risk *(continued)*

The amounts included in the table above represent the movement in the gross carrying amount between each reporting period end and not the balance as at the date of the movement.

Gains and losses arising during the year from loan modifications that did not result in derecognition were not significant. Amounts written off are in accordance with the Group's accounting policy for write-offs (see note 1g)).

The table below provides information on movements in the impairment loss allowance for commercial loans during the year.

	Group and Society 2018			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Loss allowance as at 1 January	0.2	4.9	1.8	**6.9**
Transfers due to changes in credit risk:				
From stage 1 to stage 2	-	0.1	-	**0.1**
From stage 2 to stage 1	-	(0.1)	-	**(0.1)**
Remeasurements within existing stage	-	0.9	0.3	**1.2**
Write-offs	-	-	(0.2)	**(0.2)**
Loss allowance as at 31 December	**0.2**	**5.8**	**1.9**	**7.9**
ECL coverage (%)	**0.08%**	**22.39%**	**35.19%**	**2.95%**

The loss allowances as at 1 January 2018 in the table above represent the balances following adoption of IFRS 9 on 1 January 2018. For further details see note 1b).

Given the size and nature of the Group's commercial portfolio, it is not meaningful to manage credit risk by reference to behavioural scores or PD percentages. Credit risk is predominantly managed by individual review of loans in accordance with certain criteria and includes the use of 'watchlists'. To aid an understanding of significant credit risk concentrations for the Group's commercial portfolio, the tables below provide analyses of loans by industry type, by geography and by loan-to-value percentage.

Industry analysis	Group and Society 2018				2017
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Total £m
Leisure and hotels	18.2	5.6	0.7	**24.5**	30.1
Retail	6.7	0.1	0.4	**7.2**	9.6
Nursing / residential homes	13.2	-	-	**13.2**	13.8
Offices	3.4	-	-	**3.4**	3.7
Commercial and industrial units	191.1	18.1	4.1	**213.3**	230.2
Miscellaneous	3.7	2.1	0.2	**6.0**	6.4
	236.3	**25.9**	**5.4**	**267.6**	293.8

Geographical analysis	Group and Society 2018				2017
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Total £m
North	10.4	1.7	1.1	**13.2**	14.8
Yorkshire	17.8	5.6	0.1	**23.5**	25.1
East Midlands	12.3	8.2	-	**20.5**	22.1
East Anglia	6.0	-	0.1	**6.1**	6.6
London	60.6	1.4	-	**62.0**	67.4
South East	52.4	-	0.9	**53.3**	56.1
South West	26.8	2.4	0.5	**29.7**	36.6
West Midlands	18.6	0.6	-	**19.2**	21.2
North West	21.8	4.4	2.6	**28.8**	30.7
Wales	6.1	1.0	-	**7.1**	8.4
Scotland	3.5	0.6	0.1	**4.2**	4.8
	236.3	**25.9**	**5.4**	**267.6**	293.8

Loan-to-value information on the Group's commercial loan portfolio is set out below.

Loan-to-value	Group and Society 2018				2017
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Total £m
<40%	49.2	1.1	0.3	**50.6**	46.5
40% - 50%	34.5	0.3	0.8	**35.6**	41.5
50% - 60%	46.8	0.4	0.2	**47.4**	47.2
60% - 70%	44.9	0.7	0.2	**45.8**	59.0
70% - 80%	26.2	2.6	0.4	**29.2**	29.7
80% - 90%	15.6	1.5	-	**17.1**	20.2
90% - 100%	12.2	0.3	0.3	**12.8**	18.4
>100%	6.9	19.0	3.2	**29.1**	31.3
	236.3	**25.9**	**5.4**	**267.6**	293.8

At 31 December 2018 the average loan-to-value of commercial mortgages on a valuation weighted basis (calculated as the total outstanding balance divided by the total value of collateral held), was 50.0% (2017: 52.5%). The average loan-to-value is based on the latest external valuation of the properties within the portfolio.

Forbearance

The Group's policy on forbearance for commercial mortgages is the same as the policy for residential mortgages, which is found in note 36a)(i).

At 31 December 2018 the balance of commercial mortgages where the property has been taken into possession was £nil for the Group and Society (2017: £0.6m; representing 0.2% of total outstanding loans). All possessions balances are classified as stage 3.

The tables below provide further information on commercial mortgages regarded as being in forbearance as at 31 December 2018, showing the type of account renegotiations applied. For the purpose of these forbearance tables, the Group applies the European Banking Authority (EBA) definition of forbearance. Under the EBA definition, loans are required to meet certain payment and arrears criteria before they are deemed to exit forbearance; this includes a minimum two year probation period following the forbearance event (extended to three years in certain situations).

For the purpose of the tables below, the following loans are therefore regarded as being in forbearance as at 31 December 2018:

- any loan to which forbearance measures were applied within the two years prior to the reporting date (regardless of whether the loan remains on renegotiated terms at 31 December 2018); and
- any loan to which forbearance measures were applied and which remains on renegotiated terms at 31 December 2018 (even if the forbearance event was more than two years prior to the reporting date).

36. Credit risk *(continued)*

For the purpose of the tables below, loans are presented according to the ECL stage in which they were held as at the reporting date.

For the avoidance of doubt, the Group does not, and is not required to, apply the EBA definition of forbearance in its accounting policies; the Group's accounting policy for forbearance does not therefore include the minimum two year probation period that is included in the EBA definition (for full details of the Group's accounting policies for forbearance and the measurement of impairment losses, see note 1g)).

Group and Society 2018	Total £m	Reduced payment £m	Transfer to interest only £m	Total renegotiations £m	%
Stage 1					
Not past due	236.3	0.5	0.2	0.7	0.3
	236.3	**0.5**	**0.2**	**0.7**	**0.3**
Stage 2					
Not past due	22.2	1.7	7.2	8.9	40.1
Up to 30 days past due	1.0	0.5	-	0.5	50.0
Over 30 days past due	2.7	1.7	-	1.7	63.0
	262.2	**4.4**	**7.4**	**11.8**	**4.5**
Stage 3					
Not past due	2.7	-	-	-	-
Over 90 days past due	2.7	1.2	0.9	2.1	77.8
	267.6	**5.6**	**8.3**	**13.9**	**5.2**
Loss allowance	**(7.9)**	**(1.4)**	**(2.2)**	**(3.6)**	**45.6**
	259.7	**4.2**	**6.1**	**10.3**	**4.0**

Group and Society 2017	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Total renegotiations £m	%
Neither past due nor individually impaired	288.1	-	2.7	6.1	8.8	3.1
Past due but not individually impaired:						
Up to 3 months	2.8	-	-	1.7	1.7	60.7
	290.9	-	2.7	7.8	10.5	3.6
Individually impaired:						
Low risk	0.2	-	-	0.1	0.1	50.0
High risk	2.1	0.3	0.9	0.1	1.3	61.9
Possessions	0.6	-	-	-	-	-
	293.8	0.3	3.6	8.0	11.9	4.1
Collective impairment	(0.3)	-	-	-	-	-
Individual impairment	(7.7)	-	(1.1)	(1.9)	(3.0)	39.0
	285.8	0.3	2.5	6.1	8.9	3.1

Collateral

The collateral held consists of properties held within the categories previously outlined. The use of such collateral is in line with terms that are usual and customary to standard lending activities.

An analysis of capped collateral, where the collateral is capped to the lower of the value of the property and the amount outstanding on an individual loan basis, is shown below.

Fair value of capped collateral held	Group and Society 2018 £m
Stage 1	**234.4**
Stage 2	**20.9**
Stage 3	**3.6**
	258.9
Gross loan balances	**267.6**
Negative equity	**8.7**
Capped collateral held in respect of possessions (included within Stage 3 above)	**-**

	Group and Society 2017 £m
Not individually impaired	283.4
Impaired	1.6
Possessions	0.4
	285.4
Gross loan balances	293.8
Negative equity	8.4

The fair value of commercial property used to derive the figures in the table above is determined by reference to the latest external valuation of the properties in question. The total fair value of collateral held in respect of commercial loans for the Group and the Society at 31 December 2018 is £535.3m (2017: £559.1m).

At 31 December 2018 the contractual amount outstanding on loans written off during the year due to there being no reasonable expectation of recovery, but which remain subject to enforcement activity, is £nil for the Group and the Society.

iii) Other lending

Other lending comprises the following:

	Group					
	2018			2017		
	Gross carrying amount £m	ECL allowance £m	Net carrying amount £m	Gross carrying amount £m	Impairment £m	Net carrying amount £m
Debt factoring advances	91.4	(0.8)	**90.6**	79.9	(0.8)	79.1
Other loans	69.3	-	**69.3**	61.9	-	61.9
	160.7	**(0.8)**	**159.9**	141.8	(0.8)	141.0

Financial Statements

36. Credit risk *(continued)*

The table below provides information on movements in the gross carrying amount of other loans and advances during the year.

	Group 2018 Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross carrying amount as at 1 January	139.4	2.4	-	**141.8**
Transfers due to changes in credit risk:				
From stage 1 to stage 2	(2.8)	2.8	-	-
From stage 2 to stage 1	0.6	(0.6)	-	-
From stage 2 to stage 3	-	(0.2)	0.2	-
Increases due to origination	37.1	-	-	**37.1**
Decrease due to derecognition and repayments	(17.8)	(0.2)	-	**(18.0)**
Write-offs	-	-	(0.2)	**(0.2)**
Gross carrying amount as at 31 December	**156.5**	**4.2**	**-**	**160.7**

The amounts included in the table above represent the movement in the gross carrying amount between each reporting period end and not the balance as at the date of the movement.

The table below provides information on movements in the impairment loss allowance for other loans and advances during the year.

	Group 2018 Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Loss allowance as at 1 January	-	0.8	-	**0.8**
Transfers due to changes in credit risk:				
From stage 1 to stage 2	(0.6)	0.6	-	-
From stage 2 to stage 1	0.5	(0.5)	-	-
From stage 2 to stage 3	-	(0.2)	0.2	-
Increases due to origination	0.1	-	-	**0.1**
Remeasurements within existing stage	-	0.1	-	**0.1**
Write-offs	-	-	(0.2)	**(0.2)**
Loss allowance as at 31 December	**-**	**0.8**	**-**	**0.8**

The loss allowances as at 1 January 2018 in the table above represent the balances following adoption of IFRS 9 on 1 January 2018. For further details see note 1b).

Debt factoring advances

Debt factoring advances relate to amounts advanced to clients by Skipton Business Finance Limited (SBF), the Group's debt factoring and invoice discounting business.

Credit risk is predominantly managed by rigorous due diligence controls and regular monitoring of client accounts, and includes the use of concentration limits, credit reference checks and 'watchlists' on clients' debtors. Advances are typically made to clients only against notified invoices that are less than 90 days past due.

Debt factoring and invoice discounting advances are typically secured via a legal charge against the relevant client's sales ledger. Additional security may also be taken in the form of an all assets debenture that may incorporate other unencumbered assets as well as personal guarantees. At 31 December 2018, the fair value of the total collateral held by the Group against debt factoring and invoice discounting advances is in excess of the value of the total advances outstanding.

Other loans

The table below provides information on the gross carrying amount of other loans by payment due status.

	Stage 1 £m	Stage 2 £m	Total £m
Not past due	68.9	-	**68.9**
31 to 60 days past due	-	0.4	**0.4**
	68.9	**0.4**	**69.3**

The other loans of £69.3m (2017: £61.9m) were advanced by Skipton International Limited to customers in respect of residential properties owned by a property management holding company. The loans are secured on shares in that property management holding company and the fair value of the total collateral held is £108.0m (2017: £92.4m).

b) Credit risk – balances with the Bank of England, debt securities and loans and advances to credit institutions

The Group holds treasury investments in order to meet liquidity requirements and for general business purposes. The credit risk arising from these investments is closely monitored and managed by the Group.

Collateral held for treasury assets is determined by the nature of the instrument. Loans and debt securities are generally unsecured with the exception of asset backed securities and covered bonds which are secured by pools of financial assets. For details of collateral held against debt securities see note 11. For details of collateral held against loans and advances to credit institutions see note 10. No collateral is held against balances with the Bank of England.

As at 31 December 2018 and 31 December 2017 none of the Group or the Society's treasury assets were past due. The ECLs on the Group and the Society's treasury assets were classified as stage 1 at 31 December 2018.

At 31 December 2018 all of the Group and the Society's treasury investments were assessed to have a probability of default (PD) of under 0.15%.

The Group's accounting policies on impairment losses on treasury assets and how the Group assesses ECLs and PDs on treasury assets are detailed in note 1g).

As at 31 December 2018, 95.7% (2017: 98.7%) of the Group's treasury investment assets (including cash in hand and with the Bank of England) were rated A3 or better, and for the Society 95.6% (2017: 98.7%) were rated A3 or better. The table below provides further details of the credit ratings for both the Group and the Society's treasury investment portfolios:

Rating	Group 2018 £m	%	Group 2017 £m	%	Society 2018 £m	%	Society 2017 £m	%
Aaa	**610.5**	**14.5**	394.5	11.2	**721.7**	**17.6**	516.8	15.2
Aa1	**43.3**	**1.0**	39.1	1.1	**43.3**	**1.1**	39.1	1.1
Aa2	**2,777.0**	**66.1**	2,664.6	75.5	**2,642.6**	**64.6**	2,546.6	74.6
Aa3	**424.1**	**10.1**	191.7	5.4	**404.0**	**9.9**	155.5	4.5
A1	**102.7**	**2.5**	105.5	3.0	**64.3**	**1.6**	24.5	0.7
A2	**63.3**	**1.5**	22.4	0.6	**33.6**	**0.8**	22.0	0.6
A3	**-**	**-**	68.8	1.9	**-**	**-**	66.8	2.0
Baa2	**74.3**	**1.8**	-	-	**74.3**	**1.8**	-	-
Unrated:								
Building societies	**-**	**-**	1.7	-	**-**	**-**	1.7	-
Other	**106.3**	**2.5**	45.0	1.3	**106.3**	**2.6**	45.0	1.3
	4,201.5	**100.0**	3,533.3	100.0	**4,090.1**	**100.0**	3,418.0	100.0

'Other' in the above analysis comprises an exposure to a central clearing house used to clear derivatives to manage interest rate risk.

The Group also monitors exposure concentrations against a variety of criteria including industry sector / asset class and country of risk.

36. Credit risk *(continued)*

Industry sector / asset class	Group 2018 £m	%	Group 2017 £m	%	Society 2018 £m	%	Society 2017 £m	%
Cash in hand and balances with the Bank of England	2,395.7	57.0	2,396.9	67.7	2,395.7	58.6	2,396.9	70.1
Loans and advances to banks and building societies	422.7	10.1	345.3	9.8	349.5	8.5	260.8	7.6
Gilts	219.0	5.2	153.2	4.3	203.8	5.0	153.2	4.5
Certificates of deposit	316.5	7.5	55.1	1.6	301.5	7.4	20.0	0.6
Fixed rate bonds	242.6	5.8	178.6	5.1	242.6	5.9	178.6	5.2
Floating rate notes	20.0	0.5	24.0	0.7	20.0	0.5	-	-
Treasury bills	169.0	4.0	94.0	2.7	49.8	1.2	-	-
Covered bonds	208.6	5.0	87.4	2.5	208.6	5.1	87.4	2.6
Residential mortgage backed securities	207.4	4.9	198.8	5.6	318.6	7.8	321.1	9.4
	4,201.5	100.0	3,533.3	100.0	4,090.1	100.0	3,418.0	100.0

Geographical exposure	Group 2018 £m	%	Group 2017 £m	%	Society 2018 £m	%	Society 2017 £m	%
UK	3,750.6	89.3	3,303.4	93.5	3,676.6	89.9	3,252.7	95.2
Rest of Europe	388.4	9.2	188.0	5.3	388.4	9.5	164.0	4.8
North America	32.6	0.8	38.1	1.1	0.1	-	0.1	-
Australasia	29.9	0.7	3.8	0.1	25.0	0.6	1.2	-
	4,201.5	100.0	3,533.3	100.0	4,090.1	100.0	3,418.0	100.0

c) Credit risk – trade receivables

The tables below provide information on movements in trade receivables during the year. The gross carrying amounts as at 1 January 2018 represent the balances following adoption of IFRS 9 on 1 January 2018.

As outlined in note 1g), the Group's accounting policy for trade receivables is to always recognise lifetime ECLs in accordance with the simplified approach in IFRS 9. Trade receivables are therefore allocated to ECL stage 2 when initially recognised and no amounts are presented within stage 1.

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Gross carrying amount	33.8	32.5	1.9	1.2
Loss allowance	(2.5)	(1.7)	(0.1)	(0.1)
Net carrying amount	31.3	30.8	1.8	1.1

	Group 2018 Stage 2 £m	Group 2018 Stage 3 £m	Group 2018 Total £m	Society 2018 Stage 2 £m	Society 2018 Total £m
Gross carrying amount as at 1 January	32.5	-	32.5	1.2	1.2
Transfers from stage 2 to stage 3	(0.4)	0.4	-	-	-
Increases due to origination	444.0	-	444.0	12.3	12.3
Decrease due to derecognition and repayments	(442.7)	-	(442.7)	(11.6)	(11.6)
Gross carrying amount as at 31 December	33.4	0.4	33.8	1.9	1.9

	Group 2018 Stage 2 £m	Group 2018 Stage 3 £m	Group 2018 Total £m	Society 2018 Stage 2 £m	Society 2018 Total £m
Loss allowance as at 1 January	1.7	-	1.7	0.1	0.1
Transfers from stage 2 to stage 3	(0.1)	0.1	-	-	-
Increases due to origination	1.1	-	1.1	-	-
Decrease due to derecognition and repayments	(0.3)	-	(0.3)	-	-
Loss allowance at 31 December	2.4	0.1	2.5	0.1	0.1

The table below provides information on the gross carrying amount of trade receivables by payment due status.

	Group 2018 Stage 2 £m	Group 2018 Stage 3 £m	Group 2018 Total £m	Society 2018 Stage 2 £m	Society 2018 Total £m
Not past due	13.1	-	13.1	0.5	0.5
Up to 30 days past due	12.3	-	12.3	0.5	0.5
31 to 120 days past due	5.7	0.2	5.9	0.6	0.6
Over 120 days past due	2.3	0.2	2.5	0.3	0.3
	33.4	0.4	33.8	1.9	1.9

With respect to the prior year, at 31 December 2017 the Group had £1.7m of trade receivables that were individually impaired and £17.7m of trade receivables that were past due but which were not individually impaired. The Society had £0.1m of trade receivables that were individually impaired and £0.7m of trade receivables that were past due but not individually impaired.

No collateral is held against trade receivables. At 31 December 2018 the contractual amount outstanding on trade receivables written off during the year due to there being no reasonable expectation of recovery, but which remain subject to enforcement activity, is £nil for the Group and £nil for the Society.

d) Credit risk – derivative financial instruments

A credit exposure could arise in respect of derivative contracts entered into by the Group if the counterparty was unable to fulfil its contractual obligations. The Group addresses the risks associated with these activities by monitoring counterparty credit exposure and requiring additional collateral to be posted or returned as necessary. For all but one derivative, the only form of collateral accepted by the Group in respect of derivatives is cash. Derivatives are either transacted under International Swaps and Derivatives Association (ISDA) Master Agreements or Cleared Derivatives Execution Agreements. For swaps that are cash collateralised, no Credit (CVA) or Debit (DVA) Value Adjustments have been made in respect of credit risk in determining the fair value of these derivatives as the risk is significantly mitigated. Credit Support Annexes executed with certain counterparties in conjunction with the ISDA Master Agreement require collateral to be posted regularly, as required by specific terms and conditions of the arrangements. Due to the frequency of the posting of collateral, there is no material exposure from these minimal timing differences that would require CVA or DVA adjustments. At 31 December 2018 the Group held one derivative that is not fully collateralised for cash; CVA and DVA adjustments are made to the valuation of this derivative.

Netting arrangements do not necessarily result in an offset of Statement of Financial Position (SOFP) assets and liabilities, as transactions are usually settled on a gross basis. The Group's legal documentation for derivative transactions does grant legal rights of set-off for those transactions with the same counterparty. Accordingly the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will offset positive mark to market values on derivatives. The table below provides further detail on the net exposure to derivative transaction counterparties.

36. Credit risk *(continued)*

Group	2018				2017			
	As reported in SOFP £m	Netting agreements £m	Cash collateral £m	Net amounts after offsetting £m	As reported in SOFP £m	Netting agreements £m	Cash collateral £m	Net amounts after offsetting £m
Financial assets								
Derivative financial instruments	72.3	(55.4)	(9.8)	7.1	94.2	(57.8)	(37.2)	(0.8)
Financial liabilities								
Derivative financial instruments	279.4	(55.4)	(196.7)	27.3	318.5	(57.8)	(215.8)	44.9

Society	2018				2017			
	As reported in SOFP £m	Netting agreements £m	Cash collateral £m	Net amounts after offsetting £m	As reported in SOFP £m	Netting agreements £m	Cash collateral £m	Net amounts after offsetting £m
Financial assets								
Derivative financial instruments	68.2	(57.3)	(10.1)	0.8	98.2	(58.9)	(40.6)	(1.3)
Financial liabilities								
Derivative financial instruments	282.3	(57.3)	(196.7)	28.3	318.9	(58.9)	(215.8)	44.2

With regards to the Group's derivative assets, there is a net amount after offsetting of £7.1m (2017: £(0.8)m) between the value of the derivatives and the cash collateral held. This relates mostly to the collateral arrangements for one of the Group's derivatives where the counterparty is not required to post collateral up to a threshold.

With regards to the Group's derivative liabilities, there is a net amount after offsetting of £27.3m (2017: £44.9m) between the value of the derivatives and the cash collateral pledged. This relates almost entirely to two of the derivatives the Society holds to hedge its equity release portfolio. These derivatives are long dated and bespoke in nature. They contain optionality relating to the pool balance they are linked to and an RPI cap and floor. As a result, their valuation can vary significantly depending on the assumptions and modelling techniques used. Both swap counterparties arrive at valuations that are different to the Society's, resulting in this difference between the valuation and the collateral pledged.

37. Fair values

a) Classification and measurement

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

Group	2018				2017			
	Amortised cost £m	FVOCI £m	FVTPL £m	Total £m	Amortised cost £m	Available -for-sale £m	FVTPL £m	Total £m
Cash in hand and balances with the Bank of England	2,395.7	-	-	**2,395.7**	2,396.9	-	-	2,396.9
Loans and advances to credit institutions	422.7	-	-	**422.7**	345.3	-	-	345.3
Debt securities	-	1,383.1	-	**1,383.1**	1.7	789.4	-	791.1
Derivative financial instruments	-	-	72.3	**72.3**	-	-	94.2	94.2
Loans and advances to customers	18,127.0	-	1.9	**18,128.9**	16,998.4	-	(25.7)	16,972.7
Equity release portfolio (note 1)	-	-	410.9	**410.9**	-	-	-	-
Equity share investments	-	-	0.8	**0.8**	-	0.4	-	0.4
Trade receivables	31.3	-	-	**31.3**	30.8	-	-	30.8
Contingent consideration	-	-	23.0	**23.0**	25.1	-	-	25.1
Total financial assets	**20,976.7**	**1,383.1**	**508.9**	**22,868.7**	19,798.2	789.8	68.5	20,656.5
Other non-financial assets				**335.7**				367.1
Total assets				**23,204.4**				21,023.6
Shares	16,113.5	-	-	**16,113.5**	14,985.8	-	-	14,985.8
Amounts owed to credit institutions and other customers	3,568.4	-	-	**3,568.4**	3,288.3	-	-	3,288.3
Debt securities in issue	1,420.3	-	-	**1,420.3**	666.4	-	-	666.4
Derivative financial instruments	-	-	279.4	**279.4**	-	-	318.5	318.5
Trade payables	5.4	-	-	**5.4**	4.4	-	-	4.4
Fair value of put option obligation	-	-	8.3	**8.3**	-	-	9.9	9.9
Subscribed capital	41.6	-	-	**41.6**	41.6	-	-	41.6
Total financial liabilities	**21,149.2**	**-**	**287.7**	**21,436.9**	18,986.5	-	328.4	19,314.9
Other non-financial liabilities				**242.7**				303.9
Total liabilities				**21,679.6**				19,618.8

Note
1. As outlined in note 1b), the equity release portfolio was reclassified to be held at FVTPL following adoption of IFRS 9 on 1 January 2018. For the year ended 31 December 2017 the equity release portfolio was included within loans and advances to customers and held at amortised cost, except for the embedded derivative which was held separately at FVTPL.

All financial assets and liabilities in the table above that are held as at FVTPL are mandatorily held as such.

37. Fair values *(continued)*

Society

	2018				2017			
	Amortised cost £m	FVOCI £m	FVTPL £m	Total £m	Amortised cost £m	Available -for-sale £m	FVTPL £m	Total £m
Cash in hand and balances with the Bank of England	2,395.7	-	-	**2,395.7**	2,396.9	-	-	2,396.9
Loans and advances to credit institutions	349.5	-	-	**349.5**	260.8	-	-	260.8
Debt securities	-	1,262.9	82.0	**1,344.9**	124.0	636.3	-	760.3
Derivative financial instruments	-	-	68.2	**68.2**	-	-	98.2	98.2
Loans and advances to customers	15,999.2	-	1.9	**16,001.1**	14,912.3	-	(25.7)	14,886.6
Equity release portfolio (note 1)	-	-	410.9	**410.9**	-	-	-	-
Loans to subsidiary undertakings	854.4	-	-	**854.4**	965.4	-	-	965.4
Trade receivables	1.8	-	-	**1.8**	1.1	-	-	1.1
Total financial assets	**19,600.6**	**1,262.9**	**563.0**	**21,426.5**	18,660.5	636.3	72.5	19,369.3
Other non-financial assets				**211.1**				197.3
Total assets				**21,637.6**				19,566.6
Shares	16,113.5	-	-	**16,113.5**	14,985.8	-	-	14,985.8
Amounts owed to credit institutions and other customers (note 2)	2,204.2	-	324.9	**2,529.1**	2,090.0	-	414.8	2,504.8
Debt securities in issue	1,194.4	-	-	**1,194.4**	360.0	-	-	360.0
Derivative financial instruments	-	-	282.3	**282.3**	-	-	318.9	318.9
Trade payables	1.8	-	-	**1.8**	1.5	-	-	1.5
Subscribed capital	41.6	-	-	**41.6**	41.6	-	-	41.6
Total financial liabilities	**19,555.5**	**-**	**607.2**	**20,162.7**	17,478.9	-	733.7	18,212.6
Other non-financial liabilities				**92.6**				90.0
Total liabilities				**20,255.3**				18,302.6

Notes

1. As outlined in note 1b), the equity release portfolio was reclassified to be held at FVTPL following adoption of IFRS 9 on 1 January 2018. For the year ended 31 December 2017 the equity release portfolio was included within loans and advances to customers and held at amortised cost, except for the embedded derivative which was held separately at FVTPL.
2. Included in amounts owed to other customers in 2018 are £324.9m of deemed loans payable to the Group's SPVs. Under IFRS 9, which was adopted on 1 January 2018, these deemed loans were voluntarily designated as FVTPL. For further details see note 1b). All other financial assets and liabilities that are held as at FVTPL in the table above are mandatorily held as such.

b) Valuation of financial instruments carried at fair value

The Group holds certain financial assets and liabilities at fair value, grouped into Levels 1 to 3 of the fair value hierarchy as explained below.

Valuation techniques

Fair values are determined using the following fair value hierarchy that reflects the significance of the inputs used in measuring fair value:

Level 1

The most reliable fair values of financial instruments are quoted market prices in an actively traded market. The Group's Level 1 portfolio mainly comprises gilts, fixed rate bonds and floating rate notes for which traded prices are readily available.

Level 2

These are valuation techniques for which all significant inputs are taken from observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed when no active market exists and quoted prices are available for similar instruments in active markets. Examples of Level 2 instruments are certificates of deposit and interest rate swaps.

Level 3

These are valuation techniques for which one or more significant inputs are not based on observable market data.

Valuation techniques include net present value by way of discounted cash flow models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, similar market products, foreign currency exchange rates and equity index prices. Critical judgement is applied by management in utilising unobservable inputs including expected price volatilities, expected mortality rates and prepayment rates, based on industry practice or historical observation. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's-length.

Transfers between levels

The Group makes transfers between the different levels of the fair value hierarchy where the inputs used to measure the fair value of the financial instruments in question no longer satisfy the conditions required to be classified in a certain level within the hierarchy. Any such transfer between different levels of the fair value hierarchy is made at the date the event in question that results in a change in circumstances occurs. There were no transfers between different levels of the fair value hierarchy during the year ended 31 December 2018 or the year ended 31 December 2017.

The following tables provide an analysis of financial assets and liabilities held within the Statement of Financial Position at fair value, grouped into Levels 1 to 3 of the fair value hierarchy.

Group

	2018				2017			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Financial assets held at FVOCI / available-for-sale:								
Debt securities	1,066.6	316.5	-	**1,383.1**	734.3	55.1	-	789.4
Equity share investments	-	-	-	**-**	-	-	0.4	0.4
Financial assets at FVTPL:								
Embedded derivatives within loans and advances to customers	-	-	-	**-**	-	-	(25.7)	(25.7)
Equity share investments	0.1	-	0.7	**0.8**	-	-	-	-
Derivative financial instruments	-	71.2	1.1	**72.3**	-	92.8	1.4	94.2
Equity release portfolio	-	-	410.9	**410.9**	-	-	-	-
Loans and advances to customers	-	-	1.9	**1.9**	-	-	-	-
Contingent consideration	-	-	23.0	**23.0**	-	-	-	-
	1,066.7	**387.7**	**437.6**	**1,892.0**	734.3	147.9	(23.9)	858.3
Financial liabilities								
Financial liabilities at FVTPL:								
Derivative financial instruments	-	63.9	215.5	**279.4**	-	84.6	233.9	318.5
Fair value of put option obligation	-	-	8.3	**8.3**	-	-	9.9	9.9
	-	**63.9**	**223.8**	**287.7**	-	84.6	243.8	328.4
	1,066.7	**323.8**	**213.8**	**1,604.3**	734.3	63.3	(267.7)	529.9

Financial Statements

37. Fair values *(continued)*

Society	2018				2017			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Financial assets held at FVOCI / available-for-sale:								
Debt securities	961.4	301.5	-	1,262.9	616.3	20.0	-	636.3
Financial assets at FVTPL:								
Embedded derivatives within loans and advances to customers	-	-	-	-	-	-	(25.7)	(25.7)
Derivative financial instruments	-	68.1	0.1	68.2	-	97.2	1.0	98.2
Debt securities	82.0	-	-	82.0	-	-	-	-
Equity release portfolio	-	-	410.9	410.9	-	-	-	-
Loans and advances to customers	-	-	1.9	1.9	-	-	-	-
	1,043.4	369.6	412.9	1,825.9	616.3	117.2	(24.7)	708.8
Financial liabilities								
Financial liabilities at FVTPL:								
Derivative financial instruments	-	66.9	215.4	282.3	-	86.0	232.9	318.9
Amounts owed to credit institutions and other customers	-	-	324.9	324.9	-	-	414.8	414.8
	-	66.9	540.3	607.2	-	86.0	647.7	733.7
	1,043.4	302.7	(127.4)	1,218.7	616.3	31.2	(672.4)	(24.9)

The tables below analyse the movements in the Level 3 portfolio during the year:

Group	2018						
	Equity share investments £m	Equity release portfolio £m	Loans and advances to customers £m	Derivative financial instruments £m	Fair value of put option obligation £m	Contingent consideration £m	Total £m
At 1 January	0.4	426.6	-	(232.5)	(9.9)	25.1	209.7
(Loss) / gain recognised in Income Statement	(0.2)	(17.1)[1]	-	18.1[2]	(0.2)[3]	3.3[4]	3.9
Transfer of engagements	-	-	1.7	-	-	-	1.7
Contingent consideration received (net of costs)	-	-	-	-	-	(5.4)	(5.4)
Revaluation of market values	-	-	-	-	1.5[5]	-	1.5
Accrued interest	-	8.0[6]	-	-	-	-	8.0
Repayments	-	(6.2)	(0.7)	-	-	-	(6.9)
Realised losses	-	(0.7)[7]	-	-	-	-	(0.7)
Exercise of put options by non-controlling shareholders	-	-	-	-	0.3	-	0.3
Additions / other movements	0.5	0.3	0.9	-	-	-	1.7
At 31 December	0.7	410.9	1.9	(214.4)	(8.3)	23.0	213.8

Notes
1. These are unrealised losses and are included in the 'Fair value losses on equity release portfolio' line in the Income Statement.
2. These are unrealised gains and are included in the 'Fair value gains on other derivatives' line in the Income Statement.
3. Included in the 'Interest payable and similar charges' line in the Income Statement and arises from the unwind of the liability and changes to exercise dates.
4. Included in the 'Profit on disposal of subsidiary undertakings' line in the Income Statement.
5. Included in the 'Administrative expenses' line in the Income Statement and arises from changes to assumptions regarding the market value of the put options.
6. Included in the 'Interest receivable and similar income' line in the Income Statement.
7. Included in the 'Realised losses on equity release portfolio' line in the Income Statement.

Group	2017				
	Equity share investments £m	Embedded derivatives £m	Derivative financial instruments £m	Fair value of put option obligation £m	Total £m
At 1 January	0.4	(27.7)	(246.9)	(11.7)	(285.9)
(Loss) / gain recognised in Income Statement	(0.1)[1]	1.8[2]	14.4[3]	(0.1)[4]	16.0
Losses written off during the year	-	0.2	-	-	0.2
Revaluation of market values	-	-	-	1.9[5]	1.9
Additions	0.1	-	-	-	0.1
At 31 December	0.4	(25.7)	(232.5)	(9.9)	(267.7)

Notes
1. Included in the 'Impairment losses on equity share investments' line in the Income Statement.
2. Included in the 'Impairment (charge) / credit on loans and advances to customers' line in the Income Statement.
3. Included in the 'Fair value gains on hedging instruments and hedged items' line in the Income Statement. The majority of these derivatives are held to hedge the Group's equity release portfolio and a loss, largely offsetting the above amount, was recognised through the same line in the Income Statement in respect of the underlying mortgages that were being hedged. However, some hedge ineffectiveness resulted during the year and this resulted in an overall credit to the Income Statement of £1.7m.
4. Included in the 'Interest payable and similar charges' line in the Income Statement and arises from the unwind of the liability and changes to exercise dates.
5. Included in the 'Administrative expenses' line in the Income Statement and arises from changes to assumptions regarding the market value of the put options.

Society	2018				
	Equity release portfolio £m	Loans and advances to customers £m	Derivative financial instruments £m	Amounts owed to credit institutions and other customers £m	Total £m
At 1 January	426.6	-	(231.9)	(414.8)	(220.1)
(Loss) / gain recognised in Income Statement	(17.1)[1]	-	16.6[2]	1.4[3]	0.9
Transfer of engagements	-	1.7	-	-	1.7
Accrued interest	8.0[4]	-	-	-	8.0
Repayments	(6.2)	(0.7)	-	88.5	81.6
Realised losses	(0.7)[5]	-	-	-	(0.7)
Additions / other movements	0.3	0.9	-	-	1.2
At 31 December	410.9	1.9	(215.3)	(324.9)	(127.4)

Notes
1. Included in the 'Fair value losses on equity release portfolio' line in the Income Statement.
2. £18.1m of this figure is included in the 'Fair value gains on other derivatives' line in the Income Statement; the remaining £(1.5)m is included in the 'Fair value gains on hedging instruments and hedged items' line in the Income Statement.
3. Included in the 'Fair value gains on deemed loans from subsidiary undertakings designated at FVTPL' line in the Income Statement and relates to the fair value movements in the deemed loans repayable to the Group's securitisation entities, as outlined in note 1c).
4. Included in the 'Interest receivable and similar income' line in the Income Statement.
5. Included in the 'Realised losses on equity release portfolio' line in the Income Statement.

37. Fair values *(continued)*

Society	2017			
	Embedded derivatives £m	Derivative financial instruments £m	Amounts owed to credit institutions and other customers £m	Total £m
At 1 January	(27.7)	(243.6)	(761.8)	(1,033.1)
Gain recognised in the Income Statement	1.8[1]	11.7[2]	3.0[3]	16.5
Losses written off during the year	0.2	-	-	0.2
Repayments	-	-	344.0	344.0
At 31 December	(25.7)	(231.9)	(414.8)	(672.4)

Notes
1. Included in the 'Impairment (charge) / credit on loans and advances to customers' line in the Income Statement.
2. Included in the 'Fair value gains on hedging instruments and hedged items' line in the Income Statement. The majority of these derivatives are held to hedge the Group's equity release portfolio and a loss, largely offsetting the above amount, was recognised through the same line in the Income Statement in respect of the underlying mortgages that were being hedged. However, some hedge ineffectiveness resulted during the year and this resulted in an overall credit to the Income Statement of £1.7m.
3. Included in the 'Fair value gains on hedging instruments and hedged items' line in the Income Statement and relates to the fair value movements in the deemed loans repayable to the Group's securitisation entities, as outlined in note 1c).

Equity share investments

The valuation of unlisted investments is regarded as a Level 3 valuation technique as certain inputs are not market observable. Further details are found in note 17e).

Equity release portfolio

The valuation of the equity release portfolio is regarded as a Level 3 valuation technique as certain inputs into the valuation are not market observable. Further details on the valuation techniques used are found in note 1e). Further details on the inputs into the valuation and the impact of reasonably possible alternative assumptions of certain inputs into the valuation of the portfolio are found in note 1t).

Derivative financial instruments

The Level 3 derivative financial instruments included in the tables on pages 208 to 210 comprise derivatives which are used to hedge the Group's interest rate risk and inflation risk arising from the equity release portfolio. The valuation of these derivatives is regarded as a Level 3 valuation technique as certain inputs into the valuation are not market observable. Further details on the inputs into the valuation and the impact of reasonably possible alternative assumptions of certain inputs into the valuation of the portfolio are found in note 1t).

As outlined in note 1b), following adoption of IFRS 9 on 1 January 2018, the equity release portfolio was reclassified from amortised cost to held at FVTPL. Therefore hedge accounting is no longer applied to the portfolio and, whilst the derivatives outlined above held to hedge the portfolio are still retained for commercial hedging purposes, they no longer satisfy the conditions to be applied in a hedging relationship for hedge accounting purposes. Fair value gains and losses on these derivatives are recognised within 'Fair value gains on other derivatives' in the Income Statement.

Any change in fair value of the derivative liabilities is offset to some extent by a corresponding but opposite change in the value of the equity release portfolio. The characteristics and the valuation requirements differ slightly between the derivatives and the equity release portfolio resulting in the changes in fair value not offsetting completely. During the year the net impact to the Income Statement was a £1.0m credit.

Loans and advances to customers

The valuation of these loans and advances to customers is regarded as a Level 3 valuation technique as certain inputs are not market observable. Further details are found in note 1e).

Contingent consideration

The valuation of contingent consideration is regarded as a Level 3 valuation technique as certain inputs into the valuation are not market observable. Further details are found in note 1e).

Fair value of put option obligation

A key input into the calculation of the fair value of the put option obligation is the estimate of the market value of the non-controlling shareholding. As this input is based on the judgement of senior management, the valuation of the put option obligation is considered to be a Level 3 valuation technique.

Amounts owed to credit institutions and other customers

These balances relate to deemed loans payable by the Society to the Group's SPVs. The amount represents the proceeds received by the Society for assets transferred to the SPVs. The valuation is regarded as a Level 3 valuation technique as certain inputs are not market observable. Further details are found in note 13.

c) Fair values of financial assets and liabilities not carried at fair value

The tables below summarise the carrying values and fair values of those financial assets and liabilities not presented within the Statement of Financial Position at fair value.

	Group 2018		**Society 2018**	
	Carrying value £m	**Fair value £m**	**Carrying value £m**	**Fair value £m**
Financial assets				
Cash in hand and balances with the Bank of England	2,395.7	2,395.7	2,395.7	2,395.7
Loans and advances to credit institutions	422.7	422.7	349.5	349.5
Loans and advances to customers	18,127.0	18,268.1	15,999.2	16,137.1
Trade receivables	31.3	31.3	1.8	1.8
Loans to subsidiary undertakings	-	-	854.4	854.4
	20,976.7	**21,117.8**	**19,600.6**	**19,738.5**
Financial liabilities				
Shares	16,113.5	16,186.3	16,113.5	16,186.3
Amounts owed to credit institutions	1,878.0	1,878.9	1,999.9	2,000.8
Amounts owed to other customers	1,690.4	1,694.9	204.3	204.2
Debt securities in issue	1,420.3	1,410.3	1,194.4	1,188.1
Trade payables	5.4	5.4	1.8	1.8
Subscribed capital	41.6	69.0	41.6	69.0
	21,149.2	**21,244.8**	**19,555.5**	**19,650.2**

	Group 2017		Society 2017	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash in hand and balances with the Bank of England	2,396.9	2,396.9	2,396.9	2,396.9
Loans and advances to credit institutions	345.3	345.3	260.8	260.8
Debt securities	1.7	1.7	124.0	115.8
Loans and advances to customers	16,998.4	16,936.9	14,912.3	14,859.9
Trade receivables	30.8	30.8	1.1	1.1
Contingent consideration	25.1	25.1	-	-
Loans to subsidiary undertakings	-	-	965.4	965.4
	19,798.2	19,736.7	18,660.5	18,599.9
Financial liabilities				
Shares	14,985.8	15,070.3	14,985.8	15,070.3
Amounts owed to credit institutions	1,483.2	1,491.8	1,580.1	1,588.6
Amounts owed to other customers	1,805.1	1,810.8	509.9	510.1
Debt securities in issue	666.4	675.7	360.0	364.1
Trade payables	4.4	4.4	1.5	1.5
Subscribed capital	41.6	79.0	41.6	79.0
	18,986.5	19,132.0	17,478.9	17,613.6

37. Fair values *(continued)*

Key considerations in the calculation of fair values of those financial assets and liabilities not presented within the Statement of Financial Position at fair value are set out below unless there is no significant difference between carrying value and fair value.

Loans and advances to customers

For fixed rate and tracker mortgage products, the Group has estimated the fair value of these products using discounted cash flows and has applied relevant current market product rates as discount rates in order to also incorporate an element of future expected credit losses. Incurred losses have also been included. Fixed rate and tracker mortgages have been discounted using current market product rates that are specific to the particular market to which they relate.

Market prices will generally have moved since the fixed or tracker rate was taken out, therefore the valuation of these products will change reflecting upwards or downwards movements in market rates. The valuation includes information and expectations regarding estimated redemption profiles which are regularly reviewed and updated in light of experience.

As these redemption profiles are not considered to be observable by the market, the fair value of loans and advances to customers is considered to be derived by using Level 3 valuation techniques.

For standard variable rate 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.

Shares

Savings products at variable rates are at current market rates and therefore the Group regards the fair value to be equal to the carrying value.

The fair value of fixed rate savings products has been determined using discounted cash flows, discounted using a combined yield curve of cash and swap term rates.

Changes in market prices since the product was taken out will result in increases or decreases in the fair value of the fixed rate savings products. Penalties for early withdrawal on notice accounts are such as to suggest a negligible early withdrawal rate and none has therefore been applied; as a result the valuation of shares is considered to be a Level 2 valuation technique.

Amounts owed to credit institutions and other customers

Balances in these categories are valued using discounted cash flows which use only observable market inputs consisting of the combined yield curve of cash and swap term rates. All inputs to this valuation technique are market observable and as such they are categorised within Level 2 of the fair value hierarchy.

Debt securities in issue

Where securities are actively traded in a recognised market, with readily available and quoted prices, these have been used to value the securities. These securities are therefore regarded as having Level 1 fair values. Where such prices are not available, discounted cash flows are used, again using only market observable inputs consisting of a combined yield curve of cash and swap term rates. As such, these securities are categorised as having Level 2 fair values.

Subscribed capital

Prices are quoted for these instruments in actively traded markets and, as a result, these instruments are categorised as having Level 1 fair values.

d) Fair values of non-financial assets and liabilities not carried at fair value

The fair value of investment property, which is a non-financial asset, is disclosed in these financial statements. Note 19 contains details of the valuation techniques used in estimating this fair value, together with the resulting categorisation of these valuation techniques within the fair value hierarchy.

38. Group segmental reporting

The Group's structure and reportable segments are outlined in the Strategic Report on pages 13 and 14.

Transactions between the segments are on normal commercial terms and conditions. The accounting policies of the reportable segments are consistent with the Group's accounting policies. We have not aggregated any of our operating segments for the purposes of financial reporting.

No geographical analysis is presented because substantially all of the Group's activities are conducted within the UK. Of the total external income, £38.6m (2017: £39.2m) was generated outside the UK.

A breakdown of the allocation of goodwill to each segmental area is included within note 20.

	2018				
	Mortgages and Savings £m	Estate Agency £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
Net interest income	230.6	0.3	2.1	8.2	**241.2**
Net non-interest income	31.9	428.5	30.3	(13.7)	**477.0**
Fair value gains on hedged items and derivatives	19.6	-	-	-	**19.6**
Fair value losses on equity release portfolio	(17.1)	-	-	-	**(17.1)**
Fair value losses on other financial assets held at FVTPL	-	(0.3)	-	-	**(0.3)**
Profit on disposal of Group undertakings	-	-	-	3.3	**3.3**
Share of profits from joint ventures	-	0.8	-	-	**0.8**
Total income	**265.0**	**429.3**	**32.4**	**(2.2)**	**724.5**
Administrative expenses	(148.7)	(359.3)	(24.6)	11.6	**(521.0)**
Realised losses on equity release portfolio	(0.7)	-	-	-	**(0.7)**
Impairment losses and provisions for liabilities	(1.3)	(13.1)	(0.2)	-	**(14.6)**
Profit before tax	**114.3**	**56.9**	**7.6**	**9.4**	**188.2**
Taxation	(27.2)	(11.9)	(0.9)	(0.6)	**(40.6)**
Profit after tax	**87.1**	**45.0**	**6.7**	**8.8**	**147.6**
Total assets	23,008.0	263.8	104.4	(171.8)	**23,204.4**
Total liabilities	21,595.4	134.4	106.5	(156.7)	**21,679.6**
Capital expenditure	7.6	9.2	2.6	-	**19.4**

Total income can be analysed as follows:

	2018				
	Mortgages and Savings £m	Estate Agency £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
External income	263.2	418.0	33.6	9.7	**724.5**
Income from other segments	1.8	11.3	(1.2)	(11.9)	**-**
Total income	**265.0**	**429.3**	**32.4**	**(2.2)**	**724.5**

Financial Statements

38. Group segmental reporting *(continued)*

	2017				
	Mortgages and Savings £m	Estate Agency £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
Net interest income	211.4	(0.1)	1.8	7.5	220.6
Net non-interest income	33.0	417.4	30.6	(8.5)	472.5
Fair value gains on financial instruments	1.5	-	-	-	1.5
Profit on treasury assets	2.7	-	-	-	2.7
Loss on disposal of mortgage assets	(15.0)	-	-	-	(15.0)
Profit / (loss) on disposal of Group undertakings	-	39.4	(4.9)	16.2	50.7
Dividend income from equity share investments	-	0.6	-	-	0.6
Share of profits from joint ventures	-	2.0	-	-	2.0
Total income	233.6	459.3	27.5	15.2	735.6
Administrative expenses	(141.9)	(345.5)	(27.2)	(8.5)	(523.1)
Impairment and provisions for liabilities	(2.6)	(9.6)	(0.2)	-	(12.4)
Profit before tax	89.1	104.2	0.1	6.7	200.1
Taxation	(20.9)	(20.1)	(1.1)	0.2	(41.9)
Profit / (loss) after tax	68.2	84.1	(1.0)	6.9	158.2
Total assets	20,786.0	279.8	129.2	(171.4)	21,023.6
Total liabilities	19,484.7	139.6	135.6	(141.1)	19,618.8
Capital expenditure	9.0	12.3	2.2	-	23.5

Total income can be analysed as follows:

	2017				
	Mortgages and Savings £m	Estate Agency £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
External income	232.1	447.8	28.3	27.4	735.6
Income from other segments	1.5	11.5	(0.8)	(12.2)	-
Total income	233.6	459.3	27.5	15.2	735.6

39. Capital management

Pages 32 and 33 in the Strategic Report sets out the components of the prudential group's capital and the associated regulatory framework, and is followed by quantitative disclosure of the components of capital resources and capital requirements. Page 32 of the Strategic Report sets out the Group's capital management processes. Throughout the current and previous year, the Group complied with and maintained surplus capital above all externally imposed capital requirements.

40. Adoption of new and revised International Financial Reporting Standards

The Group adopted during the year the following new accounting standards, further details of which are provided in note 1b):

- IFRS 9 *Financial Instruments*; and
- IFRS 15 *Revenue from Contracts with Customers*.

The Group also adopted during the year the following amendments to existing accounting standards, none of which had a material impact on these financial statements:

- Amendments to IFRS 12 *Disclosures of Interests in Other Entities* and IAS 28 *Investments in Associates and Joint Ventures* as part of the *Annual Improvements to IFRS Standards 2014 – 2016 cycle*;
- Amendments to IFRS 2 *Share-based payment*, which clarifies the accounting for certain types of share-based payment arrangements;
- Amendments to IAS 40 *Investment property*, regarding transfers of investment property; and
- Consequential amendments to existing accounting standards as a result of adopting IFRS 9 and IFRS 15. This includes an amendment to IAS 1 *Presentation of financial statements*, which now requires separate presentation in the Income Statement of interest receivable that is calculated using the effective interest method.

Standards issued but not yet effective

The Group notes a number of new accounting standards which will be effective for future reporting periods, none of which have been early adopted in preparing these financial statements.

IFRS 16 Leases

IFRS 16 replaces the existing requirements in IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 introduces a single, on-balance sheet accounting model for lessees. A lessee recognises a right-of-use asset, representing its right to use the underlying asset, and a lease liability, representing its obligation to make lease payments. There are optional recognition exemptions for short term leases and leases of low value items. Lessor accounting remains similar to the existing standard in that lessors will continue to classify leases as finance leases or operating leases. IFRS 16 is effective for accounting periods beginning on or after 1 January 2019, with early adoption permitted (subject to also applying IFRS 15). The Group currently plans to first adopt IFRS 16 in its half-yearly report for the six months ending 30 June 2019, with an initial application date of 1 January 2019.

The Group has assessed the estimated impact of IFRS 16 application on its consolidated financial statements, as described below. The actual impacts of adopting the standard on 1 January 2019 may change because:

- The Group's new processes and controls remain subject to refinement; and
- The Group's new accounting policies are subject to change until the Group presents its first financial statements that include the date of initial application.

The most significant impact identified to date is that the Group will recognise new assets and liabilities for its operating leases, which mainly relate to numerous branch premises. In addition, the nature of expenses related to those leases will change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and an interest expense on lease liabilities. As at 31 December 2018, the Group's future minimum lease payments under non-cancellable operating leases amounted to £69.2m on an undiscounted basis (see note 32b)).

The Group plans to apply IFRS 16 initially on 1 January 2019, using the modified retrospective approach. As permitted by IFRS 16, the Group will measure the right-of-use asset at 1 January 2019 at an amount equal to the lease liability. Based on the transition method to be applied, there will be no impact on the Group's opening balance of retained earnings at 1 January 2019 as a result of adopting IFRS 16. In accordance with this transition approach, comparative information will not be restated.

The Group plans to apply the practical expedient to 'grandfather' the definition of a lease on transition. This means that it will apply IFRS 16 to all contracts entered into before 1 January 2019 that were identified as leases in accordance with IAS 17 and IFRIC 4.

The Group estimates that the day 1 impact of adopting IFRS 16 on the Group's consolidated balance sheet at 1 January 2019 will be as follows:

- New right-of-use assets of approximately £70m;
- New lease liabilities of approximately £70m;

40. Adoption of new and revised International Financial Reporting Standards *(continued)*

- As noted above, there is no expected day 1 impact on the Group's reserves due to the choice of transition method being applied.

The Group estimates that the impact of applying IFRS 16 on the Group's Income Statement for the year ending 31 December 2019 will be to reduce profit for the year by less than £1m.

For regulatory capital purposes, we expect to treat IFRS 16 right-of-use assets in the same way as for owned tangible assets, i.e. the right-of-use asset will be 100% risk-weighted.

Other standards

The following amended standards and interpretations are not expected to have a material impact on the Group's consolidated financial statements:

- *Prepayment Features with Negative Compensation* (Amendments to IFRS 9);
- IFRIC 23 *Uncertainty over Tax Treatments*;
- *Long-term Interests in Associates and Joint Ventures* (Amendments to IAS 28);
- *Plan Amendment, Curtailment or Settlement* (Amendments to IAS 19);
- *Annual Improvements to IFRS Standards 2015-2017 Cycle* (various standards);
- *Amendments to References to Conceptual Framework in IFRS Standards*;
- IFRS 17 *Insurance Contracts*;
- *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28); and
- IFRS 14 *Regulatory Deferral Accounts.*

41. Subsequent events

There have been no material subsequent events between 31 December 2018 and the date of approval of this Annual Report and Accounts by the Board.

42. Transfer of engagements

On 1 October 2018 the Society merged with the Holmesdale Building Society ('Holmesdale') under section 42B(3)(b) of the Building Societies Act on the basis of a board resolution by Skipton. The merger was approved by members of Holmesdale on 25 July 2018 and approved by the PRA on 5 September 2018.

Holmesdale was financially strong and profitable; however it was competing in an increasingly challenging mortgage market and in an operating environment which continued to drive up costs. Its Board independently undertook a review of its commercial and financial position and unanimously concluded that it was in the best interests of current and future members to merge with a much stronger building society able to offer more choice and value to its members in the long term.

The assets and liabilities acquired on transfer of engagements and the associated accounting adjustments, with explanatory notes, are set out below.

	Notes	Cessation accounts Audited £m	Fair value adjustments £m	Take-on balances £m
Assets				
Cash in hand and balances with the Bank of England		12.9	-	**12.9**
Loans and advances to credit institutions		1.9	-	**1.9**
Derivative financial instruments	5	0.3	(0.3)	**-**
Loans and advances to customers	6	138.7	0.3	**139.0**
Property, plant and equipment		0.9	-	**0.9**
Investment property		0.3	-	**0.3**
Other assets		0.1	-	**0.1**
Corporation tax		0.1	-	**0.1**
Total assets		**155.2**	**-**	**155.2**
Liabilities				
Shares		121.9	-	**121.9**
Amounts owed to other customers		16.8	-	**16.8**
Other liabilities		0.2	-	**0.2**
Accruals		0.7	-	**0.7**
Deferred tax liability		0.1	-	**0.1**
Total liabilities		**139.7**	**-**	**139.7**
Reserves		15.5	-	**15.5**
Total members' interests and liabilities		**155.2**	**-**	**155.2**
Fair value of net assets	7			**15.5**
Purchase consideration	7			15.5
Goodwill				**-**

Notes and adjustments

1. The cessation accounts of Holmesdale have been prepared in accordance with FRS 102, *The Financial Reporting Standard Applicable in the UK and Republic of Ireland*, which is a financial reporting standard, governed by the Financial Reporting Council, for small and medium sized enterprises.
2. The cessation accounts of Holmesdale cover the period 1 April 2018 to 30 September 2018 as Holmesdale previously prepared annual accounts for accounting periods ending 31 March.
3. The assets and liabilities of Holmesdale have been included within the accounts of the Skipton Building Society at fair value. Some balance sheet reclassifications have been made to conform with International Financial Reporting Standards (IFRS) as endorsed by the EU. Balances have been adjusted in accordance with IFRS 3 *Business Combinations*. From 1 October 2018 Holmesdale's financial results are fully integrated within those of Skipton Building Society and the Group's accounting policies, as found in note 1 to the Accounts, have been applied. Any adjustments needed as a result of applying the Group's accounting policies are included within 'Fair value adjustments' in the table above.
4. The effect on the take-on balances of adopting IFRS 9 on merger with the Society has also been assessed and any impact of adoption is included within 'Fair value adjustments' above, however the impact of adopting IFRS 9 on the take-on balance has been assessed to be immaterial to the Society.
5. An embedded derivative asset was held by Holmesdale in relation to its portion of the shared equity mortgages it acquired in 2015. The fair value of the derivative has been assessed using the Group's methodology and in line with IFRS 9 is no longer bifurcated from the underlying asset, resulting in the derivative being written off in full, and being assessed as part of the overall fair value of the shared equity mortgages.
6. The entry method of mortgage valuation has been used. This method considers the rates at which new lending would be made in the market by comparison to the rates applied at the origination of the mortgage book. The majority of the Holmesdale book is on variable rates and is therefore considered to be held at market rates and so no fair value adjustment is required. The classification of the Holmesdale mortgages has also been reviewed under IFRS 9, and a small proportion of shared equity and lifetime mortgages have been assessed to fail the SPPI test and therefore are held at FVTPL. An assessment of the fair value of these mortgages on merger results in a £0.3m increase in the fair value of the Holmesdale's mortgage balances.
7. The combination of the two societies did not involve the transfer of any cash consideration. Imputed consideration represents the fair value of members' interests transferred. The value of the consideration has been calculated by measuring the fair value of the business of Holmesdale. The calculation was made with reference to publicly available valuations of quoted financial services organisations, adjusted to reflect the financial status, unquoted nature, relative size and economic diversification of the business. This resulted in a value of £15.5m being attributed to the imputed consideration, resulting in £nil goodwill being recognised on merger.

42. Transfer of engagements *(continued)*

The income and expenditure for Holmesdale for the period 1 April 2018 to 30 September 2018 is shown below for information purposes only and is not included in these financial statements.

	£m
Net interest receivable	1.9
Administrative expenses	(3.3)
Loss before tax for the period	(1.4)
Taxation	0.1
Loss for the period	(1.3)

Following the merger, Holmesdale ceased to exist, being incorporated within Skipton Building Society. It is therefore not possible to separate its results post the transfer of engagements.

4 Other Information

Country by Country Reporting

Nature of the Group's activities

The Skipton Building Society Group holds an investment in a number of subsidiary undertakings. The Society and the majority of its subsidiary undertakings are incorporated in the UK, with the exception of the entities listed below. For a full list of the principal trading subsidiaries in the Group and the nature of their activities, see note 17a) of the financial statements.

Name of subsidiary undertaking	Principal business activity	Country of incorporation	% ownership interest 31.12.18
Jade Software Corporation Limited	Provider of software development services	New Zealand	99.98
Northwest Investments NZ Limited	Provider of software development services	New Zealand	100.0
Skipton International Limited	Offshore deposit taker and lender	Guernsey	100.0

Jade Software Corporation Limited also holds a 100% ownership in the following trading subsidiary undertakings, all of which carry out the principal business activity of the Jade group of businesses.

Name of subsidiary undertaking	Country of incorporation
Jade Software Corporation (NZ) Limited	New Zealand
Jade Software Corporation Pty Limited	Australia
Jade Software Corporation UK Limited	UK
Jade Software Corporation UK Limited (Netherlands Branch)	Netherlands
Jade Software Corporation USA	USA
Jade Software Corporation Limited Dubai Branch	United Arab Emirates

In addition, the Group holds a non-controlling interest of 17.7% in Wynyard Group Limited, which entered liquidation in February 2017 and which is incorporated in New Zealand.

Country by country disclosures

An analysis of turnover, which is regarded as total income as defined below (and which excludes dividend income from subsidiaries), profit before tax, the current tax charge, corporation taxes paid, public subsidies received and the average number of employees on a full-time equivalent basis is set out below. The information presented is at a full Group level of consolidation. Total income is defined as net interest income plus fees and commissions receivable (net of fees and commissions payable), together with all other components of operating income. Total gross income and total gross profit before tax, for each country, represents consolidated income or profit before tax for that country.

2018 £m	UK	Australia	Guernsey	New Zealand	Jersey	USA	Total
Total income by country	676.5	4.1	27.0	16.9	-	0.5	725.0
Inter-country adjustments	0.2	0.9	0.2	(1.8)	-	-	(0.5)
Consolidated income	676.7	5.0	27.2	15.1	-	0.5	724.5
Profit before tax by country	164.3	0.3	20.1	3.5	-	-	188.2
Inter-country adjustments	0.1	1.3	0.8	(2.2)	-	-	-
Consolidated profit before tax	164.4	1.6	20.9	1.3	-	-	188.2

£m	UK	Australia	Guernsey	New Zealand	Jersey	USA	Total
Current tax expense	38.1	0.1	1.8	-	-	-	40.0
Corporation taxes paid	38.3	0.1	2.0	-	-	-	40.4
Public subsidies received*	-	-	-	0.2	-	-	0.2
Average number of employees	8,512	26	48	190	4	2	8,782

2017 £m	UK	Australia	United Arab Emirates	Guernsey	Netherlands	New Zealand	Switzerland	USA	Total
Total income by country	690.4	4.5	(0.1)	23.5	0.6	16.5	-	0.7	736.1
Inter-country adjustments	0.1	0.7	0.1	0.3	0.1	(1.9)	-	0.1	(0.5)
Consolidated income	690.5	5.2	-	23.8	0.7	14.6	-	0.8	735.6
Profit before tax by country	181.0	0.7	(0.3)	18.0	-	0.4	0.1	0.2	200.1
Inter-country adjustments	(0.1)	2.0	0.2	0.9	0.4	(2.9)	(0.5)	-	-
Consolidated profit before tax	180.9	2.7	(0.1)	18.9	0.4	(2.5)	(0.4)	0.2	200.1

£m	UK	Australia	United Arab Emirates	Guernsey	Netherlands	New Zealand	Switzerland	USA	Total
Current tax expense	39.8	0.3	-	1.6	-	-	-	0.2	41.9
Corporation taxes paid	39.6	0.2	-	1.5	-	-	-	0.2	41.5
Public subsidies received*	-	-	-	-	-	0.3	-	-	0.3
Average number of employees	8,372	22	4	52	2	189	2	4	8,647

* Public subsidies received relate to cash payments received from governments in the form of grants.

Annual Business Statement

1. Statutory percentages

	As at 31 December 2018 %	Statutory limit %
Lending limit	4.30	25.00
Funding limit	18.40	50.00

These percentages form part of the audited Accounts.

Explanation

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. Business assets are defined as the total assets of the Group plus provisions for impairment losses on loans and receivables, less liquid assets, intangible assets, property, plant and equipment and investment properties as shown within the Group Statement of Financial Position.

The funding limit measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. We have taken advantage of the relief set out in SI 2007/No 860, effective from April 2007, to exclude retail offshore deposits from the total of wholesale funds.

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

	2018 %	2017 %
As a percentage of shares and borrowings:		
(i) Gross capital	7.42	7.64
(ii) Free capital	6.23	6.44
(iii) Liquid assets	19.91	18.65
As a percentage of mean total assets:		
(i) Group profit after taxation	0.67	0.79
(ii) Group management expenses	2.36	2.61
(iii) Society management expenses	0.67	0.71
As a percentage of closing total assets:		
(i) Group profit after tax	0.64	0.75

These percentages form part of the audited Accounts.

Explanation

The above percentages have been calculated from the Group and Society Income Statements and Statements of Financial Position.

Shares, deposits and borrowings represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and the fair value adjustments for hedged risk.

Gross capital represents the general reserve together with the fair value reserve (2017: available-for-sale reserve), cash flow hedging reserve, cost of hedging reserve, translation reserve and subscribed capital, as shown within the Group Statement of Financial Position.

Free capital represents gross capital plus provisions for collective impairment losses on loans and advances to customers, less property, plant and equipment, investment properties and intangible assets as shown within the Group Statement of Financial Position.

Liquid assets represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities. Mean total assets are the average of the 2018 and 2017 total assets. Management expenses represent administrative expenses.

3. Information relating to Directors at 31 December 2018

The Board of Directors at 31 December 2018, their dates of birth and dates of appointment as a Director are as follows:

	Date of birth	Date of appointment
A P Bottomley*	12 July 1965	1 January 2016
A J Burton	3 January 1959	3 May 2016
M Cassoni	27 December 1951	31 July 2012
J R Coates	26 September 1951	27 March 2017
D P Cockrem	15 November 1962	1 September 2015
I M Cornelius*	11 February 1969	11 June 2012
D J Cutter*	1 January 1962	1 January 2000
R D East	18 March 1960	29 November 2011
D A Hall	9 November 1955	27 March 2017
H L Jackson	23 August 1965	24 October 2018
M J Lund	1 July 1957	25 April 2016
R S D M Ndawula*	24 February 1974	23 February 2015
H C Stevenson	10 November 1960	1 March 2013

* Executive Directors

Documents may be served on any of the above named Directors at the following address: Addleshaw Goddard, 3 Sovereign Square, Sovereign Street, Leeds, LS1 4ER.

The Directors' business occupations and other directorships at 31 December 2018 were as follows:

A P Bottomley	Building Society Distribution and Financial Services Director	Skipton Financial Services Limited Skipton Group Holdings Limited
A J Burton	Non-Executive Director	Battersea Dogs' and Cats' Home Bellmead Kennels Limited Connells Limited Countryside Properties Plc HSS Hire Group Plc Skipton Group Holdings Limited
M Cassoni	Non-Executive Director	AO World Plc EI Group Plc Jacob's Island (Providence Square Blocks A, B & C) Limited Galliford Try Plc Skipton Group Holdings Limited
J R Coates	Non-Executive Director	Skipton Group Holdings Limited TPT Retirement Solutions
D P Cockrem	Non-Executive Director	Ecclesiastical Planning Services Limited Ecclesiastical Underwriting Management Limited Edentree Investment Management Limited Lycetts Holdings Limited Skipton Group Holdings Limited
I M Cornelius	Building Society Commercial Director	Giggleswick School Incommunities Group Limited Incommunities Treasury PLC Skipton Group Holdings Limited Skipton International Limited Skipton Trustees Limited

Other Information

Annual Business Statement *(continued)*

D J Cutter	Building Society Group Chief Executive	Bailey Computer Services Limited Connells Limited Craven Educational Trust Leeds Share Shop Limited Northwest Investments NZ Limited Skipton Group Holdings Limited Skipton Group Limited Skipton Investments Limited Skipton Limited Skipton Mortgage Corporation Limited Skipton Mortgages Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Skipton Trustees Limited
R D East	Non-Executive Director & Chairman	Cattles Holdings Limited Compass Credit Limited Dial4aloan Limited Hampshire Trust Bank Plc RCWJ Limited Skipton Group Holdings Limited Welcome Financial Services Limited
D A Hall	Non-Executive Director	Cembra Money Bank Hyundai Capital Bank Europe Moneta Money Bank Skipton Group Holdings Limited
H L Jackson	Non-Executive Director	Actinista 2016 Limited Ditto AI Limited Ikano Bank AB JD Sports Fashion PLC Skipton Group Holdings Limited
M J Lund	Non-Executive Director	British Ski and Snowboard Limited Coutts & Company Equiniti Financial Services Limited MyCSP Limited MyCSP Trustee Company Limited Skipton Group Holdings Limited
R S D M Ndawula	Building Society Group Finance Director	Connells Limited Leeds Share Shop Limited Skipton Financial Services Limited Skipton Group Holdings Limited Skipton Group Limited Skipton Limited Skipton Mortgage Corporation Limited Skipton Mortgages Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Yorkshire Cancer Research
H C Stevenson	Non-Executive Director	Henley Business School NHW Consultancy Limited Kin and Carta PLC One Smart Star UK Limited Reach PLC Skipton Group Holdings Limited The Wellington College International Limited

Messrs Bottomley, Cornelius, Cutter and Ndawula have service contracts entered into on 1 January 2016, 7 December 2012, 1 January 2000 and 25 February 2015 respectively which may be terminated by either party giving one year's notice.

4. Principal office

Skipton Building Society is a building society incorporated and domiciled in the United Kingdom. The address of the principal office is The Bailey, Skipton, North Yorkshire, BD23 1DN.

Glossary

Set out below are the definitions of terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue.
Asset backed securities (ABS)	An asset backed security is a security whose value and income payments are derived from and collateralised (or 'backed') by a specified pool of underlying assets. Typically these assets are pools of residential or commercial mortgages.
Buy-to-let mortgages	Mortgages offered to customers purchasing residential property to be rented to others to generate a rental income.
Common Equity Tier 1 capital	Common Equity Tier 1 (CET 1) capital primarily comprises internally generated capital from retained profits. An adjustment is made to deduct intangible assets and goodwill. CET 1 capital is fully loss absorbing.
Contractual maturity	The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets to be solely for the benefit of the holders of the covered bonds. The Group has established covered bonds as part of its funding activities. Covered bonds use retail / residential mortgages as the asset pool.
CRD IV	CRD IV is made up of the Capital Requirements Regulation (CRR), which is directly applicable to firms across the EU, and the Capital Requirements Directive (CRD), which must be implemented through national law. CRD IV became effective in the UK from 1 January 2014.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Derivative financial instruments	A derivative financial instrument is a type of financial instrument (or an agreement between two parties) that has a value based on the underlying asset, index or reference rate it is linked to. The Group uses derivative financial instruments to hedge its exposures to market risks such as interest rate and currency risk.
Effective interest rate (EIR) method	The method used to measure the carrying value of a financial asset or liability measured at amortised cost and to allocate associated interest income or expense over the relevant period.
Expected Credit Loss (ECL)	The present value of all cash shortfalls over the expected life of the financial instrument to determine impairment allowances under IFRS 9.
Exposure at default (EAD)	The expected outstanding balance of an asset at the time of default.
Fair value	Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the Financial Services industry. Every firm authorised by the FCA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Forbearance strategies	Strategies to assist borrowers in financial difficulty, such as arrears capitalisation, a reduction in the monthly payment, a conversion to interest only or a mortgage term extension. Forbearance strategies aim, if possible, to avoid foreclosure or repossession.
Free capital	The aggregate of gross capital plus provisions for collective impairment losses on loans and advances to customers less property, plant and equipment, investment properties and intangible assets.

Glossary *(continued)*

Funding limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.
Goodwill	Goodwill arises on the acquisition of subsidiary undertakings, joint ventures, associates or other businesses and represents the excess of the fair value of consideration over the fair value of separately identifiable net assets acquired at the date of acquisition.
Gross capital	The aggregate of the general reserve, translation reserve, fair value reserve, cash flow hedging reserve, subscribed capital and non-controlling interests.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's own assessment, as part of regulatory requirements, of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Group's own assessment that current and projected levels of liquidity are sufficient and appropriate for the Group's plans, under a variety of stress scenarios. It also details the Group's compliance with the PRA's regulatory BIPRU 12 requirements.
Internal Ratings Based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under CRD IV. The IRB approach may only be used with permission from the PRA.
International Swaps and Derivatives Association (ISDA) Master Agreement	A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions.
Investment grade	The range of credit ratings from Aaa to Baa3, as measured by external credit rating agencies.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property. The calculation of the lending limit is explained in the Annual Business Statement.
Leverage ratio	The ratio of Tier 1 capital divided by total exposure, which includes on and off balance sheet assets, after netting derivatives.
Liquid assets	The total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.
Liquidity Coverage Ratio	A measure designed to ensure that financial institutions have sufficient high quality assets available to meet their liquidity needs for a 30 day liquidity stress scenario.
Liquidity ratio	Liquid assets as a percentage of shares, deposits and borrowings.
Loan-to-value ratio (LTV)	A ratio which expresses the balance of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTVs on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in a house price index).
Loans past due / past due loans	Loans on which payments are overdue including those on which partial payments are being made.
Loss given default (LGD)	An estimate of the loss that would be incurred should a borrower default on their credit obligations.
Management expenses	Management expenses represent administrative expenses. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Material Risk Takers (MRTs)	A group of employees to which the FCA's Remuneration Code applies. MRTs consist of Executive Directors, Non-Executive Directors and certain senior managers who could have a material impact on the firm's risk profile.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Medium term notes (MTN)	Corporate notes continuously offered by an entity to investors through a dealer.

Member	A person who has a share investment or a mortgage loan with the Society, or is the holder of a Permanent Interest Bearing Share in the Society.
Mortgage backed securities (MBS)	Assets which are backed by underlying mortgage collateral.
Net interest income	The difference between interest received on assets and interest paid on liabilities.
Net interest margin	Net interest income as a percentage of mean total assets.
Permanent Interest Bearing Shares (PIBS) or subscribed capital	Unsecured, deferred shares that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing members of Skipton Building Society.
Prime	Prime mortgages are those granted to the most credit worthy category of borrower.
Probability of Default (PD)	An estimate of the probability that a borrower will default on their credit obligations.
Put option	Where the Group acquires a majority shareholding in a subsidiary undertaking, but grants the non-controlling shareholders an option to sell their shares to the Group at some future date(s), a put option obligation exists.
Renegotiated loans	Loans are classed as renegotiated, with the customer's consent, when their terms have changed during the year. Loans and advances may be renegotiated whether or not the customer is experiencing financial difficulty in repaying their loan with the Group.
Repo / reverse repo	Short to medium term funding agreements which allow a borrower to sell a financial asset, such as an ABS or government bond, as security for cash. As part of the agreement the borrower agrees to repurchase the security at some later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo, which can typically be resold or repledged if desired.
Residential loans	Mortgage lending secured against residential property.
Residential mortgage backed securities (RMBS)	A category of ABS that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).
Risk appetite	The articulation of the level of risk that the Group is willing to take in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk weighted asset (RWA)	The value of assets, after adjustment, under CRD IV rules to reflect the degree of risk they represent.
Securitisation	A process by which a group of assets, usually loans, are aggregated into a pool which is used to back the issuance of new securities. 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. These securitisation structures use retail / residential mortgages as the asset pool.
Shares	Money deposited by non-corporate depositors in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares, deposits and borrowings	The total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and fair value adjustments for hedged risk.
Significant increase in credit risk	A significant increase in credit risk on a financial asset is judged to have occurred when an assessment using quantitative and qualitative factors identifies that the credit risk has increased significantly since the asset was originally recognised.
SPPI test	An assessment of whether the contractual terms of the financial asset give rise to cash flows that are in substance solely payments of principal and interest.
Stage 1	Stage 1 assets are assets which have not experienced a significant increase in credit risk since origination. 12 month ECLs are recognised and interest revenue is determined by the EIR on the gross carrying amount.

Glossary *(continued)*

Stage 2	Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECLs are recognised and interest revenue is determined by the EIR on the gross carrying amount.
Stage 3	Stage 3 assets are identified as in default and considered credit impaired. Lifetime ECLs are recognised and interest revenue is determined by the EIR on the net carrying amount.
Sub-prime	Loans to borrowers typically having weakened credit histories that include payment delinquencies and in some cases potentially more severe problems such as court judgments and discharged bankruptcies.
Term Funding Scheme (TFS)	A scheme launched by the Bank of England in 2016 which allows qualifying financial institutions to borrow central Bank of England reserves in exchange for eligible collateral to provide access to cost effective funding to support lending to customers.
Tier 1 capital	A measure of financial strength. Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital comprises general reserves from retained profits. The book values of goodwill and other intangible assets are deducted from Common Equity Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as PIBS are included in other Tier 1 capital (i.e. not Common Equity Tier 1).
Tier 2 capital	Tier 2 capital comprises PIBS that have been transitioned out of additional Tier 1 capital – under CRD IV all of the Society's PIBS will be phased out of Tier 1 capital as they fail to satisfy the CRD IV requirements. However our PIBS will continue to satisfy the criteria for Tier 2 capital and will therefore be phased into Tier 2.
Wholesale funding	Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue excluding balances deposited by offshore customers.

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