Annual Report & Accounts 2017

SKIPTON
BUILDING SOCIETY
For your life ahead

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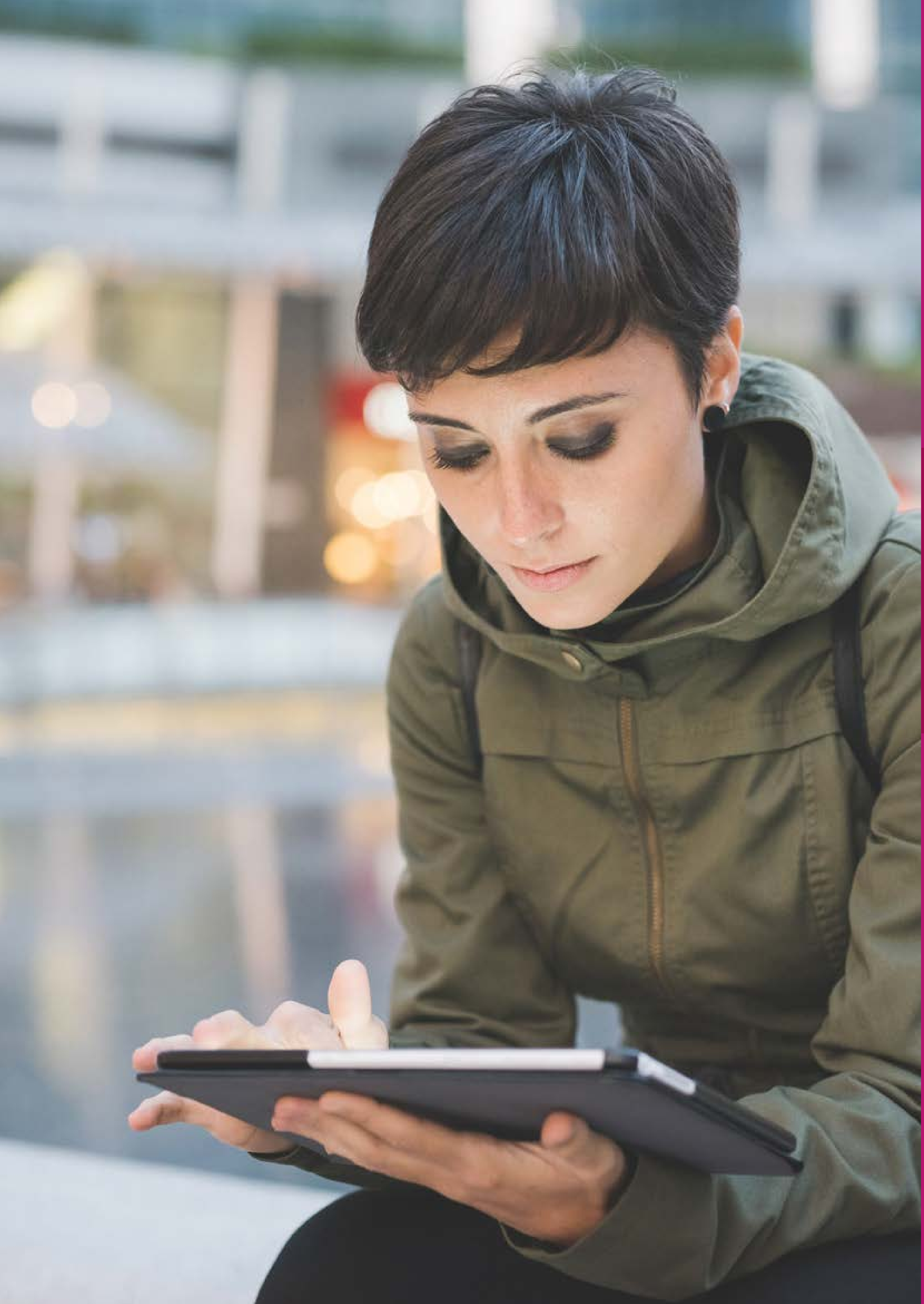


1 Performance and Strategy

2017 Group Highlights

Key performance highlights

919,060
Society Membership

Society membership increased by 58,657 (6.8%) to 919,060

£15.0bn
Savings Balances

Savings balances grew by £0.9bn to £15.0bn, an annual growth rate of 6.2% (2016: 10.0%)

33.2%
Group Common Equity Tier 1 Ratio

The Group Common Equity Tier 1 ratio strengthened further to 33.2% (2016: 23.9%)

50,590
Cash Lifetime ISA Customers

The Society was the first, and to date only, financial services provider to launch a cash Lifetime ISA and opened 50,590 accounts during 2017 since its launch in June

£4.5bn
Mortgage Lending

Gross residential mortgage lending in the year was up by 12.8% to £4.5bn (2016: £4.0bn)

£1.3bn
Mortgage Book Growth

The mortgage book grew by £1.3bn to £16.8bn, an annual growth rate of 8.3% (2016: 9.1%)

92%
Customer Satisfaction

Society net customer satisfaction was 92% (2016: 90%)

88%
Employee Engagement

Society employee engagement was 88% (2016: 90%)

£200.1m
Group Profit

Total Group profit before tax (PBT) increased by 18.5% to £200.1m (2016: £168.9m)

£165.7m
Underlying Group PBT

Underlying Group PBT (as defined on page 25) increased by 9.4% to £165.7m (2016: £151.5m)

Awards won

What Mortgage Awards 2017 – Best National Building Society

The Sunday Times Top 100 Companies to Work For

Moneyfacts Consumer Award 2018 – High Street Savings Provider of the Year

> *“At the core, our purpose will remain one of helping more people have a home, save for their life ahead and supporting their long term financial well-being. In short, we talk about this as ‘Building a better Society’, much as our founders would have done 164 years ago.”*

Chairman’s Statement

This is my first report as the Chairman of the Society, and I am delighted to share with you further growth in our membership and a strong set of results. I am pleased by the growth in membership as it demonstrates that our members value what we offer. I firmly believe both achievements are due to the dedication and commitment of our people and, importantly, their focus on delivering excellent service to members. On your behalf, I would like to thank all of them for their hard work.

Purpose

Skipton Building Society was founded 164 years ago by people who had a clear purpose in mind. They wanted to help members have homes and to provide a safe place for their savings so that they could plan for their life ahead. Profit would have been important but only so the Society could be run safely and more members helped in the future. By doing this, they created a better society for members, for the people they employed and the communities where they operated. Their focus was on the long term; it was not about maximising short term profits.

During 2017, we have reflected on our purpose and, whilst financial services, technology and many other aspects of the world have changed, we concluded that our purpose has not. I do not see it changing in the future either. At the core, our purpose will remain one of helping more people have a home, save for their life ahead and supporting their long term financial well-being. In short, we talk about this as ‘Building a better Society’, much as our founders would have done 164 years ago.

Of course, the way we deliver to members has evolved, and will continue to do so, reflecting changes in the economic, social, regulatory and political environment, and the housing market where home ownership has fallen to its lowest levels for 30 years and the average age of buying a first house has risen steeply. Technology is also re-shaping the way financial services are, and will be, delivered in the future. Increasing longevity, changes in pension legislation, and the increasing complexity of social and health care will also mean more change as people need to turn somewhere for help in navigating their way through planning and saving for their life ahead. Your Society, with the unique focus that being a mutual brings and its continued reinvestment of profits, is well placed to respond to these challenges and continue to deliver for current and future members.

Values and people

In my first year as Chairman, I have visited a number of teams and branches and been impressed by how they demonstrate the Society’s three core values of working together as one team, taking ownership, and trust. These values 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. Well trained and engaged people who are proud of the work they do, and who they work for, will do the right thing for members, provide excellent service and enable us to deliver for more members in the future.

The engagement of our people is demonstrated by the excellent engagement scores measured through our annual employee survey and also by Skipton becoming, in 2017, one of just two UK financial institutions to achieve Investors in People (IIP) Platinum. This is the highest level of IIP accreditation, which positions Skipton among a very few for its commitment to high performance through excellent people management. Just 0.5% of the 10,000 organisations across the country that are IIP accredited have achieved Platinum accreditation.

Chairman's Statement *(continued)*

This award and the high levels of engagement that our people have is a testament to the hard work and dedication of many, but particularly Rachel Fawcett, our Chief HR Officer, whose life was sadly lost after a long illness in 2017.

Business strategy and performance

Our strategy is driven by our purpose. It places customers at the heart of everything we do and ensures we have people who are able to deliver our strategy and a culture that enables them to do so. We seek to provide good value products and consistently excellent service to our customers however they choose to interact with us. We aim to maintain our strong capital position in order to be here for members for the long term.

Led by David Cutter, our Group Chief Executive, and our Executive team, the Society has had a successful year on a number of counts with growth in membership, mortgage and savings balances, and funds under management by our financial advice business.

In June we became the only UK financial institution to launch a cash version of the Lifetime ISA (LISA). It is the first product of its kind to enable people aged between 18 and 40 years old to save towards their first home and their future with support from the Government, who reward savers with a 25% bonus to top up their savings. So a person saving £4,000 a year with Skipton will receive an additional £1,000 from the Government to put towards their new home or their future.

Whilst our goal is not to maximise profits, it is important that we deliver a strong financial performance to enable us to maintain our strong capital position and invest for the future. In 2017, this was achieved despite pressures on interest margins as we continued to keep savings rates higher than market averages, recognising the impact that low savings rates have had on our members.

The Group is in a strong financial position, as demonstrated by our Common Equity Tier 1 ratio of 33.2%. The sale of a portfolio of £220m non-performing or recently non-performing loans strengthened the position during the year. The strength of our position is reflected by the upgrade in our long term credit rating from Moody's from Baa2 to Baa1, with a stable outlook, during the year. Our long term rating from Fitch Ratings is A-, with a stable outlook.

Delivering strong financial performance and maintaining our capital strength is as much about good cost management as it is about delivering good products and services. In June, we took the difficult decision to close eight branches and three agency branches. We did so after seeing a significant decline in the number of people using these branches, mirroring changing preferences to make greater use of digital and telephone services where we have continued to invest. Our remaining 87-strong branch network will continue to play a vital role in providing members with the choice of face-to-face service alongside our telephone, video and internet services.

Money saved from these closures has been reinvested back into customer service including our customer contact centre, Skipton Direct, which had 1.3 million interactions in 2017, our web chat service and our newly launched video conferencing service for mortgage and financial advice. We are also investing further in our digital service which was used by 16.8% of our members in 2017 (2016: 11.8%).

Financial advice also saw another strong year of growth. We know that face-to-face financial advice on investments, inheritance planning and pensions is important to our members. It is a service that makes us different from other banks and building societies and is something that is in short supply, but something members tell us they really value. As a result, we will continue investing in and providing this important service to help people plan and save for their life ahead.

Our subsidiaries also continue to perform strongly. Connells, our estate agency division, has reported good growth in profits despite a subdued housing market in the second half of 2017 and has continued to grow its market share of the UK residential sales market, marketing on average 6% of the properties available for sale in the UK during the course of 2017. Connells continues to invest in all parts of the business, including in the digital / online arena.

Skipton International Limited (SIL), a mortgage and savings provider based in Guernsey, has also had a strong year, with profits, mortgage and savings balances and gross lending all increasing during the year. During the year, SIL launched a mortgage centre in St Helier, Jersey, to enhance the customer experience they offer. SIL also won the Moneyfacts Best Offshore Account Provider award and the Feefo Gold Trusted Service Award.

Community

When customers join us, whether to save or take out a mortgage, they become members of Skipton Building Society. Putting the needs of our members first is at the heart of everything we do and this includes a focus on the communities where we operate and helping them tackle critical issues. In December 2016, Skipton colleagues voted to partner with the Alzheimer's Society and Alzheimer Scotland.

As well as helping raise vital funds to help the fight against dementia, our people have learned first-hand about the devastating impact it can have on family life. For example, we have been able to understand how a trip to pay some money into a savings account can turn into a distressing experience for people living with dementia. By the end of 2017, all of our branches had colleagues who had become 'dementia friends' with each making a commitment that we hope will make a difference to people living with the disease.

Our award-winning Grassroots Giving community funding programme has been supporting small groups since 2013, with £405,000 donated to 810 clubs, groups and organisations in that time. In 2017, the Society also donated £150,000 to the Skipton Building Society Charitable Foundation, which enabled the foundation to support a host of causes including the invaluable work of hospices, helping older people stay active and providing equipment for volunteers to run activities for young people. Our Charitable Foundation continues to help those whose needs are greatest.

Board composition and diversity

In April 2018, Graham Picken will be retiring from the Board following six years' service. The Board has proposed Mark Lund to succeed him as Deputy Chairman, subject to regulatory approval. We are grateful to Graham for his service.

Our Board includes four women (31% of its membership) which compares with the 33% target for women on FTSE 350 boards by 2020 as set by the Davies progress report published in October 2015. Female representation in our combined Executive team and Senior Leadership Team was 34% at the end of 2017. We recognise there is more to do to attract and retain a diverse range of colleagues working in an environment where they can be themselves, flourish, perform well and realise their potential. Diversity of thought and challenge will make the Society better able to meet the needs of our members. We will achieve this by continuing to build on how we develop leaders, recruit people, offer flexible working and help those returning to work.

The Society has made further good progress in 2017 and delivered strong growth in membership and a good set of results. It is well placed to respond to the current economic, political and competitive environment and to continue to support its members 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 will remain on managing with relentless focus through the changing times ahead and on helping more people have a home, save for their life ahead and supporting their long term financial well-being.

Robert East
Chairman

27 February 2018

“2017 was another year of strong performance for Skipton Building Society, and further demonstrated that our 164-year-old core purpose of delivering consistent value to our members is still as relevant today as it was when we were founded.”

Group Chief Executive’s Report

2017 will be remembered for an unexpected General Election, resulting in a hung Parliament, and the first rise in Bank Base Rate for over ten years. The competitive environment intensified, impacting net interest margins, with pressures from established players and new entrants alike. And political and economic uncertainties impacted buyer sentiment causing the housing market to become more subdued in the second half of the year.

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, including a 7% increase in membership numbers to almost 920,000, record customer satisfaction scores, the highest volume of gross lending in our history, record Group profits (at both a statutory and underlying level), one of the strongest CET 1 capital ratios in the industry, and the opening of over 50,000 cash LISAs, being the only such provider in the marketplace.

Performance highlights in 2017 include:

- The Society continued to grow with a 58,657 (6.8%) increase in members to 919,060;
- Group profit before tax (PBT) increased by 18.5% to £200.1m (2016: £168.9m);
- Underlying Group PBT increased by 9.4% to £165.7m (2016: £151.5m);
- The Group disposed of a £220m portfolio of non-performing or recently non-performing loans. This initiative reduced risk weighted assets (a risk measure) by £463m and resulted in a £15.0m loss on disposal;
- As a consequence, the number of Group residential mortgages in arrears by three months or more has more than halved during the year to only 0.36% of mortgage accounts (2016: 0.73%), and compares to an industry average of 0.82% of residential mortgages in arrears by more than three months (source: Council of Mortgage Lenders, December 2017);
- The Group also disposed of its remaining equity investment shareholding in ZPG Plc resulting in a £38.5m gain (2016: £17.0m);
- The disposal of Homeloan Management Limited to Computershare by the Group in 2014 included a right to contingent consideration based on future performance. As a consequence a further profit of £15.9m was recognised in 2017, which takes the total profit from the sale to £56.3m;
- Group gross mortgage lending increased by 12.8% to £4.5bn (2016: £4.0bn);
- Mortgage balances grew by £1.3bn to £16.8bn, a growth rate of 8.3% (2016: by £1.3bn, a growth rate of 9.1%);
- Savings balances grew by £0.9bn to £15.0bn, a growth rate of 6.2% (2016: by £1.3bn to £14.1bn, a growth rate of 10.0%);
- In June, the Society raised £350m of unsecured wholesale funding for a five year term, its first such issuance since the global financial crisis, broadening the Society’s funding base and lengthening its funding maturity;
- Group total assets increased by 10.5% during the year to £21.0bn (2016: £19.0bn);
- Funds under management as part of our financial advice offering increased by 9.7% to £3.4bn (2016: £3.1bn);
- The Group net interest margin reduced to 1.10% (2016: 1.18% (restated)), whilst net interest income increased to £220.6m (2016: £215.6m), an increase of £5.0m (or 2.3%);

Group Chief Executive's Report *(continued)*

- Group administrative expenses increased by £24.0m or 4.8% to £523.1m (2016: £499.1m), of which £345.5m relates to the Connells estate agency group (2016: £337.7m);
- Loan impairment provisions on residential mortgages (excluding the equity release portfolio) continued to reduce, resulting in a net credit of £1.3m (2016: a credit of £2.7m). The credit in respect of the Society's equity release book was £1.8m (2016: £3.8m charge);
- Charges for provisions and liabilities were £16.3m (2016: £10.9m) and included a levy of £1.2m payable to the Financial Services Compensation Scheme (FSCS) (2016: £2.1m). A charge of £11.4m (2016: £5.7m) was recognised for commission clawbacks in the Connells group. Charges of £5.7m were recognised for customer compensation provisions (2016: £2.9m). This relates predominantly to provisions for potential claims on payment protection insurance and potential future redress payable following an evaluation during 2017 of some historical terms and conditions for a small number of mortgages, mainly within our specialist mortgage lenders Amber Homeloans and North Yorkshire Mortgages, which have been closed to new business since 2008;
- The Common Equity Tier 1 (CET 1) ratio at 31 December 2017 was 33.2% (2016: 23.9%), benefiting from retained profits generated during the year and a reduction in capital requirements as a result of the disposal of the £220m portfolio of non-performing or recently non-performing loans;
- The leverage ratio was strong at 6.1% (2016: 5.9%), comfortably ahead of the regulator's expected minimum of 3%; and
- The robustness of the business was recognised by global credit rating agency Moody's, who upgraded the Society for the third time in four years.

2017 was another year of strong performance for Skipton Building Society, and further demonstrated that our 164-year-old core purpose of delivering consistent value to our members is still as relevant today as it was when we were founded.

Unwavering focus on our members and our people

In 2017 we enabled more people to save for their future and finance their own home than we ever have before. During the year the Society:

- Was the first, and to date only, financial services provider to launch a cash Lifetime ISA, enabling 50,590 people (as at 31 December 2017) to invest in their future by saving for their first home or for their life ahead;
- Increased our place in the independent 2017 Customer Experience Excellence survey, which rose from 33rd to 7th. This was out of 295 leading UK brands and the Society was named the UK's top building society for customer experience;
- Was again included in *The Sunday Times* Top 100 Companies to Work For;
- Achieved a net customer satisfaction rating of 92% (2016: 90%);
- Saw 14% of customer complaints referred to the Financial Ombudsman Service, during the first six months of 2017, changed in the customer's favour compared with an average of 36% for the financial services industry for the same period, being the latest available comparable market data; and
- Launched a retirement decumulation service to help customers make the most of their pensions, savings and investments as they progress through their retirement journey.

On 27 February 2018, the Society agreed heads of terms for a merger with Holmesdale Building Society. The merger is subject to approval by the members of Holmesdale Building Society and confirmation by the Prudential Regulation Authority. If approval and confirmation is received, the merger is expected to become effective through the transfer of all of the Holmesdale Building Society's engagements to Skipton on 1 October 2018.

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

The Society was the first financial services provider to launch a cash Lifetime ISA, helping over 50,000 people from its launch in June to save for their first home or longer term financial needs. The Society helped 25,979 homeowners (2016: 23,666) to purchase or remortgage their properties, including 4,540 first time buyers (2016: 4,327) and 1,498 (2016: 1,292) through participation in the Government's Help to Buy equity loan scheme.

This contributed to the Group mortgage book growing by £1.3bn to £16.8bn, a growth rate of 8.3% (2016: by £1.3bn, a growth rate of 9.1%). The Group's net residential UK mortgage lending accounted for 3.0% of the growth in the UK residential mortgage market (2016: 3.5%), compared to our 1.1% share of UK residential mortgage balances (source: Bank of England statistics, December 2017). £824.1m, or 18.4%, of the Group's gross lending during the year was on buy-to-let mortgages (2016: £588.0m or 14.8%).

Our award-winning range of competitive savings products saw retail deposit balances grow by £0.9bn to £15.0bn, an annual growth rate of 6.2% (2016: 10.0%). The growth in the Society's savings balances accounted for 1.9% (2016: 1.6%) of the growth in the UK deposit savings market, compared to our market share of savings balances of 1.0% (source: Bank of England statistics, December 2017). The average savings rate paid across all of our accounts reduced by 0.28% during the 12 month period, but nevertheless averaged 1.21% during the year, compared to an average Bank Base Rate during the year of 0.29% (source: internal monitoring). The Society paid on average 0.52% higher interest than the market average for banks and building societies during 2017 (2016: 0.55%) (source: CACI Savings Market Database for the 12 months to 31 December 2017). None of the Society's savings products currently pay less than Bank Base Rate of 0.50%.

Good performance in the Mortgages and Savings division

The Mortgages and Savings division is at the heart of the Group and is principally the Society, which provides mortgages, savings, investments and pension advice. It also includes two mortgage portfolios in run-off, and a mortgage and savings provider based in Guernsey.

The division produced a PBT of £89.1m, compared to £96.6m in 2016, a reduction of £7.5m (or 7.8%), predominantly as a result of the £15.0m loss on disposal of non-performing or recently non-performing loans as outlined above. The division reported an underlying PBT of £105.3m, up from £98.7m in 2016, an increase of 6.7%.

When expressed as a percentage of mean assets, the Group net interest margin (which is almost entirely generated by the Mortgages and Savings division) decreased by 8bps to 1.10% from 1.18% (restated), a reflection of a more competitive mortgage market and the impact of the ongoing low Bank Base Rate environment on our increasing asset base.

Further information on the performance of the Mortgages and Savings division can be found in the Strategic Report on pages 29 and 30.

Robust performance from estate agency

Connells, our estate agency division, reported profits of £104.2m (2016: £73.4m). This includes a gain of £38.5m (2016: £17.0m) on the disposal of its remaining shareholding in ZPG Plc. Underlying PBT increased by 13.7% to £64.9m (2016: £57.1m).

The housing market became more subdued after the summer months and this resulted in a decrease in Connells' house sales during the year of 4% (2016: increase of 8%); however lettings income increased by 9% (2016: 21%), mortgage services income increased by 13% (2016: 18%) and surveys and valuations income increased by 5% (2016: 16%), demonstrating the good spread of revenue generating activities carried out by the Connells group.

Further information on the performance of the Estate Agency division can be found in the Strategic Report on page 30.

Other subsidiaries

Skipton Business Finance recorded a PBT of £3.5m (2016: £3.3m). Jade Software Corporation (JSC), the provider of the Society's core database and software development language, recorded a PBT of £1.2m (2016: loss of £0.4m). On 30 June 2017, the Society increased its shareholding in JSC from 56.4% to 99.9%. At the same time, the Group disposed of a small group of companies held by JSC, Jade Logistics Holding Company and its subsidiary undertakings, resulting in a loss on disposal of £4.9m, £0.3m of which is included in the above reported profits of JSC. The disposal of this subsidiary allows JSC to focus on further strengthening its core solutions business.

Further information on the performance of these subsidiaries can be found in the Strategic Report on page 30.

Conclusion and outlook

2017 was another year of strong performance by the Society, with decent growth in both mortgage and savings balances, in excess of our market share.

Economic forecasters indicate that UK GDP growth in 2018 will not be dissimilar to that achieved in 2017, that inflation will moderate but Bank Base Rate will steadily rise, whilst the continued shortage of housing stock should underpin house prices. However, the progress with and conclusion to the Brexit negotiations are likely to dominate the political agenda and impact on consumer sentiment. Although the Society does not trade with Europe, and therefore has no direct exposure to any changes to the UK's trading relationships, it is interested in any secondary impacts of Brexit that may adversely affect the levels of employment, interest rates, house prices, and consumer confidence which, coupled with the industry needing to repay over £100bn under the Term Funding Scheme, makes forecasting the Society's performance in the medium to longer term more difficult than normal.

However, although pricing of mortgages at the start of the new year continues to be very competitive, the Society is in a strong position and well placed to capitalise on opportunities that lie ahead as well as manage any risks that may arise.

David Cutter

David Cutter
Group Chief Executive

27 February 2018

Strategic Report

*This Strategic Report sets out the strategy and objectives we have put in place to support 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 overall vision to "**Build a better Society**".*

This report also provides a summary of how we have performed against our objectives during the year.

The business model

The Society's business model, which remains unchanged from recent years, supports the delivery of our purpose, by providing a secure home for our growing number of customers' savings, which allows us to lend to borrowers, both directly and through mortgage brokers, to help more people into homes. The provision of high quality financial advice is also fundamental to our purpose to help guide and support customers, to achieve long term financial well-being.

At the core of the Group's business model is the Mortgages and Savings division, which is principally the Society but also includes mortgage lending in the Channel Islands and the UK and deposit taking through Skipton International Limited (SIL). Our specialist mortgage businesses Amber Homeloans Limited (Amber) and North Yorkshire Mortgages Limited (NYM), which both ceased lending in 2008, are also part of the division, as are the Group's special purpose vehicles, formed to acquire funds from the wholesale markets, and the intermediate holding company Skipton Group Holdings Limited (SGHL). The Mortgages and Savings division's business model is outlined below:

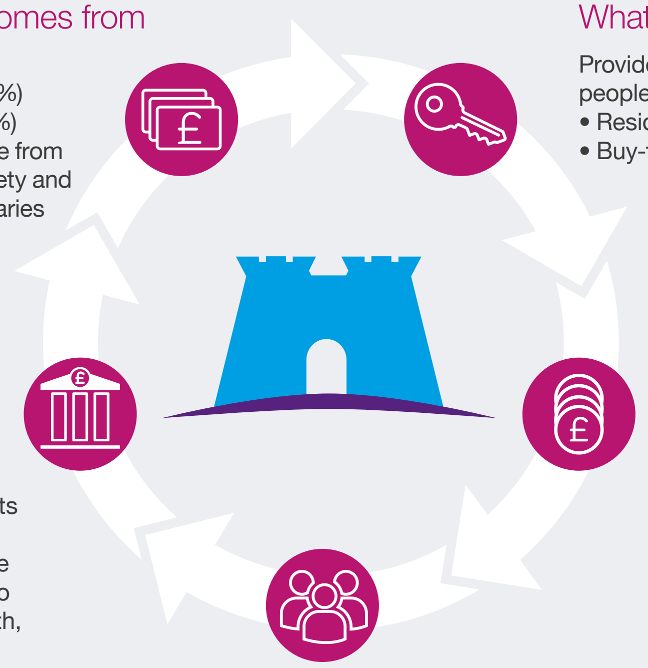
Where the money comes from

Funds are raised by:
- Members' deposits (84.6%)
- Wholesale markets (15.4%)

Our retained earnings come 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 (81.2%)
- Buy-to-let mortgages (18.8%)



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

We use the Society's profits and dividends from its subsidiaries to invest in the future of the Society and to maintain its capital strength, in order to be here for our members for the long term

What we incur costs on

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

The Society's business model is supported by maintaining a significant presence in estate agency through the Connells group which includes property sales, surveys and valuations, conveyancing, lettings, asset management and mortgage and insurance broking. Dividends from the Connells group help strengthen the Society's capital position for the benefit of all our members.

In addition, 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).

Strategy and objectives

The Society's strategy is to put members at the heart of everything we do and to differentiate our proposition by providing excellent customer service together with good long term value through the products we offer. The Society's objectives are developed to support this strategy and to ensure we continue to build a sustainable business to be here for our members over the long term, by generating sufficient profits and maintaining capital strength, whilst keeping our purpose at the heart of everything we do.

We remain committed to mutuality because we believe it is in the best interest of our current and future members. This means we are not required to pay dividends to shareholders. Instead we ensure we are generating sufficient profits to maintain a strong balance sheet and take long term decisions to invest in the development of the business for the benefit of our current and future members.

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 www.skipton.co.uk/about-us/governance.

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 22 of this report and page 55 of the Corporate Governance Report.

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 that they can recognise and prevent the use of bribery by themselves and others.

Social matters

We are committed to encouraging and enabling our people to participate in activities, and to teach them 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 of 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's 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 throughout 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're better equipped to support people who are affected.

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 that we have undertaken during the year to demonstrate our commitment to making a positive change to our society, see our Corporate Responsibility Report on pages 36 to 40.

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 39 in the Corporate Responsibility 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 and 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 Group 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 67 to 71.

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.

Developing a deep understanding of the needs of our customers through research, insight and feedback is a key objective in delivering our customer strategy. We use this insight to continuously refine, develop and improve the products and services we offer.

Our target savings and investment customers are those planning for and moving through retirement and it is in this area we seek to differentiate ourselves. We are focussed on ensuring we have a compelling proposition to meet the needs of these customers and we promote this to our customers under the strapline *'For Your Life Ahead'*.

We also 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 growing rented housing sector. This year we also launched a cash Lifetime ISA, being the first financial services provider to launch this product, helping people to save for their first home or longer term financial needs.

Maintaining a truly customer centric culture is fundamental to the delivery of our customer strategy. 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 and web-chat, or online, in order that they experience a high quality, empathetic and personalised service.

Investment in enhanced digital capability continues to be a particular area of focus to support and drive improvements to the customer experience. In 2017 we continued to focus on delivering an excellent customer experience by developing and improving our internal capability and infrastructure. Key initiatives included enhancing online security with the launch of a new digital secure passcode for customer use; launching a new improved secure website that can adapt to all devices which includes new functionality for our mortgage customers; rolling out improvements to our e-mortgages system for intermediaries to enable payment of procuration fees for product transfers; and rolling out Skipton Link, our new video conferencing facility, enabling customers to 'meet' Skipton advisers face-to-face from the comfort of their own homes.

In order to ensure our branch network is the right size and shape to support our customers and our strategy over the coming years we have taken the difficult decision to close eight branches in the year. This will allow us to re-invest in the network to continue to deliver the services our customers value. For example we have carried out a further eight branch refurbishments during the year.

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

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-focussed 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.

Our People *(continued)*

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 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.

A review of performance in the year against our people strategy is set out on pages 21 and 22.

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 proposition is delivered through two distinct brand offerings *'For Your Life Ahead'* and *'Real Life Lending'*, both of which are based on continually striving to understand what is important to our customers, listening to their feedback and ensuring that the mortgage, savings, investment and pension products and services we offer are aligned with their needs. Our *'For Your Life Ahead'* proposition focuses on meeting the needs of savings, investment and pensions customers, helping them save for life ahead and supporting their long term financial well-being, whilst our *'Real Life Lending'* proposition focuses on building strong relationships with our mortgage customers and intermediary partners in order to help more people into homes.

The provision of financial advice for our target market continues to be a key differentiator of our proposition and integral to the delivery of our *'For Your Life Ahead'* customer proposition. We have broadened our traditional face-to-face financial advice and are rolling out video conferencing appointments as well as exploring opportunities to expand our advice offering through digital and telephone channels.

A review of performance in the year against our proposition strategy is set out on page 23.

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 the majority of mortgage balances funded by retail deposits. The current economic climate means there is little appetite amongst our savings members for longer term savings products, whereas there is high demand for longer term mortgage products. We have therefore made greater use of longer term funding from the wholesale markets during the year to align the duration of our funding with longer term mortgages that our members are seeking.

Whilst we expect to continue to make greater use of the wholesale markets, we remain committed to offering competitive savings rates to our members, whilst ensuring funding costs remain affordable to allow us to generate sufficient profits to maintain our capital strength for our current and future members.

Our Financial Strength *(continued)*

The Society maintains sufficient levels of high quality liquid assets to support the Society's growth plans, without holding excess liquidity which creates additional costs. A variety of stress testing scenarios are regularly run to help ensure we remain within our liquidity risk appetite and we 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 and cost effectiveness across all areas of our business in order to create capacity to invest in our people and systems. This will help to ensure we continue to deliver excellent customer service to a growing membership base.

Managing loan impairment losses in our mortgage portfolios is also an important part of our objectives. We closely monitor and manage mortgages that have fallen into arrears, responding quickly in order to seek solutions that are appropriate for our borrowers and minimise the risk of the Society incurring financial loss.

The Group's investment in 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 24 to 35.

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.

Our Customers

Key Performance Indicator	Strategic Goal		
Our Customers			
Growth in membership numbers (Society only)*	To ensure we are attracting and retaining members	2017	58,657
		2016	22,316
		2015	43,348
Increase in member savings balances (Society only)	To help more members save for their future	2017	£881m
		2016	£1,285m
		2015	£1,367m
Group gross mortgage advances	To help us to meet our goal of helping more people into homes through prudent and controlled lending	2017	£4,476m
		2016	£3,968m
		2015	£3,675m
Group net mortgage growth	To help us to meet our goal of helping more people into homes through prudent and controlled lending	2017	£1,290m
		2016	£1,298m
		2015	£1,508m

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 72 to 88.

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 2017 Society membership numbers grew by 58,657 to take our total membership base to a record 919,060. We were the first financial services institution to launch the cash Lifetime ISA (LISA), which was a key driver in the growth in new customers to the Society. 50,590 LISA accounts were opened between its launch in June 2017 and the end of 2017, 48,852 of which were new members. The success of the LISA has significantly helped our growth in membership during the year; the competitive environment has continued to impact on our ability to attract the same level of customers across other products and services as in previous years, with the increase in member numbers, excluding the new members as a result of investing in the LISA, being 9,805 in comparison to 22,316 in 2016.

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 8.3% (2016: 9.1%), despite the disposal of a mortgage portfolio during the year as outlined on pages 26 and 27 and whilst maintaining our prudent credit risk appetite. Despite the increase in competition in the mortgage market our mortgage growth in the year was still significantly ahead of the UK residential mortgage market where net mortgage growth was 3.2% (source: Bank of England statistics, December 2017), which demonstrated our success in delivering mortgage products and services that are valued by both new and existing Skipton members.

Gross mortgage advances totalled £4,476m (2016: £3,968m) across the Group during 2017, representing an increase of 12.8% compared to 2016. During the year we helped a broad spectrum of homeowners, by offering loans requiring only a 10% 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.

In 2017 our savings balances grew by 6.2% (2016: 10.0%) compared to the UK savings market where net savings growth was 3.2% (source: Bank of England statistics, December 2017). We paid on average 0.52% higher interest than the market average for banks and building societies during 2017 (2016: 0.55%) (source: CACI Savings Market 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 November by the Bank of England and ensured none of our savings products currently pay less than the Bank Base Rate of 50 basis points.

Our People

Key Performance Indicator	Strategic Goal		
Our People			
Employee engagement* (Society only) (note 1)	To ensure our people are passionate, loyal and committed	2017	88%
		2016	90%
		2015	90%

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 72 to 88.

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 88% when measured in June 2017. 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 fourth year running.

After 20 years being an Investor in People, in 2017 the Society achieved the Investors in People Platinum accreditation. Skipton is the only building society to hold this award and only 0.5% of organisations with the Investors in People accreditation have achieved this level, so we are delighted to have achieved this accreditation.

Strategic Report *(continued)*

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. The new Networked Leadership Programme was launched to develop strategic thinking and complemented continued investment in leadership development programmes such as Modern Leaders and Skipton Leadership and Culture.

In 2017 we recruited, welcomed and trained 489 (2016: 432) new people across the Society's teams. 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 and further embedded flexible working arrangements in these areas to ensure sustainable 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 it should foster an environment where everyone is encouraged and able to fulfil their capability and potential, irrespective of their gender, ethnicity, disability or sexual orientation. We believe this is best achieved by addressing any cultural issues and removing barriers to progress, rather than setting targets which could drive the wrong behaviours and discrimination. In order to focus on the underlying themes we have set up an initiative, personally led by the Executive Committee and involving a wide range of colleagues with a focus on gender, ethnicity, LGBT, 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 34% at present. Initiatives to improve the Society's gender mix, and progress reports thereon, will be included in our Gender Pay Gap Report, published annually. Because the Society does not set a target for gender diversity at senior manager level, for the reasons given above, it is unable to fulfil one of the requirements of the Women in Finance Charter, and accordingly has not signed up to it.

The number of employees of each gender employed in the Group as at 31 December 2017 is outlined below:

Society	**Male**	**Female**	**Total**	**Percentage female**
Executive Directors	4	-	4	**-**
Other members of the Society's Senior Leadership team	37	21	58	**36.2%**
Senior Leadership team	**41**	**21**	**62**	**33.9%**
Non-Executive Directors	5	4	9	**44.4%**
Other employees	843	1,249	2,092	**59.7%**
	889	**1,274**	**2,163**	**58.9%**

Group	**Male**	**Female**	**Total**	**Percentage female**
Executive Directors (note 1)	4	-	4	**-**
Senior managers (note 2)	47	22	69	**31.9%**
	51	**22**	**73**	**30.1%**
Non-Executive Directors (note 1)	5	4	9	**44.4%**
Other employees (note 3)	4,166	5,447	9,613	**56.7%**
	4,222	**5,473**	**9,695**	**56.5%**

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, www.skipton.co.uk.

Our Proposition

Key Performance Indicator	**Strategic Goal**		
Our Proposition			
Society net customer satisfaction score* (note 1)	To ensure we are putting the customer at the heart of our business	**2017**	**92%**
		2016	**90%**
		2015	**88%**
Society Financial Ombudsman Service (FOS) complaints - change in outcome rate (note 2)	To ensure we are treating customers fairly	**2017**	**14%**
		2016	**21%**
		2015	**32%**

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 72 to 88.

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 2017, 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 service 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 2017 net customer satisfaction was 92% (2016: 90%), demonstrating the continued delivery of high quality products and services to our customers.

Proof of our commitment to providing outstanding customer service was our placing in the independent 2017 Customer Experience Excellence survey, which rose from 33rd to 7th. This was out of 295 leading UK brands and demonstrates our commitment to delivering a positive customer experience relative to other organisations.

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 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 2017 was 14% (full year 2016: 21%). This compared favourably with the financial services industry average of 36% for the first six months of 2017, 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 receiving Which? 'recommended provider status' for savings accounts. We also received 151 independent 'best-buy' mentions for our products in 2017 (2016: 181).

Strategic Report *(continued)*

Our Financial Strength

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	2017	£200.1m	Page 29
		2016	£168.9m	
		2015	£146.9m	
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	2017	£165.7m	Pages 25 and 29
		2016	£151.5m	
		2015	£153.3m	
Group net interest margin (% of mean assets) (note 1)	To manage the earnings of our core Mortgages and Savings division	2017	1.10%	Page 26
		2016	1.18%	
		2015	1.33%	
Mortgages and Savings division cost income ratio*	To maintain a manageable cost base to ensure the business remains efficient	2017	57.1%	Page 29
		2016	57.3%	
		2015	53.3%	
Mortgages and Savings division management expense ratio*	To maintain a manageable cost base to ensure the business remains efficient	2017	0.72%	Page 27
		2016	0.75%	
		2015	0.83%	
Group residential mortgages in arrears by three months or more	To manage and monitor our arrears and credit risk management	2017	0.36%	Page 31
		2016	0.73%	
		2015	0.91%	
Liquidity as a % of shares, deposits and borrowings	To ensure we hold sufficient levels of overall liquidity	2017	18.65%	Pages 31 and 32
		2016	15.90%	
		2015	16.95%	
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	2017	84.6%	Page 32
		2016	89.6%	
		2015	87.8%	
Group Common Equity Tier 1 ratio (note 2)	To ensure the Group remains financially strong by having a strong (risk weighted) capital base	2017	33.2%	Pages 33 and 34
		2016	23.9%	
		2015	16.8%	
Group Leverage ratio (note 3)	To ensure the Group remains financially strong by having a strong (non risk weighted) capital base	2017	6.1%	Pages 33 and 34
		2016	5.9%	
		2015	6.1%	

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 72 to 88.

Notes

1. The 2016 figure has been restated due to a change in accounting policy relating to the netting of gains on and costs arising from the sale of treasury assets. Further details are provided in note 1b) to the Accounts.
2. This ratio is calculated on an Internal Ratings Based (IRB) basis, following IRB status approval during the second half of 2016. The 2015 comparative figure, prepared on a standardised basis, has not been re-presented. This ratio is calculated on a transitional basis. See pages 33 and 34 for further details.
3. This ratio is calculated on an Internal Ratings Based (IRB) basis, following IRB status approval during the second half of 2016. The 2015 comparative figure, prepared on a standardised basis, has not been re-presented. This ratio is calculated on an end-point basis. See pages 33 and 34 for further details.

Financial performance

Economic 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.

The fall in the valuation of Sterling immediately following the referendum had an impact on the rate of inflation in 2017, which has risen sharply during the year relative to the growth in the economy. Whilst house prices and employment levels continued to grow, resulting in low impairment charges across our residential and commercial mortgage portfolios, the impact of rising inflation in a low interest rate environment could have real implications for both savers and borrowers in the coming year, squeezing household incomes and affordability of mortgage payments.

The recent rise in Bank Base Rate, for the first time in a decade, may go some way to alleviate the impact of high inflation on our savers. We have tried to limit the impact on our borrowers by not passing on the rate rise to our SVR and MVR rates. The mortgage market competition remains very high, and the availability of cheaper wholesale funding through the Government's Term Funding Scheme has supported low mortgage rates throughout the market, a key driver in the reduction of the Group's net interest margin year-on-year. Despite these pressures the Group has continued to sustainably grow its profits.

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. As per the Group's policy on alternative performance measures, the following items are excluded from statutory profit to arrive at underlying profit: profits or losses arising from a disposal of an investment in a Group entity, impairment losses recognised on the investment in a Group entity, profits or losses arising from the sale of mortgage assets, and the Financial Services Compensation Scheme (FSCS) levy.

The measure of underlying profit reflects the Group's current strategy and business model and the majority of the items that are excluded from the statutory profit figure to arrive at underlying profit are generated from the Group's investments in other entities not considered to be part of the Group's current strategy. The FSCS levy is also added back to arrive at underlying profit as it is a cost borne by the Group as a result of the failure of a number of financial institutions in recent years and is not viewed as a long term ongoing cost to the Group. In addition the 2017 underlying profit also excludes the loss on sale of the portfolio of non-performing or recently non-performing loans which occurred during the year (outlined on pages 26 and 27), as the sale of mortgage assets is not an ongoing trading activity of the Group, nor reflective of the Group's business model. 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 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. No other alternative performance measures are used.

Underlying Group profit before tax for the year, as shown below, increased to £165.7m (2016: £151.5m).

	2017 £m	2016 £m
Total Group profit before tax	200.1	168.9
Less profit on disposal of subsidiary undertakings	(11.3)	(15.8)
Less profit on full or part disposal of other Group undertakings	(39.4)	(16.1)
Add back loss on disposal of mortgage assets	15.0	-
Add back impairment of associate and equity share investments	0.1	12.4
Add back FSCS levy	1.2	2.1
Underlying Group profit before tax	165.7	151.5

For further details of the profit / loss on disposal of subsidiary and other Group undertakings see page 27. For further details on the loss on disposal of mortgage assets see pages 26 and 27.

A summary Group Income Statement is set out below:

	2017 £m	2016 Restated* £m
Net interest income	220.6	215.6
Net non-interest income	472.5	445.7
Fair value gains / (losses) on financial instruments	1.5	(3.7)
Profit on treasury assets	2.7	1.4
Share of profits / (losses) from joint ventures and associates	2.0	(0.6)
Dividend income from equity share investments	0.6	0.7
Loss on disposal of mortgage assets	(15.0)	-
Profit on disposal of subsidiary undertakings	11.3	15.8
Profit on disposal of joint ventures	0.9	-
Loss on disposal of associate	-	(0.9)
Profit on full or part disposal of equity share investments	38.5	17.0
Total income	735.6	691.0
Administrative expenses	(523.1)	(499.1)
Operating profit before impairment losses and provisions	212.5	191.9
Impairment credit on loans and advances to customers	4.0	0.3
Impairment losses on associate	-	(1.1)
Impairment losses on equity share investments	(0.1)	(11.3)
Provisions for liabilities	(16.3)	(10.9)
Total Group profit before tax	200.1	168.9
Tax expense	(41.9)	(39.1)
Profit after tax	158.2	129.8

* The comparative figures have been restated due to a change in accounting policy relating to the netting of gains on and costs arising from the sale of treasury assets. Further details are provided in note 1b) to the Accounts.

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

Net interest income

Net interest income, which is the main source of income for the Mortgages and Savings division, increased by 2.3% across the Group to £220.6m (2016: £215.6m). During the year a charge of £12.5m (2016: £6.2m) was recognised through interest income, following a reassessment of the expected lives of loans and advances to customers, which reduces the cash flows we expect to receive over the life of the mortgages in question.

The Group's net interest margin, one of our key measures of profitability and performance, measures net interest income as a percentage of mean total assets and was 1.10% (2016: 1.18%). Net interest income was supported by strong growth in the mortgage book and healthy retention levels, however, a more competitive mortgage market and the ongoing low Bank Base Rate environment have contributed to a reduction in the net interest margin. The mix of business in the period has also impacted margin as customers seek shorter term savings and longer term mortgages. To offset to a degree the impact of this, the Society has increased the proportion of longer term wholesale funding through the Term Funding Scheme (TFS) and a senior unsecured funding transaction in the year; further details can be found on pages 32 and 33.

Net non-interest income

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

	2017 £m	2016 £m
Mortgages and Savings	33.0	30.1
Estate Agency	417.4	397.6
Investment Portfolio	30.6	27.0
Inter-divisional adjustments^	(8.5)	(9.0)
	472.5	445.7

^ 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 saw a 5.0% increase in other income in the year. Despite a UK housing market which cooled noticeably towards the end of the year, Connells' good performance across a number of income streams, together with the returns from investments made in previous years, resulted in another robust performance, more details of which can be found on page 30.

The Mortgages and Savings division's net non-interest income increased by £2.9m in the year. This is predominately made up of financial advice activities that generated £29.3m of income (2016: £27.6m).

The Investment Portfolio saw a £3.6m increase in other income due to strong sales growth during the year in Jade Software Corporation (a software solutions provider based in New Zealand that specialises in digital solutions and large enterprise solutions).

The inter-divisional adjustments of £(8.5)m (2016: £(9.0)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. The corresponding cost to the Society is spread over the expected life of the mortgage product through net interest income.

Loss on disposal of mortgage assets

In April 2017 the Group agreed to the sale of a portfolio of non-performing or recently non-performing loans held in the Group's specialist mortgage businesses Amber and NYM. Non-performing or recently non-performing loans are loans that were in arrears by one month or more as at the time the portfolio was established for disposal or at any point in the 12 months prior to that date, or loans that were in arrears by three months or more in the 24 months prior to that date.

These loans were sold to de-risk our balance sheet and further strengthen the capital position of the Society. Transfer of legal title occurred in October 2017 and the sale completed with the transfer of £220m of mortgages and a loss of £15.0m was recognised.

Profit / loss on disposal of subsidiary undertakings, joint ventures and equity share investments

The profit on disposal of subsidiary undertakings during the year was £11.3m (2016: £15.8m). In June 2017 the Group purchased further shares in Jade for £6.6m, increasing its shareholding from 56.4% to 99.9%. In addition, 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 of £4.9m shown in the 'Profit on disposal of subsidiary undertakings' line in the Income Statement. The disposal of this group of subsidiaries allows Jade to focus on further strengthening its core solutions business, which benefits the Society as its core systems are written in the Jade language.

The sale of HML to Computershare in 2014 included contingent consideration dependent on HML's performance over a period following the disposal. This will result in contingent consideration being receivable by the Group between 2018 and 2022. A profit of £15.2m was recognised during the year (2016: £9.9m) following the receipt of information from Computershare in early 2018 in relation to the total amounts receivable. The final consideration receivable is in the process of being agreed and the contingent consideration asset at the end of 2017 of £25.1m represents our current best estimate of the present value (net of costs) of the total amounts receivable.

A further £0.7m (2016: £5.8m) profit was also recognised in the period following the release of a provision held in relation to the disposal of HML. Therefore, in total a profit of £15.9m (2016: £15.7m) is included in the 'Profit on disposal of subsidiary undertakings' line in the Income Statement relating to the disposal of HML in 2014.

In addition, £0.3m (2016: £0.1m) profit on disposal of subsidiary undertakings was recognised in the year in relation to the disposal of Pearson Jones in 2015 following the release of provisions no longer required. An analysis of the profit on disposal of subsidiary undertakings recognised during the year is shown below:

	2017 £m	2016 £m
HML – contingent consideration	15.2	9.9
HML – release of provisions no longer required	0.7	5.8
Loss on disposal of Jade Logistics	(4.9)	-
Pearson Jones – release of provisions no longer required	0.3	0.1
	11.3	15.8

A further gain of £0.9m (2016: £nil) was recognised in the 'Profit on disposal of joint ventures' line in the Income Statement from the disposal of Connells' joint venture shareholding in Home Telecom.

In 2017, Connells also sold the remainder of its shareholding in ZPG Plc, generating a profit of £38.5m (2016: £17.0m). This is shown in the 'Profit on full or part disposal of equity share investments' line in the Income Statement.

None of the above amounts are included in underlying profit before tax.

Administrative expenses

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

	2017 £m	2016 £m
Mortgages and Savings	141.9	135.9
Estate Agency	345.5	337.7
Investment Portfolio	27.2	25.8
Sundry incl. inter-divisional adjustments^	8.5	(0.3)
	523.1	499.1

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

Administrative expenses across the Group increased by 4.8% to £523.1m (2016: £499.1m).

During the year the Mortgages and Savings division's administrative expenses increased by £6.0m. The division continued to focus on careful control of its cost base. The Society has undertaken several key efficiency and cost saving initiatives in 2017 to help fund future investment aspirations. These initiatives include changes to our branch network as we adapt to changes in the operating environment. We have also undertaken initiatives which not only enable our customers to interact with us more easily but will create efficiency savings for the Society such as our capability to deliver advice remotely and the ability for our customers to receive online statements.

Despite these investments, the ratio of administrative expenses to average assets for the division, a traditional building society measure of efficiency, improved to 0.72% (2016: 0.75%).

The increase in administrative expenses within sundry / inter-divisional adjustments is due to an increase in the charge for the management incentive scheme in place for Connells' senior management; this increased to £9.7m compared to £1.0m in 2016. 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 future financial contribution this business will make to the Group. The increase in the charge in the year is a result of a revision to the future expected performance of the Connells group; the amounts paid from the incentive scheme will depend on the performance actually delivered. Further details can be found in note 26 to the Accounts.

The Group management expense ratio has seen an improvement to 2.61% from 2.73%, representing the continued focus on cost efficiency across the Group in line with our strategic objectives; however, this measure is less comparable to that of our peers given the nature of our Group, particularly the Estate Agency division. The cost income ratio for the full Group is broadly in line with last year at 75.0% (2016: 75.7%).

Impairment on loans and advances to customers

Impairment on loans and advances to customers for the Group was a credit of £4.0m during the year (2016: £0.3m credit) and is broken down as follows:

	2017	2016
	£m	£m
Residential mortgages	(1.3)	(2.7)
Equity release mortgages	(1.8)	3.8
Commercial mortgages*	(1.1)	(1.5)
Other loans	0.2	0.1
	(4.0)	(0.3)

* 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.

The credit for impairment provisions on the residential mortgage portfolio of £1.3m for the year (2016: £2.7m credit) was due to an improved arrears position on the portfolio, alongside a favourable economic landscape with falling unemployment, increasing house prices and continued low interest rates.

The equity release charge relates to the equity release portfolio acquired when the Society merged with Scarborough Building Society in 2009. The expected losses on this portfolio relate to the fair value of the 'no negative equity guarantee' provided to customers (as described in note 16 to the Accounts) which represents, inter alia, a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and the specific behaviour of this portfolio. During the year we have updated the associated key assumptions we expect to observe within this portfolio, resulting in a credit of £1.8m for the year (2016: £3.8m charge). Further details on the assumptions used in calculating the fair value of the no negative equity guarantee are found in note 38b) to the Accounts.

There was a net credit of £1.1m (2016: £1.5m credit) to the Income Statement during the year for the impairment provision on our commercial mortgages portfolio due to a number of specific cases where the provision was no longer required.

Provisions for liabilities

The Group's provisions for liabilities charge was £16.3m for the year (2016: £10.9m), £1.2m (2016: £2.1m) of which relates to the Group's share of the costs of the Financial Services Compensation Scheme levy. The levy is charged to the Society and other regulated deposit takers and compensates savers and investors for losses when financial institutions fail. Further details are found in note 27 to the Accounts.

Charges for other provisions of £15.1m (2016: £8.8m) relate mainly to commission clawbacks in the Connells group, which resulted in provisions charges of £11.4m during the year (2016: £5.7m). These arise in the ordinary course of business and have increased since 2016 predominantly as a result of an increase in the volume of business written. Provisions for customer compensation resulted in a £5.7m charge in the year (2016: £2.9m) predominantly due to provisions for potential claims on payment protection insurance and potential future redress payable following an evaluation during 2017 of some historical terms and conditions for a small number of mortgages, mainly within our specialist mortgage lenders Amber and NYM, which have been closed to new business since 2008.

Taxation

The Group's effective tax rate is 21.15% (2016: 23.07%) compared with the standard rate of UK corporation tax of 19.25% (2016: 20.00%). 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 11.36% (2016: 15.19%). The major impact on the effective rate of tax is the non-taxable dividend income received of £60.5m (2016: £57.6m). This is partially offset by the impact of the 8% surcharge on taxable profits above £25m, which increased the tax charge by £4.5m to £15.2m (2016: by £4.5m to £20.6m).

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

UK taxes borne in the year	2017	2016
	£m	£m
Corporation tax	38.6	30.1
Taxes on property	7.9	8.2
Employment taxes	26.1	26.5
Irrecoverable VAT	6.1	5.1
	78.7	69.9

More detailed tax disclosures are provided in notes 11 and 28 to the Accounts and in the Country by Country Reporting section on pages 188 and 189. Further details of the Group's taxation strategy can be found at www.skipton.co.uk/about-us/governance.

Other comprehensive income

During the year the Group recorded a net expense of £24.2m through other comprehensive income (net of tax) (2016: £29.9m). This predominantly consisted of a reversal of £38.7m of other comprehensive income previously recognised in relation to the increase in fair value of the Group's previous shareholding in ZPG Plc, £5.0m of which was recognised during 2017. This was reversed through other comprehensive income during the year and recognised in the Income Statement following the disposal of the Group's entire shareholding in ZPG Plc.

Partially offsetting this was a £10.2m gain (before tax) from the remeasurement of retirement benefit obligations (2016: loss of £50.0m). Various other movements in the Group's available-for-sale and cash flow hedging reserves account for the remainder of the overall movement.

Performance by division

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

	2017	2016
	£m	£m
Mortgages and Savings	89.1	96.6
Estate Agency	104.2	73.4
Investment Portfolio	0.1	(12.2)
Sundry incl. inter-divisional adjustments^	6.7	11.1
Profit before tax (PBT)	200.1	168.9

^ Sundry including inter-divisional adjustments relate primarily to the elimination of inter-divisional trading, the cost of the Connells management incentive scheme (£9.7m; 2016: £1.0m), and additional profit on disposal recognised in relation to the sale of HML in 2014 (£15.9m; 2016: £15.7m).

The Group's total profit increased in the year to £200.1m from £168.9m. Contributing factors to the increase in total profits were the £38.5m gain (2016: £17.0m) arising in the Estate Agency division on the sale of the Group's remaining shareholding in ZPG Plc, the fact that 2016 included losses of £15.0m in relation to the Group's investment in Wynyard Group Limited, and an increase in Connells' underlying profit of £7.8m. These factors were partially offset by the £15.0m loss on the disposal of non-performing or recently non-performing loans.

The Group's underlying profit by division was as follows:

	2017	2016
	£m	£m
Mortgages and Savings	105.3	98.7
Estate Agency	64.9	57.1
Investment Portfolio	5.0	0.4
Sundry incl. inter-divisional adjustments^	(9.5)	(4.7)
Underlying Group profit before tax	165.7	151.5

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

The Mortgages and Savings division saw a 6.7% increase in underlying profits during the year to £105.3m from £98.7m, following strong lending performance and high mortgage retention levels. Group mortgage and savings balances have seen good growth, of 8.3% and 6.2% respectively (2016: 9.1% and 10.0% respectively).

The Estate Agency division's underlying profits have increased by £7.8m following a good performance in the year as outlined on page 30.

The Investment Portfolio delivered underlying profits of £5.0m (2016: £0.4m) following continued strong performance by Skipton Business Finance generating a profit of £3.5m (2016: £3.3m) whilst Jade Software Corporation, which has reported losses over recent years as it invested in its future growth, delivered encouraging year-on-year sales growth, reporting underlying profits of £1.5m (2016: £0.4m loss). The 2016 comparative figures for the Investment Portfolio also included a £2.4m loss for the Group's share of Wynyard's trading losses.

The increase in sundry / inter-divisional charges during the year is predominantly as a result of an increase in the Connells management incentive scheme charge. For further details on the increase in the year refer to the administrative expenses section on pages 27 and 28 of this report; and for details of the calculation of the liability and the assumptions used see note 26 to the Accounts.

Mortgages and Savings

The Mortgages and Savings division has seen a good lending performance during the year despite continuing margin pressures. Profits for the year of £89.1m (2016: £96.6m) include a loss on sale of £15.0m on the disposal of a £220m portfolio of non-performing or recently non-performing mortgage assets, which is detailed on pages 26 and 27.

The division continues to show robust mortgage balance growth as a result of our strong relationships with our intermediary partners and our competitive offerings across a range of mortgage products. The Society has seen retail balances increase in the year, to £15.0bn from £14.1bn at the end of 2016, as we continue to offer competitive above market average rates.

The Society continues to invest in its financial advice offerings which remain an integral part of our customer proposition; financial advice generated £29.3m of income (2016: £27.6m). Funds under management were £3.4bn, up 9.7% on 2016, which includes £245m of new money invested during the year and £185m from returns on investment.

The division saw an overall increase in costs during the year of £6.0m to £141.9m as outlined on page 27. The division's cost income ratio remained broadly in line with the previous year at 57.1% (2016: 57.3%).

A decrease in impairment provisions for mortgage losses resulted in a credit of £4.2m (2016: £0.4m credit) as discussed on page 28, and provisions for liabilities charges for the division were £6.8m (2016: £5.2m), the majority of which relates to customer compensation provisions as discussed on page 28. The division's Channel Islands operation, SIL, continued to perform well during the year, delivering profits of £18.0m (2016: £15.2m) as it grew its mortgage and savings balances to £1.1bn and £1.4bn respectively (2016: £1.0bn and £1.2bn respectively). The quality of SIL's mortgage book continues to be strong with only one account in arrears by more than three months.

Our specialist lending businesses, Amber and NYM, reported an aggregate loss before tax of £11.6m (2016: profit of £10.5m) which includes a £15.0m loss on disposal of a mortgage portfolio of non-performing or recently 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 1.9% (2016: 5.4%), the significant reduction benefiting from the disposal of the portfolio of non-performing or recently non-performing loans. The aggregate mortgage balances in these businesses decreased in the year to £0.8bn from £1.2bn.

Estate Agency

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

	2017	2016
Total income (note 1)	**£459.3m**	£417.4m
Profit before tax	**£104.2m**	£73.4m
EBITDA (note 2)	**£80.1m**	£71.7m
Movement in:		
Estate agency – house exchanges	**-4%**	+8%
Residential lettings properties under management	**+5%**	+23%
Number of mortgages arranged	**+11%**	+10%
Surveys and valuations completed	**+1%**	+8%
Number of conveyancing transactions handled	**+3%**	+4%

Notes
1. Total income is as defined in note 39 'Group segmental reporting'.
2. EBITDA is calculated as profit before tax, interest, depreciation, amortisation, impairment and contingent consideration. It also excludes profits on disposal of group undertakings, income from joint ventures, dividends from and gains on disposal of available-for-sale assets and dividends to non-controlling interests.

Connells' total profit before tax was £104.2m (2016: £73.4m), including a £38.5m gain (2016: £17.0m) from the disposal of the remainder of its shareholding in ZPG Plc.

Connells aims to deliver an efficient, customer focussed proposition throughout its group. It also continues to invest in areas that will improve this proposition, particularly in the online and digital space. Connells also seeks to grow its business, both organically and through acquisitions, and during 2017 made four acquisitions of estate agency and lettings businesses, each of which will complement and add to Connells' proposition.

As 2017 progressed, the UK housing market became more subdued, largely as a result of general nervousness brought about by a combination of the General Election in June and subsequent hung Parliament, uncertainty persisting around the status of the UK's Brexit negotiations and increasing political tensions both at home and abroad. Consequently, the number of properties that contracts were exchanged on during 2017 was 4% lower than in 2016. The UK housing market still remains characterised by a lack of properties being brought onto the market which limits the number of sales able to be made.

Whilst UK Government tax changes over the past couple of years have adversely impacted landlords, the UK private rented sector remains a significant part of the UK's housing market. Connells has continued to address this opportunity, and increased its number of properties under management by 5% during the year.

Connells has continued to improve the performance of its financial services business and increased the number of mortgages it arranged by 11% year-on-year, despite lower property sales in the branches, generating £9.5bn worth of lending for UK mortgage providers. Investment continues in this area of business, ensuring that customers continue to receive a good experience and outcome.

Income derived from conveyancing also increased during 2017 with the number of cases handled being up by 3%. The group's conveyancing service is an important aspect of offering customers a smooth property experience in what can often be a stressful time.

Connells Survey & Valuation Limited continues to roll out new technology and process improvements, including extending their technology solutions supporting clients' risk management and improved customer outcomes. The number of qualified surveyors was 305 at the end of 2017 (2016: 293). This part of the business continues to retain and win new panel management contracts with lenders, and the number of cases carried out during 2017 increased by 1%.

Investment Portfolio

The Investment Portfolio reported a profit of £0.1m during the year (2016: loss of £12.2m). Skipton Business Finance Limited (a provider of debt factoring and invoice discounting to small and medium-sized enterprises) performed well during the year, producing a pre-tax profit of £3.5m (2016: £3.3m). Jade Software Corporation recorded a pre-tax profit of £1.2m (2016: £0.4m loss) after it delivered encouraging year-on-year sales growth. The Investment Portfolio also included a loss on disposal of £4.9m (£0.3m of which is included in the above reported profit of Jade) following the disposal of a small group of companies, Jade Logistics Holding Company and its subsidiary undertakings which were previously part of the Jade group; further details can be found on page 27. The 2016 reported loss for the Investment Portfolio included losses of £15.0m in relation to the Group's investment in Wynyard Group Limited, which was fully written down during 2016.

Sundry, including inter-divisional adjustments

Sundry, including inter-divisional adjustments of £6.7m income (2016: £11.1m income), relate primarily to the recognition of additional profit on the disposal of HML in 2014 of £15.9m (2016: £15.7m), as detailed on page 27 of this report.

The cost of the management incentive scheme for the senior managers at Connells Limited during the year increased to £9.7m (2016: £1.0m). For further details on the increase in the charge for the management incentive scheme in the year refer to the administrative expenses section on pages 27 and 28 of this report; and for details of the calculation of the Connells management incentive scheme and the assumptions used see note 26 to the Accounts.

Other inter-divisional adjustments during the period of £0.5m income (2016: £3.6m expense) relate primarily to the release of a provision which was no longer required of £0.3m (2016: £0.1m) in relation to the disposal of Pearson Jones in 2015, together with the elimination of inter-divisional trading.

Financial position

A summary Statement of Financial Position is set out below:

	2017 £m	2016 £m
Assets		
Liquid assets	**3,533.3**	2,677.4
Loans and advances to customers	**16,972.7**	15,781.6
Derivatives	**94.2**	116.1
Fixed and other assets	**423.4**	444.6
Total assets	**21,023.6**	19,019.7
Liabilities		
Shares	**14,985.8**	14,152.5
Borrowings	**3,954.7**	2,682.7
Derivatives	**318.5**	412.3
Other liabilities	**318.2**	324.9
Subordinated liabilities and subscribed capital	**41.6**	169.8
Non-controlling interests	**-**	(1.0)
Reserves	**1,404.8**	1,278.5
Total liabilities and equity	**21,023.6**	19,019.7

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

Loans and advances to customers

During the year the Group delivered another strong level of mortgage growth, with net mortgage growth amounting to £1.3bn (2016: £1.3bn). The majority of the Group's new lending was in the form of residential mortgages, including buy-to-let mortgages, for the Society's customers, which amounted to £4.2bn (2016: £3.7bn).

The increase in lending has been achieved without extending our credit risk appetite. Our new lending remains prudent, with the mortgage book being well diversified by geographical location. The average loan-to-value (LTV) on new lending in the Society in 2017 was 59.5% (2016: 64.3%). The average LTV on the Group residential mortgage book remained low at 47.2% (2016: 47.9%).

This well-managed spread of risk ensures that the quality of the Group's lending remains high and this, along with the disposal of the portfolio of non-performing or recently non-performing loans in the period, detailed on pages 26 and 27, resulted in the proportion of our residential mortgage accounts in arrears by three months or more reducing to 0.36% (2016: 0.73%), compared to the industry average of 0.82% of mortgages in arrears by more than three months (source: Council of Mortgage Lenders).

The mortgage balances of Amber and NYM continued to run off during the period and were further reduced by the disposal of the portfolio of non-performing or recently non-performing loans mentioned above. These portfolios were closed to new lending in 2008. The average LTV of these portfolios reduced to 57.0% from 60.9%. 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, which was closed to new lending in 2008, reduced in the year by 10.1% to £293.8m as we continue to manage down these balances. The average LTV of this portfolio reduced to 52.5% from 54.1% and the proportion of accounts in arrears by three months or more in this portfolio remains low at 0.68% (2016: 0.47%).

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 37 to the Accounts.

Liquidity

The Group continues to hold healthy levels of liquid assets within our prudent liquidity risk appetite to support the growth plans of the business and to counter economic uncertainty. Liquid assets in the year increased to £3.5bn from £2.7bn at 31 December 2016. The main driver of the increase was an increase in balances held with the Bank of England from £1.2bn to £2.4bn as a result of the increase in TFS funding drawn down during the year, as discussed on pages 32 and 33. When measured as a percentage of shares, deposits and borrowings, the liquidity ratio increased from 15.9% to 18.7%. The Group's liquidity levels are closely managed by the Board and senior management and they have remained above internal and regulatory limits throughout the period.

At 31 December 2017, the Society held £2.9bn (2016: £2.7bn) of High Quality Liquid Assets (HQLA) as analysed below:

	2017 £m	2016 £m
Balances with the Bank of England	2,367.0	1,181.8
Gilts	59.5	279.9
Treasury bills	-	859.8
Fixed rate bonds	146.0	147.3
Floating rate notes	-	20.1
Residential mortgage backed securities	197.8	190.4
Covered bonds	87.4	39.3
	2,857.7	2,718.4

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

	2017 £m	2016 £m
Certificates of deposit	20.0	185.4
Fixed rate bonds	32.1	36.2
Residential mortgage backed securities	1.0	1.2
	53.1	222.8

The above tables showing HQLA and non HQLA are different to the total amount of liquid assets held in the Statement of Financial Position (£3.5bn) 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 amount held under the Government's Funding for Lending Scheme (FLS), as shown in the 2016 comparative figure for Treasury bills in the HQLA table above, was also not held in the Statement of Financial Position.

The Group's treasury investments are held to provide liquidity and 98.7% (2016: 98.8%) 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 Liquidity Coverage Ratio (LCR), which is 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, was 179% at 31 December 2017 (31 December 2016: 170%), well above both the regulatory and internal limits set by the Board throughout the period.

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% at 31 December 2017) 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.

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.

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. At 31 December 2017, 84.6% (2016: 89.6%) of our funding came from retail savings. Finding the right mix of retail and wholesale funding is essential to the Group achieving both its retail savings and lending growth objectives. During the period we have taken the opportunity to raise additional funds from the wholesale markets as detailed below.

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 during the year, as detailed on page 21.

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 £1.4bn (2016: £1.2bn). These balances are included in 'Amounts owed to other customers' within the Group Statement of Financial Position.

Wholesale funding

The Society accesses the remainder of its funding through the wholesale markets, as there are certain benefits that wholesale funding brings, such as the term of funding. At 31 December 2017, £2.6bn (2016: £1.5bn) of our funding came from the wholesale markets as analysed below:

	2017 £m	2016 £m
Repo and other secured agreements	1,401.8	567.4
Deposits	498.9	395.9
Certificates of deposit	15.7	14.6
Senior unsecured funding	348.5	-
Securitisation	306.4	519.6
Fair value adjustments	(4.2)	-
	2,567.1	1,497.5

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

	2017 £m	2016 £m
Amounts owed to credit institutions	1,483.2	655.3
Amounts owed to other customers	1,805.1	1,493.2
Debt securities in issue	666.4	534.2
Less: SIL funding	(1,387.6)	(1,185.2)
	2,567.1	1,497.5

In June 2017, the Society raised £350m of wholesale funding under a senior unsecured funding transaction for a term of five years. The Society also continued to make use of the benefits 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 £1,100m (2016: £300m) under the scheme and at 31 December 2017, the Society had drawn a total of £1,400m (2016: £300m) and had repaid the outstanding funding from the Government's FLS. The amount of FLS funding outstanding at 31 December 2016 was £980m, of which £187m was held within the Statement of Financial Position.

The credit ratings of the Society are assigned by two major credit rating agencies, Fitch and Moody's. During the year Moody's upgraded our credit rating with the Society's long term rating moving to Baa1 (stable outlook) from Baa2 (positive outlook). The Society's long and short term credit ratings as at 31 December 2017 were as follows:

	Long term	Short term	Outlook	Date of last change of rating
Fitch	A-	F1	Stable	26 May 2016
Moody's	Baa1	P-2	Stable	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 is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses. Capital comprises principally the general reserve, plus subscribed capital provided through Permanent Interest Bearing Shares (PIBS).

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 £66.7m during 2017 to £1,323.7m (2016: £1,257.0m). This is mainly due to retained profits, including dividend income from Connells, accumulated during the year, which are added to the general reserve. In April 2017, the Society repaid and cancelled £50.0m of its PIBS and £35.4m of its subordinated debt on their call dates. In May 2017, the Society also repaid and cancelled £30.0m of its subordinated debt on its call date. £30.4m of the subordinated debt repaid counted towards regulatory capital at the end of 2016.

Risk weighted assets (RWAs) have reduced by £898.5m during 2017 to £3,864.7m (31 December 2016: £4,763.2m). Whilst Group mortgage balances grew by 8.3% in 2017, house price inflation and the continuation of low levels of arrears have led to a re-calibration of our point in time credit risk models. This has reduced effective risk weights resulting in a lower level of RWAs. The reduction is also due to the sale of a portfolio of non-performing or recently non-performing mortgage assets, as discussed on pages 26 and 27, resulting in a decrease in our RWAs of £463m which further strengthened our capital position.

As a result of these movements, the CET 1 ratio has significantly improved to 33.2% from 23.9% at 31 December 2016. The leverage ratio, a non-risk based capital measure, has also remained strong at 6.1% (2016: 5.9%).

The following table shows the composition of the prudential group's regulatory capital as at 31 December 2017. The capital ratios are reported on a CRD IV transitional basis. Under CRD IV end-point rules the £40m PIBS currently classified as Additional Tier 1 capital are fully transitioned into Tier 2 capital. On an end-point basis our CET 1 ratio would remain the same at 33.2%, the Tier 1 ratio would be 33.2% and the total capital ratio would remain the same at 34.3%. The leverage ratio is reported on an end-point basis.

Strategic Report *(continued)*

	2017 £m	2016 £m
Common Equity Tier 1		
General reserve	**1,307.2**	1,171.7
Available-for-sale reserve	**3.1**	4.0
Cash flow hedging reserve	**0.1**	3.3
Common Equity Tier 1 prior to regulatory adjustments	**1,310.4**	1,179.0
Common Equity Tier 1 regulatory adjustments		
Fair value adjustments (note 1)	**-**	(0.4)
Prudential adjustments (note 2)	**(0.6)**	(0.8)
Intangible assets (note 3)	**(11.0)**	(9.7)
Cash flow hedging reserve (note 4)	**(0.1)**	(3.3)
Excess of expected loss over impairment provisions (note 5)	**(15.0)**	(28.2)
Total Common Equity Tier 1 capital	**1,283.7**	1,136.6
Additional Tier 1 capital – PIBS (note 6)	**40.0**	54.0
Total Tier 1 capital	**1,323.7**	1,190.6
Tier 2		
Subordinated liabilities (note 6)	**-**	30.4
Permanent Interest Bearing Shares (note 7)	**-**	36.0
Total Tier 2 capital	**-**	66.4
Total regulatory capital	**1,323.7**	1,257.0
Risk weighted assets (RWAs)		
IRB approach		
Credit risk		
Secured mortgages on immovable property	**1,961.8**	2,721.0
Non-credit obligation assets (note 8)	**36.5**	129.4
Equity (note 9)	**308.0**	277.6
Standardised approach		
Credit risk		
Secured mortgages on immovable property	**776.7**	755.7
Corporates and retail	**64.3**	60.6
Treasury	**196.9**	268.1
Other (note 10)	**144.4**	161.2
Operational risk	**361.1**	367.3
Market risk	**-**	-
Credit valuation adjustment (note 11)	**15.0**	22.3
Total risk weighted assets	**3,864.7**	4,763.2
Pillar 1 capital requirement (RWAs x 8%)	**309.2**	381.1
Capital and leverage ratios (note 12)		
Common Equity Tier 1 ratio (CET 1)	**33.2%**	23.9%
Tier 1 ratio	**34.3%**	25.0%
Total capital ratio	**34.3%**	26.4%
Leverage ratio	**6.1%**	5.9%

Notes

1. The associated merger fair value adjustments are due to the fact that PIBS and subordinated liabilities are disclosed at par value.
2. Prudential adjustments relate to a deduction to capital for an Additional Valuation Adjustment (AVA) on fair value assets. AVA has been applied to prudently provide for the downside of fair value exposures that are intrinsically subjective in nature.
3. Under PRA rules intangible assets (including goodwill) must be deducted.
4. Under PRA rules the cash flow hedging reserve must be deducted for regulatory purposes.
5. Under PRA rules the excess of expected loss, as calculated under the IRB approach, over accounting impairment provisions is deducted from CET 1 capital.
6. In April 2017, the Society repaid and cancelled £50.0m of its PIBS and £35.4m of its subordinated debt on their call dates. In May 2017, the Society also repaid and cancelled £30.0m of subordinated liabilities on its call date. £30.4m of the subordinated debt repaid counted towards regulatory capital at the end of 2016.
7. Under CRD IV end-point rules all existing Additional Tier 1 and Tier 2 instruments that become ineligible as capital under CRD IV are excluded in full. On a transitional basis £40m of PIBS are being phased into Tier 2 over the period to 2022.
8. Non-credit obligation assets relate to property, plant and equipment and fair value adjustments for hedged assets associated with exposures measured under the IRB approach.
9. Equity exposures primarily relate to investments in subsidiary companies outside the regulatory group.
10. Other exposures include fair value adjustments for hedged assets associated with exposures measured under the standardised approach.
11. The Credit Valuation Adjustment is held in order to protect the Group from exposure to potential mark to market losses that could arise if the creditworthiness of counterparties to the Society's derivative contracts were to deteriorate.
12. 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 and Tier 2 instruments that become ineligible as capital under CRD IV are excluded in full.

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 2017 this was 3.4% (2016: 3.4%) of risk weighted assets, a point in time estimate set by the PRA.

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 1.25% in 2017 rising to 2.5% by 2019 and a macro-prudential Countercyclical Capital Buffer currently set at 0% of RWAs for exposures to the UK (the Financial Policy Committee (FPC) responsible for setting the countercyclical buffer have agreed that this will rise to 1% for exposures to the UK in November 2018). 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 page 68.

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

Minimum Requirement for Own Funds and Eligible Liabilities

Minimum Requirement for Own Funds and Eligible Liabilities (MREL) is being phased in over a transitional period to 1 January 2022. The MREL set for the Society, by the Bank of England, for the transitional period is equal to the minimum regulatory capital requirements for the period to 31 December 2019, increasing to 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 corporate plans.

Pension funds

The Group manages two funded defined benefit schemes as described in note 29 to the Accounts. The aggregate valuation of the two defined benefit schemes at 31 December 2017 resulted in a combined deficit of £100.2m (2016: £110.9m) using the methodology set out in IAS 19.

We continue to take steps to manage the deficit and both 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 £23.3m 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 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 67 to 71 and in notes 35 to 37 to the Accounts.

This Strategic Report was approved by the Board of Directors on 27 February 2018 and signed on behalf of the Board by:

Bobby Ndawula

Bobby Ndawula
Group Finance Director

We've donated £405,000 to 810 community groups since 2013 through Grassroots Giving

Corporate Responsibility Report

Our corporate responsibility to our members, our people and our communities is fundamental to our vision of Building a better Society. In 2017 we developed our Corporate Social Responsibility (CSR) strategy to make sure we carry on having a positive impact on our members, our own people, our communities and the environment. Our CSR strategy is broken down into the following areas and is intrinsically linked to our business strategy:

Our People

Developing a customer centric culture and maintaining colleague engagement

Encouraging diversity and inclusion that matches the communities we operate in

Training and developing our people so they have new skills and grow as individuals

Our Communities

Working to become a dementia friendly organisation

Taking the Society into the community

Helping people to help themselves

Raising awareness and aligning our community activity

Our Environment

Minimising the environmental impact of our activities

Creating a cost effective, carbon neutral environment

We're the only UK building society with Investors in People Platinum accreditation

Over 600 colleagues participated in Learning at Work Week in 2017

Colleagues made 511 STAR award nominations in 2017

> *"I was overwhelmed and proud to have won this fantastic award. I can't describe how humbled I felt to have been shortlisted let alone win. As a leader I have always put the development and welfare of my team at the heart of what I do, so for them to nominate me shows that the effort I put in is appreciated."*
>
> *Jackie Didcock, Regional Manager - Intermediary Relationships. Leader of the year, 2017.*

Our People

Skipton's colleagues are the people who make it possible for us to consistently deliver fantastic experiences for our members. Their relentless focus on our values of One Team, Ownership and Trust is what creates an inclusive culture at Skipton.

We're proud to have achieved high levels of employee engagement for the seventh year running, measured by our independent annual employee survey. The surveys focus on culture and engagement and tell us what we're doing well and where we need to improve. As a result of the feedback colleagues give us, we've been able to improve things like colleague well-being, reward and recognition and how we invest in colleagues.

Well-being

Actively taking steps to promote health and well-being is an integral part of our culture and we recognise colleagues have a broad spectrum of needs inside and outside of work. Over the past year we've reviewed and improved our well-being programme to make sure it supports the physical and mental welfare of our colleagues.

Reward and recognition

The STAR Awards is our colleague recognition programme. It stands for Special Thanks And Recognition. There are ten awards structured around our values and behaviours and colleagues nominate teams and individuals who they think have gone the extra mile.

Investing in our colleagues

We invest in colleagues in a number of different ways:

Pension schemes: We've introduced a higher default contribution rate when colleagues reach the age of 35, and by increasing the maximum employer contributions available to colleagues, we've seen more colleagues investing more of their salary into their pension. In 2017, 92% of colleagues were saving for their future as part of the pension scheme and 59% of those were contributing 6% or more.

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

Retirement: Colleagues have access to retirement workshops and visits from the 'retirement support services on wheels', to help them think about their own retirement plans.

Training and development: Supporting colleagues to develop their careers is really important and we've got lots of initiatives for those who want to take advantage. Reverse mentoring, Learning at Work Week, the Modern Leaders Programme and the Connecting our Future apprenticeship scheme are just a few of the initiatives we offer.

Skipton's Forget-Me-Not ball raised £47,000 for Alzheimer's Society and Alzheimer Scotland

In 2017 we reduced the tonnage of CO_2 emissions across our head office and branch network from 2,979 tonnes in 2016 to 2,703 tonnes

We've donated £405,000 to 810 community groups since 2013 through Grassroots Giving

To date the Charitable Foundation has given over £1.9 million to over 800 charities across the UK. In 2017 the Charitable Foundation donated £143,000 to 74 charities

Dementia Friends
An Alzheimer's Society initiative

Thanks for helping us raise over £4,800 by donating to our dementia friendly Christmas cards

Corporate Responsibility Report *(continued)*

Our Communities

Charity Partner

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.

Since starting the partnership in January 2017 we're proud to say:

- ***69% of all Skipton colleagues are 'dementia friends';***
- ***100% of branches have 'dementia friends' colleagues; and***
- ***We've raised over £88,000 for Alzheimer's Society and Alzheimer Scotland.***

Making a difference in our local communities

Supporting local communities across the UK has always been something we believe in. We pay a lot of attention to working with colleagues and our members to bring our communities together.

Some of our 2017 highlights include:

- ***We've supported 164 community groups through our Grassroots Giving scheme, making donations of £82,000; and***
- ***We've donated £150,000 to the Skipton Building Society Charitable Foundation.***

Charitable Foundation

The Skipton Building Society Charitable Foundation started in 2000 and provides opportunities for registered charities to apply for funding for specific projects or equipment. The Charitable Foundation is run by six trustees, including four who are independent of the Society. They meet quarterly to agree which causes will benefit from our financial support.

Grassroots Giving

Grassroots Giving is our award-winning initiative, which launched in 2013 to mark the Society's 160th birthday. It supports small local community groups with donations of £500, which aren't registered charities and might otherwise struggle to get funding.

Volunteering

At Skipton all colleagues can take up to two days additional paid leave to take part in volunteering activities. This includes individual volunteering as well as long term team projects. Many of our colleagues have used their time to support vulnerable and lonely people, taking part in telephone and face-to-face befriending schemes.

Our Environment

As a responsible corporate citizen, we set ourselves stretching goals to ensure we're doing all we can to limit the impact we have on our environment. This year we recycled 95% (2016: 95%) of our waste and we'll continue to encourage colleagues to recycle by making it even easier.

- Our recycling goes beyond bottles, cans and paper. We regularly donate office equipment we no longer need to schools, community groups and charities;
- We've installed energy efficient LED lighting in branches and head office and tap water sensors that conserve water;
- An energy saving computer programme shuts down all non-critical computers left on overnight. The programme wakes the computers up again in the morning, reducing CO_2 output; and
- Our new car 'liftshare' scheme also went live this year.

This year 133 people joined the car 'Liftshare' scheme, which contributed to some fantastic savings for our colleagues and the environment:

- ***CO_2 reduction of 14 tonnes***
- ***72,028 miles saved***
- ***Money saved of £9,320***

Looking forward

At Skipton we are proud of our heritage and we'll continue to create a lasting legacy for our members. As a mutual building society our vision is to Build a better Society and our CSR strategy is well placed to support delivery of this vision.

In 2017 we put increased rigor around how we are building a better Society and appointed a CSR Steering Group made up of stakeholders from across the Society. The role of the CSR Steering Group is to put in place the right structure and governance to meet the needs of our members, colleagues and communities in which we operate.

To find out more about how we are building a better society together, please visit the 'About Us' section on www.skipton.co.uk and download our full 2017 CSR Report.

For more information please contact – CorporateResponsibility@skipton.co.uk

2 Governance

The Board of Directors

Robert East (57)

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 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.”

David Cutter (56)

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

A chartered accountant, David has had nearly 25 years' 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 trustee of The Craven Educational Trust and a former Chairman of the Building Societies Association.

“I've been with Skipton for nearly 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 (52)

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, in 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 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 develop people and help them 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 (59)

A member of the Remuneration and Nominations Committees.

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 current directorships are Senior Independent Director and Chair of Remuneration Committee of HSS Hire Group plc and Non-Executive Director and Chair of Remuneration Committee of Countryside Properties PLC. She is 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)*

Marisa Cassoni (66)

Chairman of Audit Committee and member of the Nominations Committee.

A chartered accountant with more than 40 years' experience as a finance 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 is a member of the Competition and Markets Authority. She joined the Board in 2012.

> *"Skipton has a strong and unique culture and brings important diversity to the marketplace. I believe businesses are about people. By employing the right ones, then nurturing and challenging them, you ensure success. As a former Finance Director with many years of practical experience, I can relate to what the people I interact with are trying to do and offer a wider perspective which will help them to achieve their goals."*

Richard Coates (66)

Member of the Audit and Nominations 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 while also a member of their Risk Committees. He is also a Non-Executive Director of Police Mutual Assurance Society and 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 successful growth strategy."*

Denise Cockrem (55)

A member of the Audit, Remuneration 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 Chief Financial Officer for Good Energy plc, the AIM-listed renewable energy supplier with a strong tradition of customer share ownership, and an independent Director 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 (49)

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

A member of the Board since 2012, Ian has brought a strong, clear focus on understanding and meeting the needs of our customers in particular through developing and improving the products and services we offer. Previously Commercial Director of Homeloan Management Limited, he also held senior roles at 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 joined Skipton because it has strong values that resonate with my own and a great reputation for looking after its customers. My role is to build on the heritage and reputation that Skipton already has, with the aim of becoming the very best place to go to for financial help and advice 'for your life ahead' for both current and future generations."*

The Board of Directors *(continued)*

Denis Hall (62)

Chair of the Risk Committee and a member of the Nominations and Remuneration 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. He is also a Director and sits on the Audit and Risk Committee of Switzerland's Cembra Money Bank, 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 principles that put the member 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 with being able to weigh up different approaches to common challenges."

Mark Lund (60)

A member of the Risk and Nominations Committees.

Mark has more than 30 years' experience in commercial and financial services. His previous roles have included 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 Limited 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 we really understand our customers' needs and provide them with the right solutions from a business that continues to be in robust financial health."

Bobby Ndawula (44)

Group Finance Director, Chairman of 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 20 years of experience in IT, finance and risk he has a desire to ensure the Society's customers' financial and service interests are safeguarded. He joined the Board in 2015.

"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 (57)

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

Helen joined the Board in 2013. She'd 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. Her other directorships are Non-Executive Director of St Ives plc, Non-Executive Director of Trinity Mirror Group plc and member of Henley Business School Advisory Board. She is also governor at Wellington College. Helen brings a strong customer focus to the Board as well as being an experienced Non-Executive Director and Remuneration Committee Chair.

"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'm interested in supporting the Board maintain a powerful connection between our members and our business and evolve its strategy so that it continues to thrive in a changing marketplace."

Graham Picken (68)

Deputy Chairman, a member of Audit, Risk and Nominations Committees and a Non-Executive Director of Connells Limited.

Graham joined the Board in 2012, bringing broad experience of financial services and business management. He had previously held various senior positions at HSBC (including Executive Chairman of First Direct and Chief Executive of Forward Trust Group) and Derbyshire Building Society (Non-Executive Director then Chief Executive 2005-9). Other former directorships include Chairman of the FTSE listed HICL Infrastructure Company Limited and Non-Executive Chairman of Hampshire Trust plc.

Graham will be retiring from the Board at the conclusion of the Annual General Meeting on 23 April 2018.

Directors' Report

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2017.

The financial information given in this Directors' Report is taken from the statutory Accounts on pages 96 to 186 prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). Further unaudited information which allows comparison between 2017 and 2016 is set out on pages 20 to 35 of the Strategic Report.

Business objectives

The business objectives of the Group are set out on pages 17 to 20 of the Strategic Report.

Business review and future developments

The Chairman's Statement set out on pages 8 to 11, the Group Chief Executive's Report set out on pages 12 to 15 and the Strategic Report set out on pages 16 to 35 report on the performance of the business and its future objectives.

Profits and capital

Group profit before tax was £200.1m (2016: £168.9m). Total profit after tax transferred to the general reserve was £158.2m (2016: £129.8m).

Total Group reserves at 31 December 2017 were £1,404.8m (2016: £1,278.5m) including the available-for-sale reserve of £3.1m (2016: £32.0m) and the cash flow hedging reserve of £0.1m (2016: £3.3m).

Gross capital at 31 December 2017 was £1,446.4m (2016: £1,447.3m) including £41.6m (2016: £92.6m) of subscribed capital. The 2016 comparative also included £77.2m of subordinated liabilities, which were repaid and cancelled during the year, further details of which can be found in note 31 to the accounts. The ratio of gross capital as a percentage of shares, deposits and borrowings at 31 December 2017 was 7.64% (2016: 8.60%) and the free capital ratio was 6.44% (2016: 7.28%). The Annual Business Statement on pages 190 to 193 gives an explanation of these ratios.

Mortgage arrears

Group mortgage balances at 31 December 2017 included 84 cases (2016: 144) either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £12.5m (2016: £29.0m). The total amount of arrears on these loans was £0.9m (2016: £2.2m).

Charitable donations

During the year the Group made charitable donations of £0.3m (2016: £0.2m), primarily to the Skipton Building Society Charitable Foundation. No contributions were made for political purposes (2016: £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 2017 for the Group was 11 days (2016: 13 days).

Principal risks and uncertainties

The principal risks and uncertainties are set out on pages 67 to 71 of the Risk Management Report and in notes 35 to 37.

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 67 to 71 of the Risk Management Report and in notes 35 to 37.

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 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 Article 4 of the International Accounting Standards (IAS) Regulation 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 states that references to IFRS accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing these Annual Accounts, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the Annual Accounts on the going concern basis unless it is inappropriate to presume that the Group and Society will continue in business.

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 190 to 193.

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 20 to 35 of the Strategic Report, and a description of the principal risks and uncertainties facing the Group which is set out on pages 67 to 71 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 188 and 189.

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 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 financial statements 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 16 to 35 of the Strategic Report and on pages 64 to 71 of the Risk Management Report. In addition, notes 34 to 37 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.

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).

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 67 to 71), 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 2022. 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 long 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 2018 – 2022 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 32%, 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 long 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.
- 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. These impacts may have an effect on the performance of the Group in the outer years of the 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, appointed to position 24 April 2017)
Mr G E Picken	(Deputy Chairman)
Mr A P Bottomley*	
Ms A J Burton	
Ms M Cassoni	
Mr J R Coates	(appointed 27 March 2017)
Mrs D P Cockrem	
Mr I M Cornelius*	
Mr D J Cutter*	(Group Chief Executive)
Mr M H Ellis	(former Chairman, resigned 24 April 2017)
Mr D A Hall	(appointed 27 March 2017)
Mr M J Lund	
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 55. No Director of the Society had any interest in the shares of any Group undertaking as at 31 December 2017.

Auditor

In accordance with Section 77 of the Building Societies Act 1986, a resolution for the re-appointment of KPMG LLP 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

R. East

Robert East
Chairman

27 February 2018

Directors' Report on Corporate Governance

I was proud to be appointed as Chairman of the Society at our AGM in April 2017. 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 www.frc.org.uk.

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 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 2017 the Board believes that the Society complied with the guidance issued by the Building Societies Association on the Code.

Governance framework

The 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.

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, Mr Picken, a Society Non-Executive Director, is also a Non-Executive Director of Connells Limited. These Boards are responsible for the prudent management of the business, operating within delegated authorities, to meet agreed strategic and operational objectives as defined in their corporate plans.

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 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 Senior Executives and the Board of material changes to the risk profile of the Society or any of its divisions 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 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 57.

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 normally issued, at least, one week ahead of 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 for which minutes are not available. This ensures that all Board members are kept up to date on the key discussions and decisions made by the Committees;
- Reports from both the Chairman and Group Chief Executive;
- 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 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 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 2017 the Board comprised 13 Directors, being four Executive Directors and nine Non-Executive Directors. Details of the Directors are set out on pages 42 to 47. 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, appointed this year, Mr Coates, was previously Managing Director of a previous 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 Picken (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 his or her 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 involve an average of 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 Group Secretary.

Chairman and Group Chief Executive

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

The Chairman is 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 am independent and have no conflicting relationships or circumstances that might affect my judgement in 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 and is chaired by myself, as the Society Chairman, 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.

In addition, appointments to the sub-committees of the Board (see page 56 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 sub-committee to enable the sub-committees to fulfil their duties effectively.

The Nominations Committee also 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.

2017 saw new additions to the Board with Denis Hall and Richard Coates joining as Non-Executive Directors. The Committee used the services of Korn Ferry, an external recruitment agency independent of the Society in these appointments. In addition, the Deputy Chairman and Senior Independent Director, also supported by Korn Ferry, led the process to find a successor to Mike Ellis, who retired at the AGM on 24 April 2017. This search concluded with my 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 regime that governs 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 ad-hoc basis.

Directors have access to the advice and services of the Group 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 Group 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, LGBT, ethnicity and flexible working. Examples of activity planned or underway include developing mental health first aiders, improving diversity management information, supporting Leeds Pride and unconscious bias training whilst improving general education and awareness.

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 25% of its composition will be male or female. All appointments to the Board are made on merit.

A Davies progress report issued in October 2015 recommended that FTSE 350 boards should endeavour to comprise at least 33% female directors by 2020. At 31 December 2017, four members (31%) of the Society's Board were female.

Performance evaluation

The Board undertakes an annual evaluation of its performance and effectiveness, and also of its Committees. 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 sub-committees. The 2017 review was led by myself as Chairman, supported by the Secretary. The results were considered by the Board at its January 2018 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. Two areas that we will be focusing on are ensuring that Board papers direct attention to key matters whilst ongoing Board training will be further tailored to meet the needs of individual Directors.

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 while the Deputy Chairman and Senior Independent Director leads the Board evaluation of the Chairman's performance, which also takes into account the views of other Directors.

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, although not expected to serve more than six years, this may be extended to nine years in total.

Remuneration

Details relating to Directors' remuneration are contained in the Directors' Remuneration Report on pages 72 to 88.

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 60 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 49 and 50.

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.

Directors' Report on Corporate Governance *(continued)*

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 64 to 71, 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 chairmen of the various Board 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 has direct access to the Chairman of the Audit Committee and reports directly to the Audit Committee; and
- Regular reports to the Board, through the Board Risk Committee, from the risk functions on the principal conduct, operational, credit, market and regulatory risks facing the Group and the strength of the controls in place to mitigate such risks.

The Society has a comprehensive system for reporting financial results to the Board. Each of the divisions 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, that 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 adequately 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 64 to 71.

The Board is satisfied that during 2017 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 – details are contained in the Audit Committee Report on pages 58 to 63;
- The Board Risk Committee – details are contained in the Risk Management Report on pages 64 to 71;
- The Remuneration Committee and Non-Executive Directors' Remuneration Committee – details are contained in the Directors' Remuneration Report on pages 72 to 88; and
- The Nominations Committee – details are contained in the section on 'Appointments to the Board' on page 54 of this report.

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

Board and Committee membership attendance record

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

	Board	Audit Committee	Nominations Committee	Remuneration Committee	Board Risk Committee
Mr R D East	10/10	-	3/4	5/5	5/5
Mr G E Picken	10/10	5/5	4/4	-	7/7
Mr A P Bottomley	10/10	-	-	-	-
Ms A J Burton	10/10	-	4/4	5/5	-
Ms M Cassoni	9/10	5/5	4/4	-	-
Mrs D P Cockrem	10/10	5/5	4/4	5/5	-
Mr J R Coates	8/8	1/1	2/2	-	-
Mr I M Cornelius	10/10	-	-	-	-
Mr D J Cutter	10/10	-	-	-	-
Mr D A Hall	7/8	-	2/2	-	5/5
Mr M J Lund	10/10	-	4/4	-	6/7
Mr R S D M Ndawula	10/10	-	-	-	-
Ms H C Stevenson	10/10	-	4/4	5/5	7/7

Note: Where Directors were not available to attend meetings, due mainly to commitments made prior to their appointment, they nonetheless received all papers and provided feedback as appropriate. Mr Hall replaced Mr East as Chair of the Risk Committee on 1 September 2017.

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 www.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.

Copies of these Annual Report and Accounts 2017 are available online at www.skipton.co.uk or on request in branches or by post.

In addition, the Summary Financial Statement is included as part of the AGM magazine, the format of which is aimed at making it informative and easy to read.

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 these 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 queries.

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

On behalf of the Board

Robert East
Chairman

27 February 2018

Governance

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 G E Picken	Non-Executive Director
Mr J R Coates	Non-Executive Director (appointed to the Committee 1 August 2017)

The Committee met five times during 2017 and the attendance of its members at these meetings is set out on page 57 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 Finance Director of Connells, the Finance Director of Jade 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 Chief Financial Risk Officer, the Head of Compliance Monitoring, external audit representatives and the Chief Internal Auditor regularly attend meetings, by invitation.

The Committee is comprised of four members, all of whom are independent Non-Executive Directors. Consideration has been 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 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. Mrs Cockrem is currently Chief Financial Officer at the Good Energy Group and has also held senior finance positions at RSA Group and Direct Line. Mr Picken has wide experience within the financial services industry and is currently a Non-Executive Director of Connells Limited. Mr Coates, who joined the Committee this year, brings a wealth of experience to the Committee, having spent 30 years in senior roles at KPMG.

In terms of good governance and to ensure holistic oversight, Mr Picken is also a member of the Board Risk Committee. As part of my role as Chairman of the Audit Committee, I also attended meetings of the Remuneration Committee, the Board Risk Committee and a number of subsidiary board meetings.

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 www.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 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 instigate 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 2017 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 64 to 71.

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 2017 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 and credit risk. 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 2017, 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 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 outcome 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 mortgage book in line with requirements of IFRS 9 *Financial Instruments*, ahead of the effective implementation date of the new standard of 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 introduction 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 also receives updates, on at least an annual basis, from the Head of Financial Crime on the systems and controls in place for the detection and prevention of fraud, and 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. All actions from the 2014 effectiveness review have been completed, with the exception of the implementation of specialist audit and compliance monitoring software, which is scheduled for implementation in 2018, and the appointment of a Deputy Chief Internal Auditor.

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 2017 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 25), 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 2017 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 51 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 2017 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 50, 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. Based on this analysis, the longer term viability statement on page 50 was recommended to, and approved by, the Board.
Impairment of financial assets	The Committee has continued to monitor loan impairment provisions and has considered the impact of forbearance adopted in the Group's mortgage portfolios, as well as various other key assumptions contained in the Group's loan impairment model (such as house prices) 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. We have also reviewed the carrying value of treasury assets by scrutinising reports produced by the Market & Liquidity Risk function and consider these carrying values to be appropriate.

Significant matter	Committee action taken
Valuation of the equity release portfolio	The Group holds an equity release mortgage book, closed to new business, and, as outlined in note 16 to the Accounts, a 'no negative equity guarantee' is given to customers under the terms and conditions of the mortgages in this book. This guarantee is accounted for as an embedded derivative and held at fair value within 'Loans and advances to customers' within the Statement of Financial Position. The valuation is determined by, inter alia, a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and the specific characteristics of this portfolio. As a result, judgement is required in determining the appropriate set of assumptions to derive the valuation of the embedded derivative within the Accounts. During the year the assumptions within the valuation have been reviewed and updated where necessary, based on the external economic environment and management judgement. At 31 December 2017 the embedded derivative was valued at £25.7m (31 December 2016: £27.7m). The Committee has scrutinised papers prepared by management which provide evidence that, taking into account the specific characteristics of this portfolio and also general macro-economic indicators, the revised inputs and assumptions are appropriate, and therefore the valuation itself is appropriate. As a result, we have satisfied ourselves on the valuation of the embedded derivative and hence the carrying value of this portfolio in the Accounts. The Committee has reviewed the requirements as per IFRS 9 *Financial Instruments* for classification and measurement of the equity release portfolio and has concluded that it is appropriate for the portfolio to be measured at fair value through profit or loss from 1 January 2018 when the standard became effective. Further details on the treatment of the equity release portfolio under IFRS 9 can be found in note 41 to the Accounts. As outlined in note 38b), the Group hedges the interest rate risk arising from its equity release mortgage book 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, which is not always offset by the value of the underlying hedged item within the Statement of Financial Position; therefore income statement volatility can arise. During 2017, management revised its voluntary prepayment assumptions to reflect the historical disparity in prepayments between the three subsets of the portfolio. The swap valuation model was also updated to include a stochastic element to the RPI forecast. The Committee has reviewed papers prepared by management that support the assumptions used and outline the control framework management has in place, and has satisfied itself 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 1s) 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 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 cashflows 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 £12.5m (2016: £6.2m) charge through interest income.
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. 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 2017 had a deficit of £100.2m (31 December 2016: £110.9m). The Committee has examined and challenged the pension scheme assumptions and is satisfied that these are reasonable and appropriate.

The Group will adopt two significant new accounting standards, IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*, with effect from 1 January 2018. The Committee has maintained close oversight of the Group's preparations for these new standards, including key judgements and decisions, and has considered the appropriateness of disclosures made in these Annual Accounts. The estimated impact that the initial application of IFRS 9 and IFRS 15 will have on the Group's reserves as at 1 January 2018 is reported in note 41 to these financial statements.

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 page 93 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 the 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, whilst at the same meeting the Committee also requested and considered feedback obtained from a survey that had been carried out by KPMG of key business contacts involved with the statutory audit process. The Committee scrutinised these reports and, together with its own experience, formed an opinion as to the effectiveness of the external auditor. During the year, we concluded that the relationship with the external auditor continues 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 2017. 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 7 to the Annual Accounts and during the year non-audit fees represented 88% of the total Group audit fee (2016: 81%). 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 is monitoring 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.

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 as responsible partner. The current audit partner is Jonathan Holt who has held the role since 2014 and will be rotated 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. The Society most recently put its audit out to tender in the second half of 2014, as a result of which the Committee decided that KPMG remained the most appropriate firm at that time to be the Society's external auditor.

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, KPMG will resign as the Society's external auditors after the audit of the 2018 Annual Report and Accounts to coincide with the required rotation of the current senior partner, as outlined above. The external audit process will be put out to tender in 2018 and the Committee will be responsible for making a recommendation to the Board as to which firm they believe should be appointed as the Society's external auditors following the tender process.

The Committee has also agreed a policy for the employment, by the Group, of former employees of the auditor which is designed to further maintain the auditor's independence.

Effectiveness of the Audit Committee

The effectiveness of the Committee is assessed 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 55. The 2017 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

27 February 2018

Risk Management Report

As the recently appointed Chairman of the Board Risk Committee, I am pleased to present the 2017 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 paid particular attention to economic developments since the decision was made 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 begins the exit process, the changing economic environment could have an impact on 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 appropriately severe scenarios to test the Group's resilience to possibly unforeseen risk events and, where appropriate, build mitigating strategies. The Directors are monitoring developments closely and the Group is well placed to react to any developments accordingly.

At Skipton we have maintained focus on the external environment and 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 exercised and the prudential strength of the Group to be maintained.

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

- **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 growth plans do not increase the risk profile outside appetite;
- **Cyber risk**, to ensure that the Group has appropriate controls in place to reduce the likelihood of a successful attack;
- **Financial advice**, to ensure training and competence standards are appropriate, customers receive good advice and documentation standards substantiate this; and
- **Risk appetite**, to ensure that this remained appropriate against a changing business and economic backdrop.

The Committee receives regular reports from the Chief Financial Risk Officer and Chief Conduct Risk Officer. These reports 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 commercial or sub-prime lending.

Central to operating within this appetite is a management culture which promotes awareness of actual and potential risk exposures and an understanding of their impact 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.

Membership and attendees

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

Mr R D East, Non-Executive Director (former Committee Chairman) (stepped down 31 August 2017 following appointment as Chairman of the Board)

Mr D A Hall (appointed Committee Chairman 1 September 2017 having joined the Committee in May 2017)

Mr M J Lund, Non-Executive Director

Mr G E Picken, Non-Executive Director

Ms H C Stevenson, Non-Executive Director

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.

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:

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 which, 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 framework, to ensure that we develop and market 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 Funding for Lending Scheme and currently the Term Funding Scheme. These initiatives have provided market liquidity and have dampened competition for retail savings.

Whilst levels of mortgage arrears have continued to fall throughout 2017, 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. To reduce the risk associated with these loans further, the sale of approximately £220m of loans which were in arrears or had recently been in arrears occurred during the year, further details of which can be found on pages 26 and 27.

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 on the payment of lettings fees will impact Connells' revenue flows although, at the point of writing, implementation of this is expected to be delayed until 2019.

The Group continues to monitor closely the impact of the referendum result to leave the EU. Uncertainty surrounding the economic impact and progress of exit negotiations combined with political uncertainty underlines the need to continue to observe a robust risk policy.

The Group is also monitoring the impact of tax changes in the buy-to-let market and house price movements generally, but particularly in London and South East England. As the housing market changes, so too do the inherent risks.

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.

There has not been a material movement in the principal risks and uncertainties facing the Group during the year, with the exception of equity risk which is no longer considered to be a principal risk following the disposal of the Group's primary equity share investment, ZPG Plc, as outlined on page 27.

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 a low risk approach to new lending and will continue to do so. 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. In addition, the Group includes specialist lending businesses Amber and NYM which were also closed to new lending in 2008. 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. As noted, the Group sold c.£220m of our specialist lending portfolio during 2017, with the objective of further reducing our exposure to an economic downturn, and freeing up a material value of capital to support our preparations for the new capital regime being introduced by the regulators to ensure financial institutions are appropriately prepared for any future economic downturn.
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. To diversify our funding sources, additional funding is provided by accessing longer term wholesale funding markets. During 2017 we issued £350m of senior unsecured debt and we received approval from the regulators to issue regulated covered bonds to the wholesale funding market. Our latest corporate plan includes actions to continue to use diverse sources of funding which will further strengthen our liquidity position. In addition, funding has been accessed from the Government's Term Funding Scheme. We have also maintained the quality of the Group's liquidity portfolio, with 68% of total liquidity held within the Statement of Financial Position comprising balances held at the Bank of England. We also hold a portfolio of high quality but less liquid assets.

Risk Management Report *(continued)*

Risk	Risk mitigation and management
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. The CRD IV regulatory framework came into force on 1 January 2014. Whilst many of the proposed changes have been implemented, further material changes are anticipated, such as the requirement to hold Minimum Required Own Funds and Eligible Liabilities, initiated by the regulators in response to the previous banking crisis. The Society will assess the emerging implications for its future capital requirement, which will be required to be implemented by 2022. 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 two defined benefit schemes which carry funding deficits. The 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.
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.	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. 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 Executive Committee of the Society and the boards of Group subsidiary firms are responsible for ensuring that business risk is effectively managed. 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.

Risk Management Report *(continued)*

Risk	Risk mitigation and management
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. 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.
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. 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 which is inadequately managed can 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 the 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.

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 www.skipton.co.uk.

Conclusion

The challenges facing financial services businesses are extensive and very real. I am confident that the risk management framework operated by the 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

27 February 2018

Governance

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 2017.

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 achievement of business goals and objectives.

This year has seen a period of relative stability in relation to our remuneration arrangements and the Committee has been focussed on the embedding of previous regulatory changes and Directors' remuneration structures (following changes in 2016).

I would like to thank Robert East for his invaluable contribution to the Remuneration Committee, stepping down as a member in September 2017, and congratulate him on becoming Chairman of Skipton Building Society from April 2017. In addition, I am delighted to welcome Denis Hall (Chair of the Board Risk Committee) who has joined the Remuneration Committee from 1 October 2017.

The members of the Remuneration Committee during the period were:

Ms H C Stevenson	Non-Executive Director (Chairman of the Committee)
Miss A J Burton	Non-Executive Director (appointed 1 January 2017)
Mrs D P Cockrem	Non-Executive Director
Mr R D East	Non-Executive Director (resigned from the Committee 26 September 2017)
Mr D A Hall	Non-Executive Director (appointed 1 October 2017)

In 2016 we noted that we would consider how new regulations such as gender pay reporting may influence our practices going forward and a separate report on gender reporting and the key considerations for the Society resulting from this is available on our website, www.skipton.co.uk. This work is part of a wider Society initiative on diversity and inclusion in which the Committee will be taking an active interest. We will also be preparing for the proposed changes to the Corporate Governance Code which are due to become effective in January 2019.

We constantly strive to maintain the highest standards of governance in relation to Directors' remuneration and to provide meaningful information to our members.

This Directors' Remuneration Report is presented in four 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.
- An overview of the Directors' Remuneration Policy, which was set out in detail in the Society's 2015 Annual Report and Accounts and approved at the Annual General Meeting (AGM) in April 2016. This policy is unchanged and the overview on pages 76 to 79 serves as a reminder of the key elements of the policy.
- The Annual Report on Remuneration on pages 80 to 88 which explains how we put our existing policy into practice in 2017, aligned it with other key policies and how we intend to apply the policy in 2018.

A summary of this report will be sent to members, together with the Summary Financial Statement, ahead of the AGM in April 2018.

Remuneration policy

The remuneration policy, approved at the AGM in April 2016, remains unchanged. In developing our approach to remuneration, we considered a broader context for total reward than the financial numbers, with consideration of mutuality, strong culture and respectful work life balance. 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.

As a reminder, the key elements of our policy for the Society's Executive Directors are set out below:

- 2017 was the second year of operation for the Single Variable Pay Arrangement (SVPA) (a single variable pay scheme replacing the previous short term incentive (STI) and medium term incentive (MTI) arrangements). The final performance period for the 2015/2017 MTI scheme concluded in December 2017 and no further MTI awards will be made;
- 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;
- 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);
- 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 sustained.

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

Remuneration in respect of 2017

The Society's performance has remained strong, with membership numbers increasing by 58,657 (to 919,060), an increase in Group profit before tax of 18.5% (to £200.1m) and an increase in underlying profit before tax of 9.4% (to £165.7m). This is despite the context of increasing competition in the mortgage market and pressure on our net interest margin.

The core Mortgages and Savings division profit before tax was £89.1m (2016: £96.6m). The division has seen a reduction in profit of £7.5m, predominantly as a result of the loss on disposal of non-performing or recently non-performing loans. This initiative, to reduce risk, resulted in a £15.0m loss on disposal. However, this has benefitted the Common Equity Tier 1 (CET 1) ratio which was at 33.2% at 31 December 2017 (2016: 23.9%).

Despite the increased market and economic pressures, the launch of our cash LISA and our range of competitive mortgage and savings products has resulted in good growth for our mortgage and savings balances (growth of £1.3bn or 8.3% and £0.9bn or 6.2% respectively).

As outlined in our Chief Executive's report, our strong performance in 2017 has meant that we were able to pay, on average, 0.52% higher interest than the market average for banks and building societies during 2017 (source: CACI Savings Market Database).

Key decisions taken

- Taking into account the market competition, economic factors, our acceptable risk profile and our continued strong performance, the Committee made awards under the Society's SVPA with respect to the 2017 outturn. The average award payable to the Executive Directors is 46.6% (2016: 33.1%) of base salary (as at 31 December 2017) out of a possible maximum 50% (2016: 50%). Other Executive Committee members also participating in the SVPA received an average award of 36.3% of base salary (2016: 28.5%) out of a possible maximum of 40%. The average award made to senior managers who were full year participants in the Senior Leadership Team (SLT) incentive scheme is 28.3% (2016: 21.6%) of base salary. The maximum opportunity for SLT members in the scheme ranges from 25% to 50%.
- The annual incentive scheme for the remainder of our people in the Society resulted in an average payment of 7.7% (2016: 5.0%) of base salary for eligible, full year participants rated as 'achieving' or above. The maximum award from this scheme in 2017 was 15%.
- The three year performance cycle for the 2015/2017 MTI scheme, put in place in January 2015, came to an end in December 2017. Having reviewed the cumulative performance to December 2017, the Committee made an overall award of 39.7% (of salary on commencement of the scheme), half of which is paid in 2018 followed by a quarter in 2019 and a quarter in 2020. The MTI and 2015 STI were replaced by the SVPA in 2016 which, combined with an adjustment to basic salaries in January 2016, was designed to achieve a cost neutral position at on target earnings over the long term.
- The Remuneration Committee continues to focus on managing risk in its remuneration schemes including risk adjustment arrangements. In 2018, the Committee will continue its work in this area and will also consider how new regulations may influence our remuneration policy and practices going forward. These include changes to secondary legislation on corporate governance and executive pay, the Financial Reporting Council's consultation on the UK Corporate Governance Code ('the Code') and other industry best practice guidance on companies' approaches to wider stakeholders.

Conclusion

On behalf of the Committee, I hope that this report gives you a clear view of how we have implemented the policy in 2017. The Committee recommends that members vote in favour of the 2017 Annual Remuneration Report at the forthcoming AGM.

Helen Stevenson
Chairman of the Remuneration Committee

27 February 2018

Directors' Remuneration Report *(continued)*

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.

Single figure remuneration 2017

The table below summarises the total payments made to Executive Directors in respect of the 2017 financial year. The figures shown in the graph are included in the single figure table on page 80. Further details on the variable pay awards, the performance measures and the extent to which they are achieved are on pages 81 to 83.

Key highlights of 2017		Base salary	Benefits and Pension	SVPA	MTI	Total £000	Total variable as % of max	Amount deferred to future years £000
2.4% average salary increase for Executive Directors	Mr D J Cutter	500	115	234	163	1,012	87.0%	222
46.6% average SVPA award – minimum of 50% deferred for between 1 to 5 years or 60% deferred between 3 to 7 years	Mr A P Bottomley	287	55	133	97	572	86.3%	115
	Mr I M Cornelius	292	41	137	95	565	87.0%	116
39.7% average 2015/2017 MTI award – 50% paid in 2018, 25% in 2019 and 2020	Mr R S D M Ndawula	312	43	148	99	602	87.6%	139

Base salary | Benefits and Pension | SVPA | MTI

	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 measures	●	●	●	
Customers (growth and satisfaction)	●		●	
Risk and governance		●	●	●
People			●	
Personal objectives including strategy development and implementation		●	●	●
MTI measures (three year performance period)				
Group profit	●			
Net customer satisfaction	●		●	
Customer satisfaction online channel	●		●	
Net customer growth	●		●	
Features applicable to both schemes				
Risk adjustment		●	●	●
Deferral of at least 50% of incentive		●		●
Discretion to reduce / defer / recover payments		●	●	●

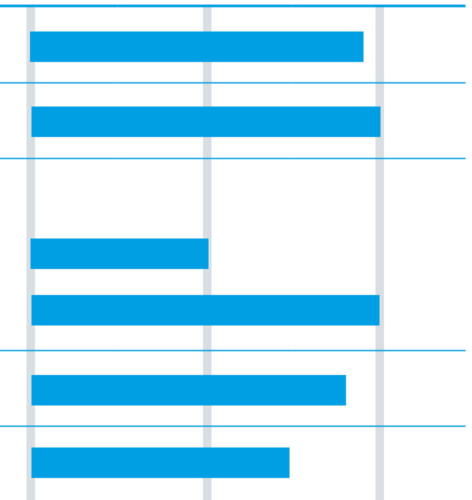
Note

1. For bonus purposes, the Group profit and Mortgages and Savings profit is 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, Connells management incentive scheme costs, FSCS charges, profit or loss on disposal of Group undertakings, impairment of Group undertakings or goodwill and profits or losses on disposal of mortgage assets.

Single Variable Pay Award (SVPA) – introduced in 2016

The table below shows the 2017 performance measures and level of achievement:

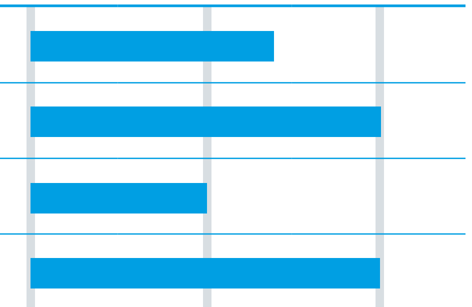
Measure	Weight	Performance achieved (Threshold / Target / Maximum)
Group profit (adjusted)	10%	
Mortgages and Savings division profit (adjusted)	30%	
Mortgages and Savings division efficiency ratios	10%	
Management expense ratio		
Cost income ratio		
Team KPIs	30%	
Personal and strategic objectives (average)	20%	



Performance of the 2015/2017 Medium Term Incentive (MTI)

The MTI is a legacy scheme with final awards being made in 2017. The table below shows the 2015/2017 performance measures and level of achievement:

Measure	Weight	Performance achieved (Threshold / Target / Maximum)
Group profit (adjusted)	50%	
Net customer satisfaction	20%	
Customer satisfaction online channel	10%	
Net customer growth	20%	



Full details of the payments and awards in 2017 can be found in the section headed 'Annual Report on Remuneration in 2017' on pages 80 to 86.

Directors' Remuneration Policy

The Directors' Remuneration Report in the 2015 Report and Accounts (available on our website at www.skipton.co.uk/financialresults) explained fully our policy on Executive Directors' remuneration effective from 2016. The structure of this policy remains unchanged. To provide context and to enhance understanding of our 2017 report, we have set out below the key elements of our Executive and Non-Executive Directors' remuneration and how each element links to our overall business strategy.

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.

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, and those regulated by the FCA, which include the Society and the general principles for these firms 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 that 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 87). The principles are reviewed annually and are supported by key policies.

General principles of remuneration

a. A total rewards approach to remuneration is taken which encompasses the key elements deployed to attract, engage and retain employees namely: remuneration (basic and variable), benefits and the 'work experience'. The 'work experience' includes but is not restricted to our culture, values and working environment, work/life balance, career development and recognition.

b. Remuneration at the Skipton Group encourages a high level of stewardship and corporate governance. Senior management and those responsible for drafting remuneration schemes are expected to adhere to these principles and to incorporate them into remuneration policy and scheme design. All schemes must comply with prevailing PRA, FCA and European Banking Authority (EBA) regulations in so far as they apply to the individual firm or type of employee. Remuneration must be paid in accordance with the principles and not circumvent the regulatory requirements.

c. Remuneration policies, procedures and practices reflect sound, effective risk management and do not encourage risk taking which falls outside the Board Risk Appetites, which are reviewed annually, or the scope of Board policies. Remuneration practices are to be reviewed at least annually by the senior forum in each business, responsible for approving remuneration, to ensure they do not encourage inappropriate risk taking behaviour or present conflicts of interest which may result in poor outcomes for our customers.

d. Remuneration should be competitive and sufficient to secure and retain the services of talented individuals from other companies or mutual organisations with the key skills, knowledge and expertise necessary to run Group businesses effectively, recognising the diverse nature of the Group and the nature of its stakeholders.

e. All employees will be 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. Remuneration should recognise the appropriate level of Group/Society and individual performance which will create a strong and sustainable business, aligning with our values, strategic objectives and the long term interests of our members.

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

h. Remuneration arrangements are transparent, consistent and fair, reflecting individual responsibilities and performance. Basic pay will reflect the core role and responsibilities of the individual whereas variable pay will reflect the achievement of agreed targets, or objectives which are over and above the individual's business as usual activities.

i. Remuneration policies, practices and procedures (including performance appraisal) should be: cost effective, free from conflicts of interest, clearly documented and straightforward to understand, communicate and administer.

j. Employees in control functions (such as Risk, Compliance, Legal, Audit Services and specific roles in Finance and Human Resources) should be rewarded competitively to attract and retain adequately experienced employees and will be assessed on their functional objectives as well as financial targets.

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 twelve 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	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; and • 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

Governance

Element How element supports our strategy	Operation	Maximum potential value	Performance conditions and assessment
Single Variable Pay Arrangement (SVPA) (continued)	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.		vary from year to year as determined by the Committee.
Medium Term Incentive (MTI) 2014 and 2015 Schemes (discontinued in 2016) • Encourages the right behaviours in respect of long term, sustainable performance that supports the achievement of strategic goals; and • Provides a balance between long and short term rewards in the overall remuneration package for those Senior Executives eligible to participate.	Payments are based on performance (as determined by performance against agreed corporate plan targets) over rolling three year cycles. The corporate plan targets for each three year performance period are reviewed and agreed by the Board annually. The performance for each three year cycle is based on cumulative performance against the annual targets for the three year cycle. Payments are made over three years so that: • 50% of the incentive earned is paid immediately following completion of the three year performance period; • 25% is deferred for one year; and • 25% is deferred for two years. The Committee may reduce or withdraw the payment of a deferred amount in certain circumstances and has the power to reduce or cancel payments due under the MTI if it believes in extreme circumstances that 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 MTI was discontinued in 2016. The current MTI scheme for 2015/2017 continued until completion of the performance period and will be paid as per scheme rules. The maximum incentive which may be earned for any year from the MTI scheme is 50% of salary at the beginning of the scheme. For each performance measure, the Committee determines a threshold, target and maximum level of performance. No MTI 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 MTI of 60% of the maximum.	50% of the award is based on Group profit (adjusted) and 50% of the award is based on customer measures. The measures are assessed independently. Any payment from the MTI is subject to reduction, up to and including the whole payment, based on CET 1 capital levels at the end of each three year cycle. Any payment from the MTI is subject to satisfactory individual performance.

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 financial year to which they relate.

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 2018 are outlined in the 'Statement of implementation of Remuneration Policy in 2018' section of this report.

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.

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. Newly appointed Non-Executive Directors will receive fees in line with the policy outlined above. Non-Executive Directors do not have service contracts.

Annual Report on Remuneration in 2017

Executive Directors' remuneration

The total remuneration for Executive Directors in 2017 is set out in the table below:

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[1]	15	12	12	12	51
2017 annual performance award (SVPA)[2]	234	133	137	148	652
MTI (2015/2017)[3]	163	97	95	99	454
Pension[4]	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[5]	(222)	(115)	(116)	(139)	(592)
Prior years' deferred performance pay now released[6]	85	33	32	30	180
Total paid in 2017 or payable in 2018[7]	**875**	**490**	**481**	**493**	**2,339**

2016 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	490	283	287	299	1,359
Benefits	15	12	12	12	51
2016 annual performance award (SVPA)	161	94	96	101	452
MTI (2014/2016)	157	96	88	81	422
Other[8]	-	180	-	-	180
Pension	98	42	29	30	199
Total remuneration in respect of performance periods ending in 2016	921	707	512	523	2,663
Total 2016 performance pay deferred	(175)	(95)	(92)	(91)	(453)
Prior years' deferred performance pay now released	85	-	21	-	106
Total paid in 2016 or payable in 2017	831	612	441	432	2,316

Notes
1. Benefits comprise the provision of a car or car allowance and private medical insurance contributions.
2. £140,227 (60%) of the 2017 SVPA award for Mr Cutter (2016: £96,747) 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 2018 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 2019. £88,949 (60%) of Mr Ndawula's 2017 SVPA award will also be deferred on the same basis as Mr Cutter's (2016: £50,381 deferred for between one and five years). 50% of the awards for Mr Bottomley and Mr Cornelius will be deferred for between one and five years in line with the scheme rules.
3. The full outturn relating to the 2015/2017 MTI scheme (awarded in 2015) is included in this row. 50% of this award is paid in 2018 and the remaining portion is paid 25% in 2019 and 25% in 2020.
4. Mr Cutter's 2017 pension figure includes the additional value earned in the defined benefit scheme during 2017 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.
5. These are amounts which have vested in respect of the performance periods ending in December 2017 (from the 2017 SVPA scheme and 2015/2017 MTI scheme) which are due to be paid in future years in line with the scheme rules.
6. These are deferred amounts from STI schemes from 2014 onwards plus deferred payments from the 2014/2016 MTI scheme which are payable in 2018.
7. Total payable is salary, benefits, pension and other payments which have been paid in 2017 and variable pay from 2017 (and from prior years) which is payable in 2018.
8. In 2016, on joining the Society, Mr Bottomley was awarded £180,000 in one-off awards to compensate him for remuneration he forfeited on leaving his previous employer.

In 2017, no payments were made to past Directors for loss of office.

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 following a benchmarking exercise conducted by PwC in the first quarter of 2017 and taking into account the average pay review award in the wider Society, which was 3.24% for employees below Executive Committee level. The increases were effective from 1 April 2017:

Director	% increase	April 2017	April 2016
Mr D J Cutter	**2.0%**	**£502,121**	£492,275
Mr A P Bottomley	**2.0%**	**£288,150**	£282,500
Mr I M Cornelius	**2.0%**	**£293,760**	£288,000
Mr R S D M Ndawula[1]	**4.0%**	**£315,120**	£303,000

Note
1. Mr Ndawula's increase was based on market review and alignment to the market.

Variable pay

Single Variable Pay Arrangement (SVPA)

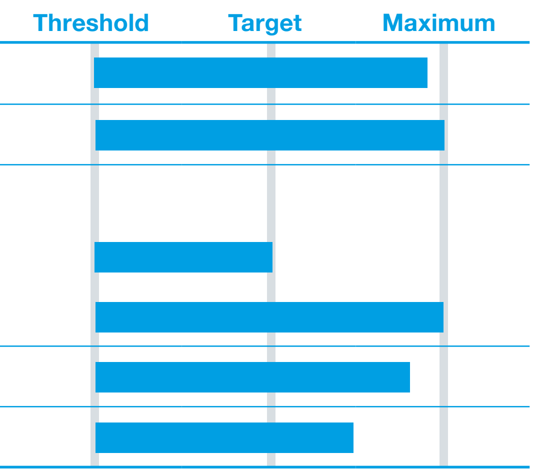
The measures, weightings and the final payments from the 2017 SVPA scheme are set out below. Taking into account the Prudential Valuation Adjustment as required by the PRA, the final awards were as follows:

Director	Target bonus opportunity (% of salary)	Maximum bonus opportunity (% of salary)	Weighting: Group profit (adjusted)	Weighting: Mortgages and Savings division profit (adjusted)	Weighting: Efficiency measures	Weighting: Team KPIs[1]	Weighting: Personal objectives	SVPA award: % of salary	SVPA award: £000
Mr D J Cutter	30%	50%	10%	30%	10%	30%	20%	**46.6%**	**234**
Mr A P Bottomley	30%	50%	10%	30%	10%	30%	20%	**46.1%**	**133**
Mr I M Cornelius	30%	50%	10%	30%	10%	30%	20%	**46.6%**	**137**
Mr R S D M Ndawula	30%	50%	10%	30%	10%	30%	20%	**47.1%**	**148**

Note
1. Team KPIs include the measures for customer growth, customer satisfaction, risk and governance and people as set out in the policy table.

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

Measure	Weight	Performance achieved (Threshold / Target / Maximum)
Group profit (adjusted)[1]	10%	
Mortgages and Savings division profit (adjusted)[1]	30%	
Mortgages and Savings division efficiency ratios	10%	
Management expense ratio		
Cost income ratio		
Team KPIs	30%	
Personal and strategic objectives (average)	20%	



Note
1. For bonus purposes, the Group profit and Mortgages and Savings profit is 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, fair value gains or losses on financial instruments, Connells management incentive scheme costs, FSCS charges, profit or loss on disposal of Group undertakings, impairment of Group undertakings or goodwill and profits or losses on disposal of mortgage assets.

For personal and strategic objectives, all Executive Directors have performed well.

Risk considerations

As part of approving incentive outcomes for 2017, 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 2017, 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 2017 and that performance remained within risk appetite, no adjustment to remuneration was required.

Deferral arrangements for 2017

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 instruments, but for ourselves as a mutual organisation this means that 50% of the award payable in each year will be retained for a further twelve 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 2017, the total remuneration awarded to Mr Cutter exceeded the threshold and therefore 60% of his SVPA award will be deferred for a period of three to seven years. This means that in 2018, Mr Cutter will receive 50% of the non-deferred element of his SVPA award (£46,742) in March 2018 and 50% will be retained until March 2019. He will then receive 50% of the annual deferred payment in cash (£14,023) in March each year from 2021 to 2025 (i.e. 10% each year) and the remaining 50% of each payment, which is retained and paid in instruments, will be paid twelve months later subject to capital remaining at or above the agreed level.

Mr Ndawula's remuneration for 2017 also exceeded the threshold and the deferral will follow the same pattern as Mr Cutter's i.e. 50% of the non-deferred element of his SVPA award (£29,650) will be paid in March 2018 with 50% retained until March 2019. 50% of the annual deferred payment in cash (£8,895) will be paid in March each year from 2021 to 2025 with the remaining 50% of each payment, which is retained and paid in instruments, to be paid twelve months later subject to capital remaining at or above the agreed level.

50% of Mr Bottomley and Mr Cornelius's awards will be deferred over a period of five years in line with the 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) 2015/2017 scheme

Awards from the 2015/2017 scheme are based on a three year performance period commencing January 2015 and ending December 2017 with the first payments due in March 2018. Payments are determined on whether the performance objectives have been achieved and consideration of any risk adjustment measures which may need to be applied. The MTI award can be reduced or not awarded at all if the CET 1 capital ratio falls below certain levels. As the CET 1 capital ratio was 33.2% at the end of 2017, no reductions were made to the award in this respect for the 2015/2017 scheme.

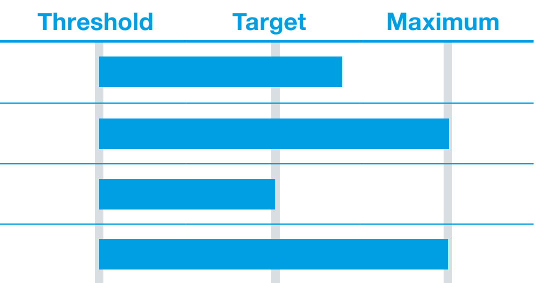
The measures, weightings and the final payments from the 2015/2017 MTI scheme were as follows:

Director	Target MTI (% of salary)	Maximum MTI (% of salary)	Weighting				MTI award	
			Group profit	Net customer satisfaction	Customer satisfaction online channel	Net customer growth	(% of salary)	£000
Mr D J Cutter	30%	50%	50%	20%	10%	20%	39.7%	163
Mr A P Bottomley	30%	50%	50%	20%	10%	20%	39.7%	97
Mr I M Cornelius	30%	50%	50%	20%	10%	20%	39.7%	95
Mr R S D M Ndawula	30%	50%	50%	20%	10%	20%	39.7%	99

For the purposes of the de minimis calculation, the 2015/2017 MTI cycle was treated as awarded in 2015 and is therefore not included in the 2017 calculation. As such the payments are phased, in line with the original scheme arrangements over a three year period commencing in 2018. 50% of the 2015/2017 MTI award is paid in March 2018 with the remaining 50% paid in equal instalments in 2019 and 2020 at which point the legacy MTI scheme will be concluded.

The table below summarises the outcome against the various measures underlying the 2015/2017 MTI:

Measure	Weight	Performance achieved (Threshold / Target / Maximum)
Group profit (adjusted)	50%	
Net customer satisfaction	20%	
Customer satisfaction online channel	10%	
Net customer growth	20%	



Governance

Directors' Remuneration Report *(continued)*

Directors' pension benefits

Mr Cutter is a deferred member of the Skipton Building Society (2015) Group Pension Scheme (and before merger a member of the Skipton Building Society Pension & Life Assurance 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 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	-

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 2016	Normal retirement date	Member's contribution for the year ended 31 December 2016 £000	Accrued pension entitlement at 31 December 2015 £000 pa	Accrued pension entitlement at 31 December 2016 £000 pa	Value of remuneration for the year ended 31 December 2016 £000
Mr D J Cutter	1 January 2027	-	89	89	-

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 2017 recommended that the basic Non-Executive Director fee and Deputy Chairman fee should be increased by £1,000 to £50,000 and by £2,000 to £56,000 respectively with effect from 1 August 2017. The Deputy Chairman Fee increase includes a £1,000 role increase and a £1,000 Non-Executive Director increase. The Deputy Chairman is a Non-Executive Director of Connells Limited for which he receives an annual fee of £26,000 (2016: £25,000) included in the following table.

The fees for chairing the Audit and Board Risk Committees were increased by £1,000 to £14,000 per annum and the fee for the chair of the Remuneration Committee was similarly increased by £1,000 to £12,000 per annum with effect from 1 August 2017.

The Chairman's fees are reviewed and approved by the Remuneration Committee. Mr East's fee was set at £150,000 from his appointment as Chairman on 24 April 2017.

Audited	Note	2017 Fees £000	2017 Committee chair fees £000	2017 Taxable benefits(1) £000	2017 Total £000	2016 Fees £000	2016 Committee chair fees £000	2016 Taxable benefits(1) £000	2016 Total £000
Mr R D East (Chairman)	2	118	4	6	128	48	13	1	62
Mr G E Picken (Deputy Chairman)	3	81	-	3	84	77	-	4	81
Mrs C Black	4	-	-	-	-	16	-	2	18
Ms A J Burton	5	49	-	3	52	32	-	1	33
Ms M Cassoni	6	49	13	4	66	48	13	5	66
Mr J R Coates	7	38	-	-	38	-	-	-	-
Mrs D P Cockrem		49	-	6	55	48	-	7	55
Mr M H Ellis (former Chairman)	8	52	-	2	54	165	-	5	170
Mr D A Hall	9	38	5	3	46	-	-	-	-
Mr M J Lund	10	49	-	5	54	32	-	3	35
Ms H C Stevenson	11	49	11	4	64	48	7	4	59
Mr P J S Thompson	12	-	-	-	-	18	4	1	23
		572	33	36	641	532	37	33	602

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, who is also a Non-Executive Director 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 Picken is also a Non-Executive Director of Connells Limited for which he receives an annual fee of £26,000 (2016: £25,000) included in the table above.
4. Mrs Black retired from the Board on 25 April 2016.
5. Ms Burton was appointed to the Board on 3 May 2016.
6. Ms Cassoni is the Chairman of the Audit Committee.
7. Mr Coates was appointed to the Board on 27 March 2017.
8. Mr Ellis retired from the Board on 24 April 2017.
9. Mr Hall was appointed to the Board on 27 March 2017 and appointed Chairman of the Board Risk Committee on 1 September 2017.
10. Mr Lund was appointed to the Board on 25 April 2016.
11. Ms Stevenson was appointed Chairman of the Remuneration Committee on 26 April 2016.
12. Mr Thompson retired from the Board on 25 April 2016.

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 nine 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 as % of maximum	MTI as % of maximum
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 80% to 50%).
2. From 2018, the SVPA (max. 50% of salary) will be the only variable pay awarded.
3. A proportion of the SVPA and MTI is deferred and paid in future years as set out in the table on page 80.

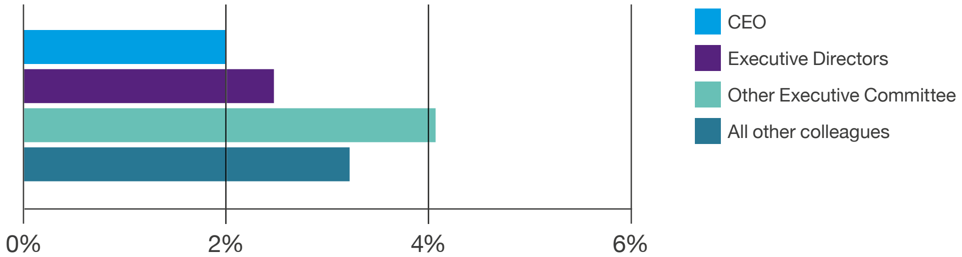
Governance

Comparison to the remuneration of other employees in 2017

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

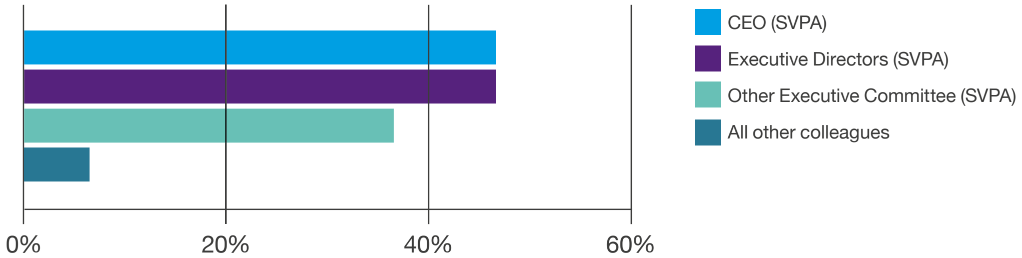


As outlined earlier in the report, the Group Chief Executive's base salary increased in April 2017 by 2.0% (1.5% in April 2016). This compares to an annual average pay review award in April 2017 of 3.2% of base salary for all other Society employees below Executive level (3.3% in April 2016). The Society 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.

Comparison of annual variable pay awarded in 2017

The table below illustrates the average annual variable pay awards, expressed as a percentage of salary, made in 2017.

Variable pay award as a % of salary



The Chief Executive's award under the Society's SVPA scheme in respect of 2017 represented 46.6% of his base salary (2016: 32.8%). This compares to the average amount awarded to the Executive Directors of 46.6% (2016: 33.1%) and other Executive Committee members of 36.3% (2016: 28.5%). The average amount awarded to the Senior Leadership Team was 28.3% (2016: 21.6%) and to the remainder of our people in the Society was 7.7% (2016: 5.0%).

Statement of implementation of Remuneration Policy in 2018

The SVPA for 2018 will continue to be based on a balanced scorecard of financial and non-financial measures, as currently outlined in the 2017 policy. The measures and weightings in 2018 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	20%
Mortgages and Savings division profit	30%	Net customer satisfaction	5%	Strategic team objectives	10%
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 intended to give a greater focus on strategy in 2018. For participants in the Risk, Audit or Compliance areas of the business, the combined personal and strategic objectives will have a 50% weighting, with a 30% weighting on financial measures.

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

The deferral arrangements operated in 2017 will continue to apply in 2018 and Directors' salaries will be reviewed on 1 April 2018 as they are for all colleagues in the Society.

On a broader level, the Society will be actively planning for the introduction in January 2019 of the Financial Reporting Council's revised UK Corporate Governance Code ('the Code') and the broader remit that this will bring. The Committee will also continue its involvement in addressing the gender pay gap and its involvement in the broader diversity aims of the Society.

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 2018 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 2017 are included in the Pillar 3 document which is available at www.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 the 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.

Directors’ Remuneration Report *(continued)*

The Committee has established clear remuneration principles for the Society and its subsidiaries. For the PRA and FCA regulated businesses, the principles, which are reviewed annually, set appropriate standards for remuneration governance, risk management, variable pay structures (and the link to performance) and remuneration for MRTs. The Committee receives annual reports from the Group Remuneration Oversight Committee and from the Chief Conduct Risk Officer and Secretary on the implications of the remuneration policies within the Group on risk management and compliance with the principles.

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 www.skipton.co.uk.

The Remuneration Committee met five times during 2017. 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 Committee currently comprises four Non-Executive Directors, as listed on page 72. 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 2017 and have received £51,000 (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.

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.

Statement of voting at the 2017 AGM

At the 2017 AGM the Directors’ Remuneration Report was subject to an advisory vote of members, the results of which were as follows:

	Votes		
	For	**Against**	**Withheld**
2016 remuneration report	**60,723 (89.06%)**	**7,460 (10.94%)**	**1,607**

Helen Stevenson
Chairman of the Remuneration Committee

27 February 2018

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 2017 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 2017 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 appointed as auditor by the members before 1989. The period of total uninterrupted engagement is for more than the 29 financial years ended 31 December 2017.

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:	£7.5m (2016: £7.5m)	
Group annual accounts as a whole	4.6% (2016: 5.0%) of normalised Group profit before tax	
Coverage	97.2% (2016: 100.0%) of Group profit before tax	
Risks of material misstatement		vs 2016
Recurring risks	Impairment of loans and advances to customers	◄►
	Equity release no negative equity guarantee	◄►
	Provisions for liabilities	▲
	Revenue recognised based on the effective interest rate method	◄►
	New: Revenue recognition in respect of estate agency income	▲

2. Key audit matters: 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 annual accounts 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 for both the Group and Society, in decreasing order of audit significance, 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 annual accounts 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
Impairment of loans and advances to customers fully secured on residential property ("FSRP") and fully secured on land ("FSOL") (Group: £15.3 million; 2016: £28.5 million, and Society: £12.5 million; 2016: £14.3 million) *Refer to page 60 (Audit Committee Report), pages 109 and 110 (accounting policy) and pages 128 to 130 (financial disclosures).*	**Subjective estimate** Impairments cover individual loans identified as impaired and a collective impairment of all other loans for those impairments incurred but not yet specifically identified. Due to the significance of loans and advances to customers and the related judgement applied by the directors in assessing the level of impairment, this is considered a key audit risk. Both individual and collective impairment of FSRP loans is derived from a model that uses a combination of the Group's and Society's historical experience, adjusted for current conditions. In particular, judgement is required on the key assumptions of movements in the house price index, borrower default rates and the likelihood that borrowers will recover from being in arrears ("cure rates"). The overall level of impairment provision held is also sensitive to the application of adjustments made outside the model. Collective impairment of FSOL loans is derived from a model that uses the Society's historical experience, adjusted for current conditions. In particular, judgement is required on the key assumptions of indexed security value, default rates and the forced sale discount. Individual impairment of FSOL loans is considered for loans with balances over £500,000 and which are in arrears by more than three months, or where other specific concerns have been raised. The directors make judgements as to the expected recoverable amount of the loan, based on expected future cash flows, and recognise impairment accordingly.	Our procedures included: – **Benchmarking assumptions:** We compared the key assumptions used in the FSRP model of probability of default with comparable lenders and, for the house price index, to externally available data; We compared the forced sale discount assumption used in the FSOL model with comparable lenders; – **Sensitivity analysis:** We performed sensitivity analysis on judgemental assumptions, including probability of default, to critically assess the quantum of impact on FSRP loan impairment provisions arising from a range of possible outcomes based on observable evidence; We considered the significance of estimates within the FSOL model by performing sensitivity analysis on the forced sale discount, probability of default and indexing of property values to observe the impact on the model output; – **Historical comparison:** We critically assessed certain assumptions used in the FSRP model, including probability of default and cure rates, against the Group's and Society's historical experiences; – **Tests of details:** We selected a sample of FSOL loans to test the Society's individual impairment estimate by evaluating the assumptions used in assessing the loan's recoverable amount, including the value of realisable collateral, correspondence between the Society and borrower, and third party valuations; – **Tests of detail:** We tested adjustments made outside the Group's and Society's models, by considering the reason for the adjustment and the source data used. We tested these adjustments back to supporting evidence such as analysis of external market data; – **Assessing transparency:** We critically assessed the adequacy of the Group's and Society's disclosures in note 1 about the degree of estimation involved in arriving at the impairment balance and the sensitivity to key assumptions. **Our results** – We found the resulting estimate of the impairment for FSRP and FSOL loans to be acceptable (2016: acceptable).
Equity release no negative equity guarantee (Group and Society: £25.7 million; 2016: £27.7 million) *Refer to page 61 (Audit Committee Report), page 110 (accounting policy) and page 175 (financial disclosures).*	**Subjective valuation** Included within loans and advances to customers are equity release mortgage portfolios which 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. This guarantee is accounted for as a separable embedded derivative, with fair value movements recorded in the Income Statement. The directors assess the fair value of the guarantee by considering key input assumptions to the NNEG valuation model including forecast house price growth, house price volatility, the retail	Our procedures included: – **Historical comparison:** We compared assumptions applied in the valuation model against the Society's historical experience for early voluntary redemption rates and against historical market data for house price volatility; – **Our actuarial expertise:** We used our own actuarial specialists to assess the mortality assumptions applied in the model by comparing these to our independent methodology and third party mortality data; – **Benchmarking assumptions:** We compared the discount rate and RPI assumptions to third party market data; – **Sensitivity analysis:** We performed sensitivity analysis on judgemental assumptions, including early voluntary redemption rates and house price growth, to determine those most significant to the valuation and

	The risk	Our response
Equity release no negative equity guarantee *(continued)*	price index ("RPI"), mortality, early voluntary redemption rates and the discount factor. Particularly given the anticipated longevity of the portfolio, there is significant uncertainty in the calculation of this fair value. This gives rise to subjectivity in and sensitivity of underlying assumptions, in particular long term house prices and house price volatility.	critically assess the impact on the NNEG valuation for a range of alternative assumptions; – **Assessing transparency:** We critically assessed the adequacy of the disclosures in note 38b) regarding the degree of estimation uncertainty involved in arriving at the valuation. **Our results** – We found the resulting valuation of the no negative equity guarantee to be acceptable (2016: acceptable).
Liabilities for claims and compensation (Group: £12.7 million; 2016: £10.9 million and Society: £4.7 million; 2016: £3.6 million) *Refer to page 61 (Audit Committee Report) and pages 141 to 143 (financial disclosures).*	**Omitted exposure** Regulatory focus continues to be significant in the sector and providing a wide range of customer services across the Group heightens the risk of non-compliance by the Group and of other litigation and claims emerging. Whether a liability exists can be inherently uncertain. Accordingly, liabilities or contingent liabilities may not be provided for or disclosed, respectively, despite a need to do so. Additionally, there may be issues which give rise to a liability but which have not been identified and consequently have not been provided for.	Our procedures included: – **Our sector experience:** We compared common industry issues with those areas provided for by the Group and Society to determine applicability or relevance to the business and to consider completeness of the matters assessed by the directors; – **Enquiry of lawyers:** For certain matters, we enquired with the Group's external legal counsel to understand whether any litigation and claims on which they were engaged were likely to result in a liability for the Group, together with obtaining formal confirmations from external legal counsel on such matters; – **Enquiry of regulator:** We assessed correspondence with the Group's regulators accompanied by discussions with regulators; – **Assessing transparency:** We assessed whether the disclosures detailing significant legal proceedings adequately disclose the potential liabilities of the Group and Society. **Our results** – The results of our testing were satisfactory and we considered the liability recognised and the contingent liability disclosures made, to be acceptable (2016: acceptable).
	Subjective estimate Due to the uncertainties that can arise in measuring present obligations resulting from operational, legal and regulatory matters, the directors apply judgement in estimating the value of any associated liabilities. There is judgement in how the directors determine the appropriate methodologies to calculate the value of potential liabilities and the assumptions used in these methodologies.	Our procedures included: – **Methodology implementation:** We assessed the methodologies used by the Group and Society in determining the estimated values of liabilities by considering whether they are appropriate to the liability being estimated; – **Benchmarking assumptions:** We compared underlying assumptions, such as run rates of customer complaints, against those used by comparable entities holding provisions for the same or similar customer compensation matters; – **Historical comparisons:** For those underlying assumptions based on the Group's and Society's historical experience, we critically assessed whether these remained appropriate and considered the basis for any adjustments. **Our results** – We found the resulting estimate of provisions for liabilities to be acceptable (2016: acceptable).

	The risk	Our response
Revenue recognised based on the effective interest rate method for FSRP loans (Group and Society: £25.5 million; 2016: £39.8 million) *Refer to page 61 (Audit Committee Report), pages 107 and 108 (accounting policy) and page 127 (financial disclosures).*	**Subjective estimate** Interest earned and fees earned and incurred on loans and advances to customers are recognised using the effective interest rate ("EIR") method that spreads directly attributable expected income over the expected lives of the loans. The most critical element of judgement in this area is the estimation of the future redemption profiles of the loan. This judgement is informed by product mix and past customer behaviour of when loans are repaid.	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; – **Sensitivity analysis:** We observed sensitivity analysis performed using parameters determined by us for judgemental assumptions, including expected customer lives, to critically assess which of these the EIR asset was most sensitive to; – **Historical comparison:** We critically assessed the expected life assumptions against the Society's historical experience of customer behaviour by product type; – **Assessing transparency:** We assessed the adequacy of the Society's disclosures about the degree of estimation involved in arriving at the interest income recognised and sensitivity to key assumptions. **Our results** – We found the resulting estimate of the interest income to be acceptable (2016: acceptable).
Revenue recognition in respect of estate agency income (Group: £283.6 million; 2016: £276.1 million) *Refer to page 62 (Audit Committee Report), page 112 (accounting policy) and page 118 (financial disclosures).*	**2017/2018 sales** Revenue based targets and incentives may place pressure on management to influence the recognition of estate agency income. This may result in overstatement or deferral of revenues to assist in meeting current or future targets or expectations. In particular, we consider this risk relevant for the estate agency revenue streams including commissions earned on property sales and property lettings as well as survey and valuations income, which are more significant to the Group and more susceptible to fraudulent financial reporting.	Our procedures included: – **Control design:** We evaluated the design and implementation of the control over branch to subsidiary income reconciliation; – **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 were recorded in the appropriate period. **Our results** – The results of our testing were satisfactory and we considered the amount of revenue recognised to be acceptable (2016: acceptable).

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

Materiality for the Group annual accounts as a whole was set at £7.5m (2016: £7.5m), determined with reference to a benchmark of Group profit before tax, normalised to exclude this year's profit on disposal of subsidiary undertakings, profit on disposal of other Group undertakings, loss on disposal of mortgage assets and impairment of associate and equity share investments as disclosed on page 25, of £164.4 million, of which it represents 4.6% (2016: 5.0%).

Materiality for the parent Society's annual accounts as a whole was set at £4.0m (2016: £3.9m), determined with reference to a benchmark of Society profit before tax, normalised to exclude dividend income and this year's impairment of investments in subsidiaries, of which it represents 4.8% (2016: 5.0%).

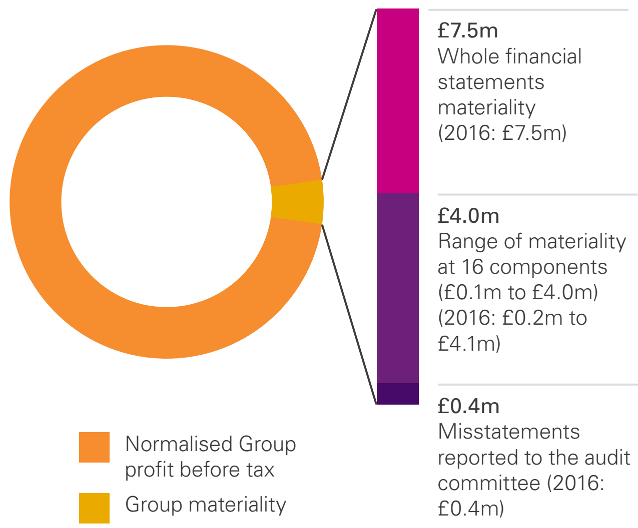
We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.4m, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's 16 (2016: 16) reporting components, we subjected eight (2016: 16) to full scope audits for Group purposes.

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

Normalised Group profit before tax
£164.4m (2016: £151.5m)

Group materiality
£7.5m (2016: £7.5m)



3. **Our application of materiality and an overview of the scope of our audit** *(continued)*

The remaining 3% of total Group revenue, 3% of Group profit before tax and 1% of total Group assets is represented by eight 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 £0.1 million to £4.0 million, having regard to the mix of size and risk profile of the Group across the components. The work on four of the 16 components (2016: four of the 16 components) was performed by component auditors and the rest, including the audit of the parent Society, was performed by the Group team. For those items excluded from normalised Group profit before tax, the component teams performed procedures on items relating to their components. The Group team performed procedures on the remaining excluded items.

The Group team visited 12 (2016: 13) components in one location (2016: two locations) to assess the audit risk and strategy. 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.

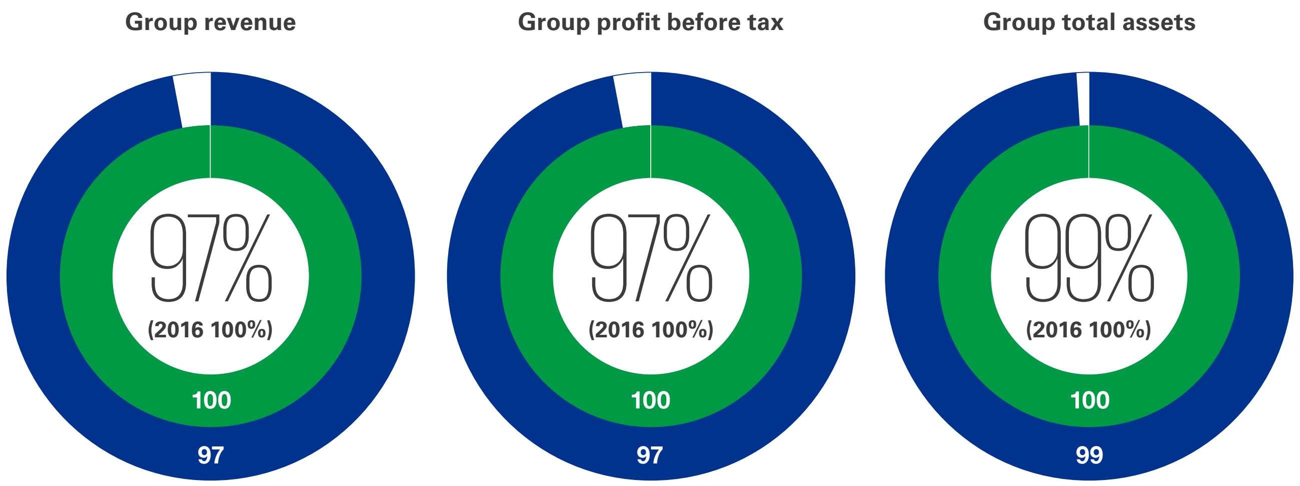
Scope – disclosure of IFRS 9 effect

The Group is adopting IFRS 9 *Financial Instruments* from 1 January 2018 and have included an estimate of the financial impact of the change in accounting standard in accordance with IAS 8 *Changes in Accounting Estimates and Errors* as set out in note 41. This disclosure notes that the Group continues to refine its expected credit loss model and embed its operational processes which may change the actual impact on adoption. While further testing of the financial impact will be performed as part of our 2018 year end audit, we have performed sufficient audit procedures for the purposes of assessing the disclosures made in accordance with IAS 8. Specifically we have:

– Considered the appropriateness of key technical decisions, judgements, assumptions and elections made by management;
– Considered key classification and measurement decisions, including business model assessments and solely payment of principal and interest (SPPI) outcomes;
– Involved credit risk modelling and economic specialists in the consideration of credit risk modelling decisions and macroeconomic variables, including forward economic guidance and generation of multiple economic scenarios; and
– Considered transitional controls and governance processes related to the approval of the estimated transitional impact.

4. **We have nothing to report on going concern**

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 twelve months from the date of approval of the annual accounts. We have nothing to report in these respects.



Full scope for Group audit purposes 2017
Full scope for Group audit purposes 2016
Residual components

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 annual accounts. Our opinion on the annual accounts 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 annual accounts audit work, the information therein is materially misstated or inconsistent with the annual accounts 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 pages 49 to 51, 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 annual accounts 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 annual accounts 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 relevant areas of laws and regulations that could have a material effect on the financial statements from our 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.

We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related building society legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related annual accounts items.

In addition we considered the impact of laws and regulations in the specific areas of regulatory capital and liquidity, and conduct including PPI mis-selling, money laundering, financial crime, market abuse regulations and mortgage advice and record keeping, recognising the financial and regulated nature of the Society's activities. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the directors and other management and inspection of regulatory and legal correspondence. We considered the effect of any known or possible non-compliance with these as part of our procedures on the related annual accounts items.

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 with a request to report on any indications of potential existence of non-compliance with relevant laws and regulations (irregularities) in these areas, or other areas directly identified by the component team.

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.

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
27 February 2018

Income Statements

For the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 Restated* £m	Society 2017 £m	Society 2016 Restated* £m
Interest receivable and similar income	2	400.0	430.2	346.7	390.7
Interest payable and similar charges	3	(179.4)	(214.6)	(170.7)	(219.1)
Net interest receivable		220.6	215.6	176.0	171.6
Fees and commissions receivable	4	477.9	452.9	34.4	20.3
Fees and commissions payable		(8.1)	(9.6)	(2.1)	(1.7)
Fair value gains / (losses) on financial instruments		1.5	(3.7)	1.8	(4.3)
Profit on treasury assets	5	2.7	1.4	3.1	1.4
Loss on disposal of mortgage assets	6	(15.0)	-	-	-
Income from shares in subsidiary undertakings		-	-	60.5	57.6
Profit on disposal of subsidiary undertakings	17c)	11.3	15.8	-	-
Profit on disposal of joint ventures	17d)	0.9	-	-	-
Loss on disposal of associate		-	(0.9)	-	-
Profit on full or part disposal of equity share investments	17e)	38.5	17.0	-	-
Dividend income from equity share investments		0.6	0.7	-	-
Share of profits from joint ventures		2.0	1.8	-	-
Share of losses from associate		-	(2.4)	-	-
Other income		2.7	2.4	2.8	3.3
Total income		735.6	691.0	276.5	248.2
Administrative expenses	7	(523.1)	(499.1)	(132.1)	(106.0)
Operating profit before impairment losses and provisions		212.5	191.9	144.4	142.2
Impairment credit / (charge) on loans and advances to customers	16	4.0	0.3	3.0	(1.8)
Provision against investments in subsidiary undertakings	17a)	-	-	(9.9)	-
Impairment losses on associate		-	(1.1)	-	-
Impairment losses on equity share investments	17e)	(0.1)	(11.3)	-	-
Provisions for liabilities	27	(16.3)	(10.9)	(3.7)	(4.8)
Profit before tax		200.1	168.9	133.8	135.6
Tax expense	11	(41.9)	(39.1)	(15.2)	(20.6)
Profit for the financial year		158.2	129.8	118.6	115.0
Profit for the financial year attributable to:					
Members of Skipton Building Society		158.2	130.1	118.6	115.0
Non-controlling interests		-	(0.3)	-	-
		158.2	129.8	118.6	115.0

* The comparative figures have been restated due to a change in accounting policy relating to the netting of gains on and costs arising from the sale of treasury assets. Further details are provided in note 1b).

Segmental performance of the Group is shown in note 39.

The notes on pages 103 to 186 form part of these Accounts.

Statements of Comprehensive Income

For the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Profit for the financial year		158.2	129.8	118.6	115.0
Other comprehensive income:					
Items that will not be reclassified to profit or loss:					
Remeasurement gains / (losses) on defined benefit obligations	29	10.2	(50.0)	2.9	(26.7)
Movement in reserves attributable to non-controlling interests		-	0.9	-	-
Income tax on items that will not be reclassified to profit or loss	32	(1.9)	10.2	(0.7)	6.6
		8.3	(38.9)	2.2	(20.1)
Items that may be reclassified subsequently to profit or loss:					
Available-for-sale investments: valuation gains taken to equity	32	8.1	6.5	3.2	3.8
Available-for-sale investments: realised gains transferred to Income Statement	32	(43.0)	(6.2)	(4.4)	(0.4)
Cash flow hedges: (losses) / gains taken to equity	32	(0.7)	8.9	(0.7)	8.9
Cash flow hedges: realised gains transferred to Income Statement	32	(1.9)	(0.2)	(1.9)	(0.2)
Cash flow hedges: gains reclassified to Income Statement	32	(1.7)	-	(1.7)	-
Exchange differences on translation of foreign operations	32	(0.4)	1.7	-	-
Translation loss transferred to Income Statement on deemed disposal of associate	32	-	0.5	-	-
Income tax on items that may be reclassified to profit or loss	32	7.1	(2.2)	1.4	(3.1)
		(32.5)	9.0	(4.1)	9.0
Other comprehensive expense for the year, net of tax		(24.2)	(29.9)	(1.9)	(11.1)
Total comprehensive income for the year		134.0	99.9	116.7	103.9
Total comprehensive income attributable to:					
Members of Skipton Building Society		134.0	99.3	116.7	103.9
Non-controlling interests		-	0.6	-	-
		134.0	99.9	116.7	103.9

The notes on pages 103 to 186 form part of these Accounts.

Statements of Financial Position

As at 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Assets					
Cash in hand and balances with the Bank of England		2,396.9	1,212.7	2,396.9	1,212.7
Loans and advances to credit institutions	12	345.3	409.6	260.8	309.0
Debt securities	13	791.1	1,055.1	760.3	1,262.0
Derivative financial instruments	14	94.2	116.1	98.2	125.1
Loans and advances to customers	15	16,972.7	15,781.6	14,886.6	13,523.4
Deferred tax asset	28	30.4	30.4	13.9	13.7
Investments in Group undertakings	17a)	-	-	1,086.0	1,319.6
Investments in joint ventures		12.8	12.5	-	-
Equity share investments	17e)	0.4	36.4	-	-
Property, plant and equipment	18	78.2	77.8	33.9	32.2
Investment property	19	14.4	15.0	14.3	14.9
Intangible assets	20	164.4	164.8	2.6	2.6
Other assets	21	122.8	107.7	13.1	11.3
Total assets		21,023.6	19,019.7	19,566.6	17,826.5
Liabilities					
Shares	22	14,985.8	14,152.5	14,985.8	14,152.5
Amounts owed to credit institutions	23	1,483.2	655.3	1,580.1	786.5
Amounts owed to other customers	24	1,805.1	1,493.2	924.7	1,054.1
Debt securities in issue	25	666.4	534.2	360.0	14.6
Derivative financial instruments	14	318.5	412.3	318.9	409.1
Current tax liability		19.9	19.7	8.2	10.8
Other liabilities	26	110.4	106.2	7.8	5.4
Accruals		50.5	49.5	15.9	12.5
Deferred income		3.7	3.1	-	-
Provisions for liabilities	27	26.1	23.3	7.1	7.1
Deferred tax liability	28	7.4	12.2	0.8	3.0
Retirement benefit obligations	29	100.2	110.9	51.7	53.8
Subordinated liabilities		-	77.2	-	77.2
Subscribed capital	30	41.6	92.6	41.6	92.6
Total liabilities		19,618.8	17,742.2	18,302.6	16,679.2
Members' interests					
General reserve		1,396.4	1,236.6	1,260.8	1,140.0
Available-for-sale reserve		3.1	32.0	3.1	4.0
Cash flow hedging reserve		0.1	3.3	0.1	3.3
Translation reserve		5.2	6.6	-	-
Attributable to members of Skipton Building Society		1,404.8	1,278.5	1,264.0	1,147.3
Non-controlling interests		-	(1.0)	-	-
Total members' interests		1,404.8	1,277.5	1,264.0	1,147.3
Total members' interests and liabilities		21,023.6	19,019.7	19,566.6	17,826.5

The notes on pages 103 to 186 form part of these Accounts.

These Accounts were approved by the Board of Directors on 27 February 2018 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 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 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 32)	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
Balance at 1 January 2016	1,146.3	31.7	(3.2)	4.4	1,179.2	(1.6)	1,177.6
Profit / (loss) for the financial year	130.1	-	-	-	130.1	(0.3)	129.8
Other comprehensive income:							
Remeasurement losses on defined benefit obligations	(39.8)	-	-	-	(39.8)	-	(39.8)
Movement in reserves attributable to non-controlling interests	-	-	-	-	-	0.9	0.9
Net gains from changes in fair value	-	3.2	6.7	-	9.9	-	9.9
Realised gains transferred to Income Statement	-	(2.9)	(0.2)	-	(3.1)	-	(3.1)
Exchange differences on translation of foreign operations	-	-	-	1.7	1.7	-	1.7
Translation loss transferred to Income Statement on deemed disposal of associate	-	-	-	0.5	0.5	-	0.5
Total other comprehensive income (note 32)	(39.8)	0.3	6.5	2.2	(30.8)	0.9	(29.9)
Total comprehensive income for the year	90.3	0.3	6.5	2.2	99.3	0.6	99.9
Balance at 31 December 2016	1,236.6	32.0	3.3	6.6	1,278.5	(1.0)	1,277.5

Statements of Changes in Members' Interests *(continued)*

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 32)	**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**
Balance at 1 January 2016	1,045.1	1.5	(3.2)	1,043.4
Profit for the financial year	115.0	-	-	115.0
Other comprehensive income:				
Remeasurement losses on defined benefit obligations	(20.1)	-	-	(20.1)
Net gains from changes in fair value	-	2.8	6.7	9.5
Realised gains transferred to Income Statement	-	(0.3)	(0.2)	(0.5)
Total other comprehensive income (note 32)	(20.1)	2.5	6.5	(11.1)
Total comprehensive income for the year	94.9	2.5	6.5	103.9
Balance at 31 December 2016	1,140.0	4.0	3.3	1,147.3

The notes on pages 103 to 186 form part of these Accounts.

Statements of Cash Flows

For the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 Restated* £m	Society 2017 £m	Society 2016 Restated* £m
Cash flows from operating activities					
Profit before tax		**200.1**	168.9	**133.8**	135.6
Adjustments for:					
Impairment (credit) / charge on loans and advances to customers	16	**(4.0)**	(0.3)	**(3.0)**	1.8
Loans and advances written off, net of recoveries	16	**(2.3)**	(4.7)	**(0.8)**	(2.6)
Depreciation and amortisation	18,19,20	**21.0**	20.6	**5.2**	4.1
Impairment of property, plant and equipment	18	**0.1**	-	**0.1**	-
Impairment losses on associate		**-**	1.1	**-**	-
Impairment losses on equity share investments	17e)	**0.1**	11.3	**-**	-
Income from shares in subsidiary undertakings		**-**	-	**(60.5)**	(57.6)
Provision against investments in subsidiary undertakings	17a)	**-**	-	**9.9**	-
Dividend income from equity share investments		**(0.6)**	(0.7)	**-**	-
Interest on subscribed capital and subordinated liabilities	3	**6.8**	11.4	**6.8**	11.4
Profit on sale of property, plant and equipment, investment property and intangible assets		**(1.6)**	(0.1)	**(0.7)**	-
Profit on treasury assets		**(2.7)**	(1.4)	**(3.1)**	(1.4)
Loss on disposal of mortgage assets	6	**15.0**	-	**-**	-
Share of (profits) / losses from joint ventures and associates		**(2.0)**	0.6	**-**	-
(Profit) / loss on disposal of associates and joint ventures		**(0.9)**	0.9	**-**	-
Profit on full or part disposal of equity share investments	17e)	**(38.5)**	(17.0)	**-**	-
Profit on disposal of subsidiary undertakings	17c)	**(11.3)**	(15.8)	**-**	-
(Losses) / gains from changes in fair value of cash flow hedges		**(0.7)**	8.9	**(0.7)**	8.9
Remeasurement gains / (losses) on defined benefit obligations	29	**10.2**	(50.0)	**2.9**	(26.7)
Other non-cash movements		**(3.2)**	7.8	**(4.8)**	10.5
		185.5	141.5	**85.1**	84.0
Changes in operating assets and liabilities:					
Movement in prepayments and accrued income		**(0.7)**	(4.2)	**(0.1)**	(0.4)
Movement in accruals and deferred income		**(4.2)**	7.4	**(3.9)**	0.2
Movement in provisions for liabilities		**3.7**	(3.4)	**-**	0.5
Movement in fair value of derivatives		**(71.9)**	94.4	**(63.3)**	91.1
Movement in fair value adjustments for hedged risk		**59.7**	(79.9)	**54.8**	(75.5)
Fair value movements in debt securities	13	**10.5**	(9.6)	**10.5**	(9.6)
Movement in loans and advances to customers		**(1,487.7)**	(1,298.4)	**(1,468.0)**	(1,284.2)
Disposal of mortgage assets		**197.3**	-	**-**	-
Purchase of mortgage assets		**(19.7)**	-	**-**	-
Movement in shares		**888.7**	1,284.6	**888.7**	1,284.6
Income Statement charge for fair value of subsidiary management incentive scheme liability	26	**9.7**	1.0	**-**	-
Net movement in amounts owed to credit institutions and other customers		**1,138.6**	25.5	**663.5**	(340.7)
Net movement in debt securities in issue		**136.7**	(74.5)	**349.6**	(6.5)
Net movement in loans and advances to credit institutions		**49.5**	(94.9)	**47.3**	(92.7)
Net movement in other assets		**(4.2)**	1.4	**(4.0)**	(4.8)
Net movement in other liabilities		**(9.8)**	25.1	**0.4**	12.5
Income taxes paid		**(41.5)**	(37.0)	**(16.0)**	(18.2)
Net cash flows from operating activities		**1,040.2**	(21.0)	**544.6**	(359.7)

* The comparative figures have been restated due to a change in accounting policy relating to the netting of gains on and costs arising from the sale of treasury assets. Further details are provided in note 1b).

Financial Statements

Statements of Cash Flows *(continued)*

For the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 Restated* £m	Society 2017 £m	Society 2016 Restated* £m
Net cash flows from operating activities		**1,040.2**	(21.0)	**544.6**	(359.7)
Cash flows from investing activities					
Purchase of debt securities	13	**(666.5)**	(1,130.2)	**(419.4)**	(1,189.1)
Proceeds from disposal of debt securities		**922.9**	1,190.0	**913.9**	1,376.2
Purchase of property, plant and equipment and investment property	18,19	**(17.5)**	(22.6)	**(6.5)**	(4.3)
Purchase of intangible assets	20	**(6.0)**	(5.7)	**(1.0)**	(1.6)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		**4.8**	1.3	**1.8**	0.3
Dividends received from subsidiary undertakings		**-**	-	**60.5**	57.6
Decrease in loans to subsidiary undertakings	17a)	**-**	-	**223.7**	138.6
Dividends received from equity share investments		**0.6**	0.7	**-**	-
Exercise of share options in subsidiary management incentive scheme	26	**(6.5)**	(10.0)	**-**	-
Proceeds from full or part disposal of equity share investments		**40.8**	18.2	**-**	-
Proceeds from disposal of joint ventures		**1.0**	-	**-**	-
Dividends received from joint ventures		**1.6**	2.1	**-**	-
Purchase of subsidiary undertakings, net of cash acquired		**(0.6)**	(6.6)	**-**	-
Purchase of non-controlling interest	17b)	**(6.6)**	-	**-**	-
Cash paid on disposal of subsidiary undertaking		**(1.5)**	-	**-**	-
Investment in equity share investments	17e)	**(0.1)**	(0.4)	**-**	-
Investment in associate		**-**	(2.5)	**-**	-
Purchase of other business units	17b)	**(1.1)**	(7.1)	**-**	-
Deferred consideration paid in respect of prior year acquisitions of subsidiary undertakings and business units		**(1.8)**	(0.8)	**-**	-
Net cash flows from investing activities		**263.5**	26.4	**773.0**	377.7
Cash flows from financing activities					
Repurchase of subordinated liabilities	31	**(65.4)**	-	**(65.4)**	-
Repurchase of subscribed capital	31	**(50.0)**	-	**(50.0)**	-
Redemption of subordinated liabilities	31	**(10.0)**	-	**(10.0)**	-
Interest paid on subordinated liabilities	31	**(2.6)**	(3.0)	**(2.6)**	(3.0)
Interest paid on subscribed capital	31	**(6.3)**	(8.4)	**(6.3)**	(8.4)
Net cash flows from financing activities		**(134.3)**	(11.4)	**(134.3)**	(11.4)
Net increase / (decrease) in cash and cash equivalents		**1,169.4**	(6.0)	**1,183.3**	6.6
Cash and cash equivalents at 1 January		**1,285.6**	1,291.6	**1,187.3**	1,180.7
Cash and cash equivalents at 31 December		**2,455.0**	1,285.6	**2,370.6**	1,187.3

* The comparative figures have been restated due to a change in accounting policy relating to the netting of gains on and costs arising from the sale of treasury assets. Further details are provided in note 1b).

Analysis of the cash balances as shown within the Statement of Financial Position:

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Cash in hand and balances with the Bank of England		**2,396.9**	1,212.7	**2,396.9**	1,212.7
Mandatory reserve deposit with the Bank of England		**(26.3)**	(25.4)	**(26.3)**	(25.4)
		2,370.6	1,187.3	**2,370.6**	1,187.3
Loans and advances to credit institutions	12	**84.4**	98.3	**-**	-
Cash and cash equivalents at 31 December		**2,455.0**	1,285.6	**2,370.6**	1,187.3

The notes on pages 103 to 186 form part of these Accounts.

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 49 and 50 of the Directors' Report) and in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and effective at 31 December 2017 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 revaluation of available-for-sale assets, whilst derivatives, the put option obligation and the management incentive scheme are measured at fair value through profit or loss.

The Annual Accounts are presented in pounds Sterling and, except where otherwise indicated, have been rounded to the nearest one hundred thousand pounds.

During the year the Directors have adopted the following amendments to accounting standards:

- Amendments to IAS 7 *Statement of Cash Flows*;
- Amendments to IAS 12 *Income Taxes*.

Note 41 summarises the impact of the above.

b) Change to accounting policy

During the year the Group has changed its accounting policy for recognising the cost or benefit of unwinding hedging instruments following disposal of associated treasury investments held as available-for-sale.

The disposal of these investments often includes a resulting cost or benefit relating to the unwinding of hedging instruments, which are held as a hedge against these treasury investments in line with the Group's risk management policies. The cost of unwinding these instruments on disposal was previously recognised in 'Interest receivable and similar income' in the Income Statement, as this is where the income or expense on the hedging instruments is recognised. The gain or loss on disposal of the treasury investment itself is recognised in 'Profit on treasury assets' in the Income Statement.

The change to the accounting policy is to net the cost or benefit of unwinding the hedging instrument and the gain or loss on disposal of the investment and present the net profit or loss within 'Profit on treasury assets' in the Income Statement, as they arise as a result of one transaction and this gives a clearer presentation of the underlying substance of the transaction.

In accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the comparatives have been restated to apply this accounting policy to the prior year's figures. The tables below show the impact of the change to accounting policy on these financial statements. There was no impact on profit before tax.

Income Statements

For the year ended 31 December 2016

	Group Previously published £m	Group Change in accounting policy £m	Group Restated £m	Society Previously published £m	Society Change in accounting policy £m	Society Restated £m
Interest receivable and similar income	427.0	3.2	**430.2**	387.5	3.2	**390.7**
Net interest receivable	212.4	3.2	**215.6**	168.4	3.2	**171.6**
Profit on treasury assets	4.6	(3.2)	**1.4**	4.6	(3.2)	**1.4**

1. Accounting policies *(continued)*

Statements of Cash Flows

For the year ended 31 December 2016

	Group				Society			
	Previously published	Change in accounting policy	Reclassification of cashflow activities	Restated	Previously published	Change in accounting policy	Reclassification of cashflow activities	Restated
	£m	£m	£m	£m	£m	£m	£m	£m
Profit on treasury assets	(4.6)	3.2	-	(1.4)	(4.6)	3.2	-	(1.4)
Other non-cash movements	7.3	0.5	-	7.8	10.0	0.5	-	10.5
Net movement in other liabilities	24.3	-	0.8	25.1	12.5	-	-	12.5
Net cash flows from operating activities	(25.5)	3.7	0.8	(21.0)	(363.4)	3.7	-	(359.7)
Proceeds from disposal of debt securities	1,193.7	(3.7)	-	1,190.0	1,379.9	(3.7)	-	1,376.2
Deferred consideration paid in respect of prior year acquisitions of subsidiary undertakings and business units	-	-	(0.8)	(0.8)	-	-	-	-
Net cash flows from investing activities	30.9	(3.7)	(0.8)	26.4	242.8	(3.7)	138.6	377.7
Net cash flows from financing activities	(11.4)	-	-	(11.4)	127.2	-	(138.6)	(11.4)

During the year the classifications of cash flow activities have been evaluated following the adoption of amendments to IAS 7 *Statement of Cash Flows*. Loans to subsidiary undertakings for the Society have been reclassified as investing activities from financing activities, resulting in a £138.6m increase to Society net cash flows from investing activities for 2016 and a corresponding decrease in net cash flows from financing activities. In addition cash flows resulting from payments of deferred consideration in relation to acquisitions of subsidiary undertakings and other business units have been moved from other liabilities to be shown in 'Deferred consideration paid in respect of prior year acquisitions of subsidiary undertakings and business units' within investing activities. This has resulted in a £0.8m increase to Group net cash flows from operating activities for 2016 and a corresponding reduction to net cash flows from investing activities. Further details on the adoption of amendments to IAS 7 are found in note 41.

Key Performance Indicator

For the year ended 31 December 2016

	Group		
	Previously published	Change in accounting policy	Restated
	%	%	%
Group net interest margin	1.16	0.02	1.18

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.

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.

All transaction or acquisition costs are written off to the Income Statement as incurred.

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 under common control

Where trading operations, assets and liabilities of a subsidiary are 'hived-up' into the business of another Group undertaking, i.e. the operations of a subsidiary are integrated into another Group undertaking, the Group has chosen to transfer the assets and liabilities at their book value at the date of transfer.

Joint ventures and associates

A joint venture is an undertaking in which the Group has joint control and has rights to the net assets of the arrangement. An associate is a company over which the Group has significant influence and that is neither a subsidiary undertaking nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is neither control nor joint control over those policies.

The results and assets and liabilities of joint ventures and associates are accounted for in these consolidated financial statements using the equity method of accounting. Investments in joint ventures and associates 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 or associate, less any impairment in the value of individual investments.

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. Equity share investments are accounted for in these consolidated financial statements as available-for-sale financial assets. As such they are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in their fair value recognised in equity, except for impairment losses which are 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.

1. Accounting policies *(continued)*

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 13. 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 the risks and rewards of these mortgage portfolios through the receipt of substantially all of the profits of the SPVs. 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.

Where the Society issues the debt, as is the case for the covered bond (see note 17a)), it then lends the proceeds on back-to-back terms to Skipton Covered Bonds Limited Liability Partnership (LLP). Under the terms of the LLP transaction documents for the sale of the beneficial interest in mortgage loans, the Society is legally treated as having made a capital contribution to the LLP in an amount equal to the difference between the current balance of the beneficial interest in the loans sold at the transfer date and the cash payment made by the LLP for the loans and relevant security. In the accounts of the Society, the loan to the LLP and the consideration for the transfer of mortgage loans are not recognised separately as additional assets and liabilities. This is to avoid the 'grossing up' of the Statement of Financial Position.

To manage interest rate risk, the Society enters into derivative transactions with the LLP, receiving a rate of interest based on the mortgages in the pool and paying a floating market rate. In accordance with IAS 39 *Financial instruments: Recognition and Measurement*, these internal derivatives are treated as part of the deemed loan and not separately fair valued because the relevant mortgage loans are not derecognised. All other derivatives relating to securitisations are treated as explained in note 1e).

Further details on the nature and amount of the beneficial interest transferred to the SPVs can be found in notes 15 and 17 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 (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. Goodwill written off to reserves under UK GAAP prior to 1 January 2004 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

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 when the cost incurred leads to the creation of an identifiable asset and it is probable that the asset created will generate future economic benefits which will flow to the Group. 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.

e) Financial assets

In accordance with IAS 39, the financial assets of the Group have been classified into the following categories:

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are not classified as loans and receivables, at fair value through profit or loss or held to maturity. Available-for-sale assets are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in fair value recognised in equity, except for impairment losses which are recognised in the Income Statement. Interest income is recognised in the Income Statement on an effective yield 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 yield basis. Any amounts amortised are charged or credited to the Income Statement in the relevant financial periods.

The fair values of available-for-sale assets are based on quoted prices or, if these are not available, fair value valuation techniques considered appropriate by the Group. For quoted prices the bid price is used and fair value valuation techniques include, but are 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 are non-derivative financial assets with fixed or determinable payments that are 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 are classified as loans and receivables and are 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 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.

1. Accounting policies *(continued)*

A change to management's estimate of expected mortgage lives is accounted for in accordance with Application Guidance 8 (AG 8) of IAS 39 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)), this is accounted for in accordance with AG 7 of IAS 39 if it can be demonstrated that this change is driven by changes in market rates. This results in 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 in accordance with AG 8 of IAS 39 (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.

Contingent consideration assets are measured at amortised cost using the effective interest method. Therefore the asset is measured by discounting, to present value, the forecast future cash flows involved. Trade receivables are also recognised at amortised cost.

At fair value through profit or loss

Fair value through profit or loss financial assets are those that are designated on initial recognition as assets to be recognised at fair value and movements in fair value are recognised in the Income Statement.

The Group's derivative financial instruments are classified as at fair value through profit or loss and are held at fair value within the Statement of Financial Position.

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. By applying the hedge accounting rules set out in IAS 39, 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) or an unrecognised firm commitment, 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, the Group applies estimated prepayments assumptions using historical analysis.
- 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 directly in equity. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. Once the forecast transaction has occurred, the cumulative gain or loss recognised in equity is recycled to the Income Statement in the same period in which the underlying transaction affects profit or loss. If the forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss recognised in equity is recognised immediately in the Income Statement.

The Group discontinues hedge accounting when:

- it is evident from hedge effectiveness testing that a derivative is not, or has ceased to be, highly effective as a hedge;
- the derivative expires or is sold, terminated or exercised; or
- the underlying item matures or is sold or repaid.

The Group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge.

If the derivative no longer meets the criteria for hedge accounting or is 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 is amortised to the Income Statement over the remaining life of the hedged item.

Certain derivatives are embedded within other financial instruments. These are treated as separate derivatives where:

- the economic characteristics and risks are not closely related to the host instrument;
- the host instrument is 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 are 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 is then measured in accordance with the relevant accounting policy.

Fair values are determined by the three tier valuation hierarchy as defined within IFRS 13 *Fair Value Measurement* and Amendments to IFRS 7 *Financial Instruments: Disclosures* and as described in note 38. 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. Other gains and losses on all derivatives, hedged items and on the sale of available-for-sale assets are recognised in the 'Fair value gains / (losses) on financial instruments' line in the Income Statement, with the exception of cash flow hedging derivatives, where unrealised fair value gains and losses are recognised in the cash flow hedging reserve.

Any derivatives that do not qualify for hedge accounting are held at fair value with changes in fair value recognised in the Income Statement.

f) Financial liabilities

Borrowings, comprising shares, deposits, debt securities in issue and subordinated liabilities 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 Society elects to apply the fair value option to the deemed loans repayable to the special purpose vehicles described in note 1c). In applying the fair value option to these financial liabilities, the Society has considered the effect of its own credit risk and considers this not to be material.

g) Impairment of financial assets

Impairment of loans and advances secured on residential property or land

The Group carries out an assessment of impairment of loans and advances to customers at each reporting date. Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession or where fraud or negligence has been identified. Objective evidence of impairment may include indications that the borrower or group of borrowers is 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 relate to affordability issues driven by unemployment and increased costs of living. Based upon these assessments an individual impairment provision is made in one of two ways.

For properties that are either in possession or where sufficient information is available to calculate a specific provision on an account-by-account basis (for example, accounts that are on a defined 'watch list') the provision is 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 have reached the point at which an impairment provision is needed but where it is not possible to specifically determine the amount ultimately likely to be received, assumptions are 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.

1. Accounting policies *(continued)*

In addition, a collective impairment provision is made against the remaining portfolio of loans and advances where objective evidence indicates that credit losses have been incurred but not yet identified at the reporting date. The impairment value is calculated by applying various factors to pools within the Group's mortgage portfolio that have similar characteristics. These factors take 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 takes into account the level of forbearance applied to loans, such as payment reductions, term extensions, conversion to interest only and capitalisation of arrears, and reflects the relative performance of each of these pools.

Impairment provisions are recognised in the Income Statement and reflected in a separate account which is netted against the total carrying value of mortgage assets within the Statement of Financial Position. Interest on the impaired asset continues to be recognised through the unwinding of the discount on an effective interest rate basis. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is recognised through the Income Statement.

Where a loan is not recoverable, the related provision for loan impairment is written off once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the Income Statement.

Losses on the equity release portfolio relate to the fair value of the 'no negative equity guarantee' provided to the customers of this portfolio. This guarantee is accounted for as an embedded derivative due to its economic characteristics, the policy for which is outlined on page 175. Losses on the equity release portfolio are recognised in the 'Impairment credit / (charge) on loans and advances to customers' line in the Income Statement.

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 usually 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.

Impairment of other loans and advances

Individual impairment provisions are made to reduce the value of other impaired loans and advances to the present value of the amount that the Directors consider is likely ultimately to be received, based upon objective evidence. The level of impairment provisions is assessed at each reporting date. Where a loan or advance is not recoverable, the related provision for impairment is written off.

Impairment of other financial assets

At each reporting date the Group assesses, on an individual basis, whether there is objective evidence that other financial assets held by the Group, except those held at fair value through profit or loss, are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that other financial assets are 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 are 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 are recognised in the Income Statement and reflected as a deduction against the carrying value of the asset. When a subsequent event causes the amount of impairment loss to decrease, the decrease in the impairment loss is recognised through the Income Statement.

Where impairment is identified on available-for-sale financial assets, impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to the Income Statement. The cumulative loss that is removed from equity and recognised in the Income Statement is 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 increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the Income Statement, the impairment loss is reversed through the Income Statement.

Impairment losses on equity instruments classified as available-for-sale cannot be reversed through the Income Statement and any increase in the fair value of such an instrument after an impairment loss has been recognised is recognised through Other Comprehensive Income.

h) Financial assets and liabilities – derecognition and offsetting

Financial assets are derecognised when the contractual rights to receive cash flows have expired or where substantially all the risks and rewards of ownership have been transferred. 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.

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.

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 profits or losses 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.

1. Accounting policies *(continued)*

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 two defined benefit pension schemes. The two 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.

Past and current 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

Fees and commissions receivable are generally recognised, net of VAT (where applicable), as the services are provided.

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 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.

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.

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.

Fees and commissions payable are generally recognised on an accruals basis as services are 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% of net book value

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 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. We have not aggregated any of our operating segments for the purposes of financial reporting.

Information regarding the results of each reportable segment is included in note 39.

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'.

1. Accounting policies *(continued)*

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) Critical accounting estimates and judgements 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 SPVs, 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 SPVs and the nature of the Society's control over the SPVs are found in note 17a).

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).

Other

Following 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 Board considered whether its decision, in 2010, to remove the ceiling on the Society's Standard Variable Rate (SVR) could result in future cash outflows, and concluded that the probability of this remains remote.

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 2017 £m	2016 £m
One month increase / (decrease)	22.5 / (17.7)	15.1 / (14.5)

During the year a charge of £12.5m (2016: £6.2m) 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 Group regularly reviews the performance of its residential loan portfolios to assess the level of impairment. In determining whether an impairment loss should be recorded in the Income Statement, management makes judgements as to whether there is any objective data indicating that there is a measurable impairment loss. Specifically, management regularly assesses key assumptions that contribute to the probability of an account defaulting and the likely loss incurred through forced sale or write-off as a result.

Critical estimates in calculating the eventual loss incurred in the event of sale are the movement in house prices, default rates and cure rates (being the proportion of accounts that go into default, but then return to their original position out of default at a later date). The following table outlines the impact of reasonably possible alternative assumptions of certain estimates used in calculating the impairment provision:

Assumption	Change to current assumption	Group 2017 Increase in impairment provision £m	Group 2016 Increase in impairment provision £m	Society 2017 Increase in impairment provision £m	Society 2016 Increase in impairment provision £m
House price index	10% decrease in any one year*	0.9	3.5	0.7	1.3
Default rates	10% increase	0.3	1.2	0.2	0.4
Cure rates	10% decrease	0.9	1.8	0.6	0.6

* For example, a 7% fall in house prices compared to an assumption of a 3% increase.

The Group also holds an equity release residential mortgage portfolio and the estimates and judgements used in fair valuing the no negative equity guarantee, a separately identifiable embedded derivative (movements in which impact the Income Statement and are included within the 'Impairment credit / (charge) on loans and advances to customers' line), together with sensitivity disclosures, are outlined in note 38b).

In respect of commercial mortgage exposures, an impairment model exists based on a set of assumptions but, due to the non-standard nature of the properties, each account is also individually reviewed on a monthly basis and specialist commercial underwriters objectively assess additional impairment provisions as required. However, one assumption contained within the commercial impairment model is an assumed forced sale discount, and the impact of an additional 5% discount compared to that assumed (for example, from a forced sale discount assumption of 25% to 30%) would be to increase the total impairment provision by £0.5m (2016: £0.6m) for the Group and Society.

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 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 2017 Increase in liability* £m	Group 2016 Increase / (decrease) in liability* £m
Connells Limited EBITDA	10% increase (note 1)	2.4	3.2
Date of exercise of options	Latest possible opportunity (note 2)	3.4	(0.9)

* 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 to the liability that would result if it was assumed that Connells' forecast EBITDA was 10% higher each year (from 2018 to the period of exercise) than that included in its corporate plans.
2. The fair value of the liability at 31 December 2017 is currently based on the assumption that management will exercise their remaining options at the earliest available opportunity under the terms of the scheme.

1. Accounting policies *(continued)*

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 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 2017, to the extent that discount rates were to increase by 25%, e.g. from 10% to 12.5%, there would be a £1.0m increase to the goodwill impairment charge (2016: £nil). A reduction in the long term growth rate assumption from 2.5% to 0% would result in no increase to the impairment charge (2016: £0.1m).

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 pension liabilities that would result. Each sensitivity considers one change in isolation.

Assumption	Change in assumption	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Discount rate	+/-0.25% pa	-/+12.4	-/+12.5	-/+6.7	-/+7.0
Rate of inflation	+/-0.5% pa	+/-11.1	+/-10.3	+/-5.4	+/-5.3
Rate of salary growth	+/-0.5% pa	-	-	-	-
Commutation allowance	+/-10% pa	+/-2.4	+/-2.5	+/-1.1	+/-1.3
Life expectancy	+1 year	+8.1	+7.9	+4.4	+4.7

The rate of salary growth has no impact on the pension liabilities as the scheme is closed to future accrual of benefit. The estimated average duration of the defined benefit obligation as at 31 December 2017 is 18 years (2016: 18 years).

2. Interest receivable and similar income

	Group 2017 £m	Group 2016 Restated* £m	Society 2017 £m	Society 2016 Restated* £m
On financial assets not at fair value through profit or loss:				
On loans fully secured on residential property	445.6	473.7	364.9	389.0
On other loans and advances:				
To subsidiary undertakings	-	-	32.9	51.5
Other	10.7	11.9	5.7	6.7
On debt securities	10.2	16.5	9.8	16.2
On other liquid assets	6.0	6.4	5.9	5.9
	472.5	508.5	419.2	469.3
On financial assets at fair value through profit or loss:				
Net expense on derivative financial instruments held for hedging assets	(72.5)	(78.3)	(72.5)	(78.6)
	400.0	430.2	346.7	390.7

* The comparative figures have been restated due to a change in accounting policy relating to the netting of gains on and costs arising from the sale of treasury assets. Further details are provided in note 1b).

Included within interest receivable and similar income on debt securities is income from fixed income securities in the Group of £8.0m (2016: £13.8m) and in the Society of £7.7m (2016: £13.6m). Within interest receivable and similar income on debt securities is income from available-for-sale assets in the Group of £10.0m (2016: £16.3m) and in the Society of £9.6m (2016: £16.0m).

Included within interest receivable and similar income is interest accrued on impaired financial assets in the Group of £1.2m (2016: £2.5m) and in the Society of £0.8m (2016: £0.9m).

3. Interest payable and similar charges

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
On financial liabilities not at fair value through profit or loss:				
On shares held by individuals	174.0	209.0	174.0	209.0
On shares held by others	1.2	1.4	1.2	1.4
On subscribed capital	5.6	8.4	5.6	8.4
On deposits and other borrowings:				
Subordinated liabilities	1.2	3.0	1.2	3.0
Subsidiary undertakings	-	-	17.3	40.4
Wholesale and other funding	25.9	31.0	6.5	3.5
	207.9	252.8	205.8	265.7
On financial liabilities at fair value through profit or loss:				
Net income on derivative financial instruments held for hedging liabilities	(28.6)	(38.4)	(35.1)	(46.6)
Finance charge on unwind of put option liability	0.1	0.2	-	-
	179.4	214.6	170.7	219.1

4. Fees and commissions receivable

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Mortgage origination fees	36.9	32.3	-	-
Other mortgage related fees	1.9	1.8	1.9	1.8
General insurance fees	51.0	47.4	1.1	2.9
Commissions earned on property sales	163.8	165.4	-	-
Commissions earned on property lettings	60.3	55.5	-	-
Survey and valuation services	59.5	55.2	-	-
Financial advice fees	31.6	31.4	29.8	14.2
Software licences and consultancy fees	20.7	18.2	-	-
Conveyancing fees	31.2	30.7	-	-
Other fees and commissions	21.0	15.0	1.6	1.4
	477.9	452.9	34.4	20.3

5. Profit on treasury assets

Profits on treasury assets arise on the sale of debt securities and similar treasury instruments, which have been sold in the normal course of business. Following a change in accounting policy adopted during 2017, profits on the disposal of treasury assets held as available-for-sale financial assets are shown net of any associated costs or benefits of the unwinding of hedging instruments held in relation to the treasury assets disposed of. Further details are provided in note 1b).

The net profit on disposal of treasury assets held as available-for-sale during the year for the Group and the Society was £2.7m (2016: £1.4m). The gross profit on the disposal of these assets, prior to the cost of unwinding any associated swaps, was £2.9m (2016: £0.9m) for the Group and the Society.

In addition, the Society recognised a profit of £0.4m (2016: £nil) on the sale of treasury assets held at amortised cost.

6. Loss on disposal of mortgage assets

In April 2017 the Group agreed the disposal of a portfolio of non-performing or recently non-performing mortgage loans held in the Group's specialist mortgage businesses Amber Homeloans Limited and North Yorkshire Mortgages Limited, which both ceased new lending in 2008.

Transfer of legal title occurred in October 2017 and the sale completed, with the disposal resulting in a £219.6m reduction in loans and advances to customers and a £15.0m loss on disposal, which includes the impact of releasing £8.7m of provisions for impairment losses held in relation to these mortgages.

7. Administrative expenses

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Employee costs:				
Wages and salaries	311.2	294.8	72.1	60.7
Social security costs	29.9	28.4	7.2	5.7
Pension costs:				
Defined contribution arrangements (note 29)	8.3	7.9	5.0	4.3
Settlement gain (note 29)	-	(0.1)	-	-
	349.4	331.0	84.3	70.7
Other administrative expenses	173.7	168.1	52.4	47.4
Central administrative costs recharged to Group undertakings	-	-	(4.6)	(12.1)
	523.1	499.1	132.1	106.0
Other administrative expenses comprise:				
Depreciation and amortisation (notes 18, 19 and 20)	21.0	20.6	5.2	4.1
Impairment of property, plant and equipment (note 18)	0.1	-	0.1	-
Amounts payable under operating leases	19.2	18.6	5.2	5.6
Other property and establishment costs	17.9	16.7	5.1	5.5
Postage and communications	15.9	19.1	5.7	5.2
IT costs	11.9	7.8	7.4	6.5
Marketing and advertising	25.0	25.0	7.4	5.6
Insurance	5.4	5.3	2.2	2.2
Legal, professional and consultancy	13.1	19.5	8.8	8.2
Training, recruitment and other employee related costs	16.9	17.8	4.2	3.7
Costs of Connells' management incentive scheme (note 26)	9.7	1.0	-	-
Other	17.6	16.7	1.1	0.8
	173.7	168.1	52.4	47.4

The remuneration of the external auditor, which is included within legal, professional and consultancy costs above, is set out below (excluding VAT):

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Audit of the Society and Group Annual Accounts	0.3	0.2	0.3	0.2
Audit of the Group's subsidiary undertakings' accounts pursuant to legislation	0.4	0.5	-	-
Audit-related assurance services	0.1	0.1	0.1	0.1
Other assurance services	0.5	0.5	0.4	0.4
	1.3	1.3	0.8	0.7

8. Employee numbers

The average number of full and part-time persons employed during the year (including Executive Directors) was as follows:

	Group 2017	Group 2016	Society 2017	Society 2016
Principal office	1,363	1,137	1,363	1,137
Society branches	784	798	784	798
Subsidiary undertakings	7,405	7,456	-	-
	9,552	9,391	2,147	1,935

* The comparative figure for subsidiary undertakings includes 191 Skipton Financial Services (SFS) employees which in 2017 are included in the principal office figures following the integration of SFS into the Society in August 2016.

9. Directors' emoluments

Directors' emoluments are set out within the Directors' Remuneration Report on pages 72 to 88.

Total Directors' emoluments for 2017 amounted to £3.4m (2016: £3.3m).

10. 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

Key management personnel comprises the Executive Directors and Non-Executive Directors, who are responsible for ensuring that the Society and its subsidiary undertakings meet their strategic and operational objectives.

The table below summarises the benefits paid to key management personnel in the year:

Group and Society	2017 £m	2016 £m
Salary, benefits and annual performance pay	3.2	3.1
Employer pension contributions	0.2	0.2
	3.4	3.3

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:

	2017 £m	2016 £m
Mortgage loans outstanding at 31 December	-	-
Savings balances at 31 December	1.3	1.1

Interest receivable and payable on the above accounts during the year was as follows:

	2017 £000	2016 £000
Interest receivable	-	1
Interest payable	7	11

Loans and savings of key management personnel are at normal commercial rates. There are no provisions for impairment against these loans.

Directors' loans and transactions

At 31 December 2017 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £100 (2016: £600) to one (2016: one) Director or persons who are connected with Directors.

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 £11.6m (2016: £14.5m) and £5.6m (2016: £8.2m) 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:

	2017 £m	2016 £m
Rendering and receiving of services	0.4	3.3
Recharges of central costs	4.6	12.1
Interest receivable	32.9	51.5
Interest payable	(17.3)	(40.4)
Other income	1.6	2.2
Collateral transferred to funding vehicles	986.3	487.0
Purchase of debt securities	-	146.4
Repayment of debt securities	(142.1)	(251.2)

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 2017 the Society owed £667.9m (2016: £925.5m) to subsidiary undertakings and was owed £965.4m (2016: £1,189.1m) by subsidiary undertakings. Interest on intra-Group borrowings is charged at an appropriate market rate.

During the year the Group had the following related party transactions with joint ventures and associates:

	2017 £m	2016 £m
Services provided to the Group	2.4	0.7
Services provided by the Group	3.6	5.2

At 31 December 2017 the Group was owed £nil (2016: £nil) by joint ventures and associates, and owed £nil (2016: £0.1m) to joint ventures and associates.

There are 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 2017 or 31 December 2016.

11. Tax expense

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Current tax	41.9	41.0	17.0	21.0
Deferred tax (note 28)	-	(1.9)	(1.8)	(0.4)
	41.9	39.1	15.2	20.6

11. 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 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Profit before tax	200.1	168.9	133.8	135.6
Share of (profits) / losses from joint ventures and associates, net of tax	(2.0)	0.6	-	-
	198.1	169.5	133.8	135.6
Tax calculated at standard UK corporation tax rate of 19.25% (2016: 20.00%)	38.1	33.9	25.8	27.1
Effects of:				
Expenses not deductible for tax purposes	4.6	4.9	2.3	0.8
Adjustment to tax expense in respect of prior periods	(1.9)	(0.7)	(3.8)	(0.2)
Tax assets not recognised on losses	-	0.3	-	-
Non-taxable income	(1.0)	(1.9)	(11.7)	(11.6)
Corporation tax rate change	(0.6)	(0.1)	(0.2)	-
Effects of lower tax rates in other jurisdictions (see below)	(1.7)	(1.4)	-	-
Banking surcharge	4.5	4.5	4.5	4.5
Reversal of deferred tax asset previously recognised	(0.2)	-	-	-
Other	0.1	(0.4)	(1.7)	-
Tax expense	41.9	39.1	15.2	20.6

The effective tax rate for the Group for the year ended 31 December 2017 is 21.15% (2016: 23.07%) compared with the standard rate of UK corporation tax of 19.25% (2016: 20.00%). 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 2017 is 11.36% (2016: 15.19%). The major impact on the effective rate of tax is the non-taxable dividend income received of £60.5m (2016: £57.6m). This is partially offset by the impact of the 8% surcharge on taxable profits above £25m.

12. Loans and advances to credit institutions

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Repayable on demand:				
Cash and cash equivalents	84.4	98.2	-	-
Cash pledged as collateral	259.7	300.1	259.7	300.1
Other loans and advances to credit institutions	-	1.9	-	-
	344.1	400.2	259.7	300.1
In not more than three months:				
Cash and cash equivalents	-	0.1	-	-
Cash pledged as collateral	-	5.9	-	5.9
Other loans and advances to credit institutions	0.1	0.3	-	-
	0.1	6.3	-	5.9
In more than three months but not more than one year:				
Other loans and advances to credit institutions	-	0.1	-	-
	-	0.1	-	-
In more than one year but not more than five years:				
Cash pledged as collateral	1.1	3.0	1.1	3.0
	1.1	3.0	1.1	3.0
Total loans and advances to credit institutions	345.3	409.6	260.8	309.0
Total included within cash and cash equivalents	84.4	98.3	-	-

At 31 December 2017 £260.8m (2016: £309.0m) of cash has been pledged by the Group and Society against derivative contracts. The repayment of the cash pledged is dependent upon the fair value movements of the derivative contracts which have a maximum contractual period of up to 40 years.

13. Debt securities

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Gilts	153.2	377.5	153.2	377.5
Certificates of deposit	55.1	232.9	20.0	185.4
Fixed rate bonds	178.6	183.7	178.6	183.7
Floating rate notes	24.0	30.1	-	20.1
Treasury bills	94.0	-	-	-
Covered bonds	87.4	39.3	87.4	39.3
Residential mortgage backed securities	198.8	191.6	321.1	456.0
	791.1	1,055.1	760.3	1,262.0
Debt securities have remaining maturities as follows:				
In not more than one year	299.4	363.7	146.4	377.3
In more than one year	491.7	691.4	613.9	884.7
	791.1	1,055.1	760.3	1,262.0
Transferable debt securities comprise:				
Listed on a recognised investment exchange	640.3	820.5	738.6	1,074.9
Unlisted	150.8	234.6	21.7	187.1
	791.1	1,055.1	760.3	1,262.0
Market value of listed transferable debt securities	640.3	820.5	730.4	1,075.2
Carrying value of on-balance sheet securities pledged as collateral under sale and repurchase agreements	0.4	194.0	94.4	206.4

The majority of debt securities held are highly liquid assets which are used on a continuing basis in the Group's activities.

Debt securities of the Group, included in the table above, with a carrying value (excluding accrued interest) of £0.4m (2016: £194.0m) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership.

The Society holds £94.0m (2016: £12.4m) of securities, included in the table above, which are pledged as collateral with a Group subsidiary, Skipton International Limited (SIL), in a repurchase agreement.

Included in the Society's residential mortgage backed securities are £47.0m (2016: £47.0m) and £75.3m (2016: £146.4m) of notes purchased by the Society from the Group's securitisation vehicles Darrowby No. 3 plc and Darrowby No. 4 plc respectively. The 2016 comparative also includes £71.0m of notes purchased by the Society from Darrowby No. 2 plc, which were repaid during 2017.

The Group's investments in residential mortgage backed securities, as shown in the table above, 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 less any unrealised gains recognised within the available-for-sale reserve as shown below:

Group and Society	2017 £m	2016 £m
Carrying value: available-for-sale financial assets	198.8	191.6
Cumulative unrealised gains recognised in available-for-sale reserve	(0.6)	(0.5)
Maximum exposure to loss at 31 December	198.2	191.1

During the year, the Group and Society received interest income of £1.8m (2016: £2.3m) from its investments in unconsolidated structured entities and incurred impairment charges of £nil (2016: £nil). In addition, £0.1m of unrealised profits (2016: £0.5m) were recognised through the available-for-sale reserve, as shown in the 'Available-for-sale investments: valuation gains taken to equity' line in the Statement of Comprehensive Income.

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 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.

Movements in debt securities during the year are summarised as follows:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
At 1 January	1,055.1	1,104.4	1,262.0	1,438.6
Additions	666.5	1,130.2	419.4	1,189.1
Disposals	(920.0)	(1,189.1)	(910.6)	(1,375.3)
Changes in fair value	(10.5)	9.6	(10.5)	9.6
At 31 December	791.1	1,055.1	760.3	1,262.0

14. Derivative financial instruments

	Group 2017 Positive market value £m	**Group 2017 Negative market value £m**	**Society 2017 Positive market value £m**	**Society 2017 Negative market value £m**
Derivatives designated as fair value hedges:				
Interest rate swaps	76.0	99.8	78.8	100.5
Index swaps	-	203.5	-	203.5
	76.0	**303.3**	**78.8**	**304.0**
Derivatives designated as cash flow hedges:				
Interest rate swaps	5.5	0.2	5.6	0.6
	5.5	**0.2**	**5.6**	**0.6**
Other derivatives held at fair value:				
Interest rate swaps	4.2	6.4	5.3	5.7
Index swaps	8.5	-	8.5	-
Investment products - embedded derivatives	-	8.6	-	8.6
	12.7	**15.0**	**13.8**	**14.3**
	94.2	**318.5**	**98.2**	**318.9**

	Group 2016 Positive market value £m	Group 2016 Negative market value £m	Society 2016 Positive market value £m	Society 2016 Negative market value £m
Derivatives designated as fair value hedges:				
Interest rate swaps	80.1	173.6	85.5	174.2
Index swaps	-	216.3	-	216.3
	80.1	389.9	85.5	390.5
Derivatives designated as cash flow hedges:				
Interest rate swaps	14.2	0.7	14.4	0.8
	14.2	0.7	14.4	0.8
Other derivatives held at fair value:				
Interest rate swaps	10.7	10.5	14.1	6.6
Index swaps	11.1	-	11.1	-
Investment products - embedded derivatives	-	11.2	-	11.2
	21.8	21.7	25.2	17.8
	116.1	412.3	125.1	409.1

All derivatives are measured at fair value through the Income Statement and are held for economic hedging purposes.

15. Loans and advances to customers

	Group 2017 £m	Group 2016 £m	**Society 2017 £m**	Society 2016 £m
Loans fully secured on residential property*	**16,318.6**	14,999.6	**14,375.9**	12,873.3
Other loans:				
Loans fully secured on land	**285.8**	317.4	**285.8**	317.4
Other loans and advances	**141.0**	123.8	**0.1**	0.1
Fair value adjustment for hedged risk	**227.3**	340.8	**224.8**	332.6
	16,972.7	15,781.6	**14,886.6**	13,523.4
The remaining maturity of loans and advances to customers from the reporting date is as follows:				
On call and at short notice	**83.0**	77.6	**3.1**	2.2
In not more than three months	**39.5**	38.1	**26.4**	21.6
In more than three months but not more than one year	**45.2**	90.2	**37.3**	45.2
In more than one year but not more than five years	**441.7**	515.1	**357.2**	347.4
In more than five years	**16,405.1**	15,117.4	**14,500.8**	13,149.0
	17,014.5	15,838.4	**14,924.8**	13,565.4
Less: Impairment (note 16)	**(41.8)**	(56.8)	**(38.2)**	(42.0)
	16,972.7	15,781.6	**14,886.6**	13,523.4

* Includes the equity release portfolio (Group and Society) (2017: £279.0m; 2016: £274.3m).

Included in loans fully secured on residential property is a £25.5m asset (2016: £39.8m) 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. Further details can be found in note 1s).

At 31 December 2017, loans and advances to customers include £1,312.9m (2016: £761.8m) of balances for both the Group and Society which have been used in secured funding arrangements, resulting in the beneficial interest in these loans being transferred to Darrowby No. 2 plc (£nil; 2016: £187.3m), Darrowby No. 3 plc (£173.1m; 2016: £226.6m), Darrowby No. 4 plc (£241.7m; 2016: £347.9m) and Skipton Covered Bonds LLP (£898.1m; 2016: £nil) which are consolidated into the Group Accounts. These loans secure £306.4m (2016: £519.6m) of funding for the Group.

The carrying value of these loans at the date the beneficial interest was transferred was £1,920.3m (2016: £1,480.0m). These loans are retained within the Society's Statement of Financial Position.

16. 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 loans (note 1) £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
At 1 January 2016					
Individual impairment	16.2	11.4	0.6	-	28.2
Collective impairment	9.0	0.6	-	24.0	33.6
	25.2	12.0	0.6	24.0	61.8
Amounts written off during the year, net of recoveries					
Individual impairment	(3.3)	(1.2)	(0.1)	-	(4.6)
Collective impairment	-	-	-	(0.1)	(0.1)
	(3.3)	(1.2)	(0.1)	(0.1)	(4.7)
Income Statement					
Impairment losses on loans and advances					
Individual impairment	(0.6)	(1.8)	0.1	-	(2.3)
Collective impairment	(1.7)	0.3	-	3.8	2.4
	(2.3)	(1.5)	0.1	3.8	0.1
Adjustment to impairment losses on loans and advances resulting from recoveries during the year					
Individual impairment	(0.4)	-	-	-	(0.4)
(Credit) / charge for the year	(2.7)	(1.5)	0.1	3.8	(0.3)
At 31 December 2016					
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

Note 1: The fair value of embedded derivatives on equity release loans relates to the no negative equity guarantee provided to customers in the equity release portfolio, as described on page 175.

Society

	Loans fully secured on residential property £m	Loans fully secured on land £m	Fair value of embedded derivatives on equity release loans (note 1) £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
At 1 January 2016				
Individual impairment	4.7	11.4	-	16.1
Collective impairment	2.1	0.6	24.0	26.7
	6.8	12.0	24.0	42.8
Amounts written off during the year, net of recoveries				
Individual impairment	(1.3)	(1.2)	-	(2.5)
Collective impairment	-	-	(0.1)	(0.1)
	(1.3)	(1.2)	(0.1)	(2.6)
Income Statement				
Impairment losses on loans and advances				
Individual impairment	(0.1)	(1.8)	-	(1.9)
Collective impairment	-	0.3	3.8	4.1
	(0.1)	(1.5)	3.8	2.2
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.4)	-	-	(0.4)
(Credit) / charge for the year	(0.5)	(1.5)	3.8	1.8
At 31 December 2016				
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

Note 1: The fair value of embedded derivatives on equity release loans relates to the no negative equity guarantee provided to customers in the equity release portfolio, as described on page 175.

16. Impairment losses on loans and advances to customers *(continued)*

The no negative equity guarantee provided to equity release customers is accounted for as an embedded derivative due to its economic characteristics (as described in note 38b)). The losses on this portfolio represent the fair value movement of the embedded derivative and are a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and the specific behaviour of this portfolio.

During the year the Directors have assessed the fair value of the embedded derivative, based on the performance of the wider economy and management's assessment of the specific characteristics of the portfolio, resulting in a credit of £1.8m to the Income Statement (2016: £3.8m charge).

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 2017 £m	Shares in subsidiary undertakings 2016 £m	Loans to subsidiary undertakings 2017 £m	Loans to subsidiary undertakings 2016 £m	Total 2017 £m	Total 2016 £m
Cost						
At 1 January	186.0	186.0	1,189.1	1,327.7	1,375.1	1,513.7
Additions	-	-	73.9	2.5	73.9	2.5
Repayments	-	-	(297.6)	(141.1)	(297.6)	(141.1)
At 31 December	186.0	186.0	965.4	1,189.1	1,151.4	1,375.1
Provisions						
At 1 January	55.5	55.5	-	-	55.5	55.5
Provided in the year	9.9	-	-	-	9.9	-
At 31 December	65.4	55.5	-	-	65.4	55.5
Net book value at 31 December	120.6	130.5	965.4	1,189.1	1,086.0	1,319.6

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 provided £9.9m against the carrying value of its investments in Amber Homeloans Limited and North Yorkshire Mortgages Limited (2016: £nil).

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 2017	Percentage of ownership interest 2016
Amber Homeloans Limited	Lending body	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Beckindale No. 2 Limited	Funding vehicle	40a Station Road, Upminster, Essex, RM14 2TR	(See below)	(See below)
Connells Limited and subsidiary undertakings*	Estate agency and related businesses	The Bailey, Skipton, North Yorkshire, BD23 1DN	99.8	99.7
Darrowby No. 2 plc	Funding vehicle	40a Station Road, Upminster, Essex, RM14 2TR	(See below)	(See below)
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	99.9	56.4
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	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) Beckindale No. 2 Limited (liquidated during the year), Darrowby No. 2 plc, 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 arrangement or intention to provide additional financial or other support to these SPVs.

b) Acquisitions

In June 2017 the Jade group, headed by Jade Software Corporation, 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%. In line with accounting standards, the increased shareholding in Jade was recognised directly in equity and there was no goodwill recognised on the increased investment. At the same time, as part of the restructure, a small group of companies was disposed of, as outlined below in section *c) Disposals*.

The Group made no further increases to its shareholdings in existing subsidiary undertakings during 2017.

Connells Limited acquired Roberts & Co, an estate agency business, during 2017 for cash consideration of £0.6m (with a further £0.2m deferred consideration), generating goodwill of £0.4m. Connells also purchased the trade and assets of a number of small businesses during 2017 for total consideration of £1.1m (with a further £0.1m deferred consideration), generating goodwill of £0.4m.

17. Investments in Group undertakings *(continued)*

In February 2016, Connells purchased 95% of the share capital and voting rights of the estate agency business Rook Matthews Sayer Limited (RMS) for cash consideration of £6.2m. A put option liability of £0.4m was recognised in relation to the remaining 5% shareholding, bringing the fair value of the total consideration to £6.6m. The transaction resulted in the recognition of intangible assets of £2.0m in relation to customer relationships and brands, and other net assets acquired that were fair valued at £1.1m, generating £3.5m of goodwill. The intangible assets recognised were separately identified in accordance with IAS 38 and valued using the discounted cash flow method.

Also in 2016, Connells purchased six further subsidiary undertakings for cash consideration of £2.5m (with a further £0.9m deferred consideration), generating £1.0m of goodwill.

In addition, Connells purchased the trade and assets of a number of businesses during 2016 for consideration of £7.1m (with a further £0.4m deferred consideration), generating goodwill of £3.3m.

c) Disposals

The profit on disposal of subsidiary undertakings during the year was £11.3m (2016: £15.8m).

In June 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 of £4.9m. The assets disposed comprised £1.7m of intangible assets and £2.9m of other assets (predominantly being trade receivables and prepayments). The disposal also resulted in a reduction in liabilities of £1.2m, which predominantly consisted of accruals and deferred income.

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 will result in amounts being receivable by the Group between 2018 and 2022. In addition to £9.9m contingent consideration booked in 2016, a further £15.2m was recognised during 2017 (which includes the unwind of the discounted cash flows relating to the amount booked in the prior year) following the receipt of information from Computershare in early 2018. The final consideration receivable is in the process of being agreed and the contingent consideration asset at the end of 2017 of £25.1m represents the Group's current best estimate of the present value (net of associated costs) of the total amounts receivable.

A further £0.7m (2016: £5.8m) profit was also recognised during the year following the release of a provision held in relation to the disposal of HML.

A further £0.3m (2016: £0.1m) profit on disposal of subsidiary undertakings was recognised relating to the disposal of Pearson Jones plc in 2015 following the release of a provision no longer required.

d) Joint ventures

At 31 December 2017, 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 2017	2016
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, 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
Home Telecom Limited	Telecommunications services	Warwick House 25-27 Buckingham Palace Road, London, England, SW1W 0PP	Ordinary	**-**	24.5

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.

During the year, the Group disposed of its shareholding in Home Telecom Limited, recognising a profit on disposal of £0.9m (2016: £nil).

e) Equity share investments

At 31 December 2017, the Group held interests in the following companies:

Name of investment	Principal business activity	Percentage of ownership interest 2017	2016
ZPG Plc	Property search provider	**-**	2.7
Hearthstone Investments Limited	Property fund management	**13.9**	13.9
Tactile Limited	Software application provider	**8.7**	8.7
Wynyard Group Limited	Provider of software development services	**17.7**	17.7

The above investments are held as available-for-sale financial assets.

The movement in the Group's equity share investments during the year is analysed below:

	Group 2017 £m	Group 2016 £m
At 1 January	**36.4**	40.9
Additions	**0.1**	0.4
Reclassification from associate investment	**-**	10.6
Disposals	**(41.0)**	(18.2)
Impairment recognised in Income Statement	**(0.1)**	(11.3)
Gain recognised in Other Comprehensive Income	**5.0**	14.0
At 31 December	**0.4**	36.4

During the year the Group sold its entire shareholding in ZPG Plc, generating a profit of £38.5m (2016: £17.0m). This is shown in the 'Profit on full or part disposal of equity share investments' line in the Income Statement.

An unrealised gain of £5.0m (2016: £14.0m) was recognised during the year resulting from the change in fair value of the Group's holding in ZPG Plc, based on the change in its quoted share price up to the date of its disposal. On disposal the cumulative unrealised gains recognised on the disposed shareholding were recycled to the Income Statement.

The Directors have reviewed the carrying value of the Group's investment in Tactile (trading as Fixflo) and believe its current carrying value of £0.4m is the best indication of its fair value.

In 2017 the Group subscribed to a rights issue of shares in Hearthstone, increasing the carrying value of the investment to £0.1m, which was immediately written down to nil resulting in £0.1m (2016: £0.7m) impairment being recognised in the Income Statement.

In 2016 a further £10.6m impairment charge was recognised in relation to the Group's holding in Wynyard Group Limited, following that company going into voluntary administration in October 2016. It subsequently entered liquidation in February 2017. These impairment charges are shown in the 'Impairment losses on equity share investments' line in the Income Statement.

18. Property, plant and equipment

Group

	2017			2016		
	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	91.3	85.6	176.9	82.3	74.2	156.5
Additions	7.5	10.0	17.5	8.9	13.6	22.5
Disposals	(2.8)	(3.7)	(6.5)	-	(3.3)	(3.3)
Acquisition of subsidiary undertakings	-	-	-	0.1	0.2	0.3
Acquisition of other business assets	-	-	-	-	0.1	0.1
Foreign exchange movements on translation	-	(0.3)	(0.3)	-	0.8	0.8
Reclassification to investment property	(1.0)	-	(1.0)	-	-	-
At 31 December	95.0	91.6	186.6	91.3	85.6	176.9
Depreciation						
At 1 January	38.7	60.4	99.1	34.6	54.1	88.7
Charge for the year	5.0	8.7	13.7	4.1	8.1	12.2
Impairment charge	0.1	-	0.1	-	-	-
Disposals	(1.3)	(2.7)	(4.0)	-	(2.4)	(2.4)
Foreign exchange movements on translation	-	(0.1)	(0.1)	-	0.6	0.6
Reclassification to investment property	(0.4)	-	(0.4)	-	-	-
At 31 December	42.1	66.3	108.4	38.7	60.4	99.1
Net book value at 1 January	52.6	25.2	77.8	47.7	20.1	67.8
Net book value at 31 December	52.9	25.3	78.2	52.6	25.2	77.8

Society

	2017			2016		
	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	49.7	30.8	80.5	46.6	29.1	75.7
Additions	2.7	3.8	6.5	3.1	1.1	4.2
Disposals	(1.1)	(0.2)	(1.3)	-	-	-
Transfer of property, plant and equipment on integration of subsidiary undertaking into the Society	-	-	-	-	0.6	0.6
Reclassification to investment property	(1.0)	-	(1.0)	-	-	-
At 31 December	50.3	34.4	84.7	49.7	30.8	80.5
Depreciation						
At 1 January	20.3	28.0	48.3	18.2	27.0	45.2
Charge for the year	2.1	1.5	3.6	2.1	0.8	2.9
Impairment charge	0.1	-	0.1	-	-	-
Disposals	(0.7)	(0.1)	(0.8)	-	-	-
Transfer of property, plant and equipment on integration of subsidiary undertaking into the Society	-	-	-	-	0.2	0.2
Reclassification to investment property	(0.4)	-	(0.4)	-	-	-
At 31 December	21.4	29.4	50.8	20.3	28.0	48.3
Net book value at 1 January	29.4	2.8	32.2	28.4	2.1	30.5
Net book value at 31 December	28.9	5.0	33.9	29.4	2.8	32.2

The net book value of land and buildings comprises:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Freehold	38.9	39.8	24.2	24.5
Long leasehold	1.8	1.3	0.9	1.3
Short leasehold	12.2	11.5	3.8	3.6
	52.9	52.6	28.9	29.4

19. Investment property

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Cost				
At 1 January	28.2	28.4	27.9	28.1
Additions	-	0.1	-	0.1
Disposals	(1.1)	(0.3)	(1.1)	(0.3)
Transfer from property, plant and equipment	1.0	-	1.0	-
At 31 December	28.1	28.2	27.8	27.9
Depreciation				
At 1 January	13.2	12.5	13.0	12.3
Charge for the year	0.6	0.7	0.6	0.7
Disposals	(0.5)	-	(0.5)	-
Transfer from property, plant and equipment	0.4	-	0.4	-
At 31 December	13.7	13.2	13.5	13.0
Net book value at 1 January	15.0	15.9	14.9	15.8
Net book value at 31 December	14.4	15.0	14.3	14.9

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 £2.3m (2016: £2.3m) for the Group and £1.6m (2016: £1.6m) for the Society.

The aggregate estimated market value of investment properties is set out in the table below:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Market value of investment property	16.6	16.7	16.3	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 38b).

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 no impairment should be recognised during the year (2016: £nil).

20. Intangible assets

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Goodwill	139.7	138.9	-	-
Other intangible assets	24.7	25.9	2.6	2.6
	164.4	164.8	2.6	2.6

Goodwill	Group 2017 £m	Group 2016 £m
Cost, less amortisation to 1 January 2004*		
At 1 January	146.5	141.5
Acquisitions of subsidiary undertakings and business units	0.8	7.8
Additions and revaluations of put options	-	(0.8)
Transferred to investments in joint ventures	-	(2.0)
At 31 December	147.3	146.5
Impairment losses		
At 1 January	7.6	7.6
At 31 December	7.6	7.6
Net book value at 1 January	138.9	133.9
Net book value at 31 December	139.7	138.9

* 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 2017 Cost of goodwill £m	Group 2017 Accumulated impairment £m	Group 2017 Carrying value £m
Mortgages and Savings	2.9	0.1	2.8
Estate Agency	135.6	2.2	133.4
Investment Portfolio	8.8	5.3	3.5
Total goodwill	147.3	7.6	139.7

Operating segment	Group 2016 Cost of goodwill £m	Group 2016 Accumulated impairment £m	Group 2016 Carrying value £m
Mortgages and Savings	2.9	0.1	2.8
Estate Agency	134.8	2.2	132.6
Investment Portfolio	8.8	5.3	3.5
Total goodwill	146.5	7.6	138.9

Based upon the Directors' assessment of recoverable amounts, the Directors have concluded that no impairment is required to be recognised in respect of goodwill in 2017 (2016: £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.

20. Intangible assets *(continued)*

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% (2016: 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 financial advice 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 client losses 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 2017 %	Group 2016 %
Mortgages and Savings	11	13
Estate Agency	11	11
Investment Portfolio	11	11

Other intangible assets	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Cost				
At 1 January	86.9	68.2	17.9	14.5
Acquisition of subsidiary undertakings	0.5	3.5	-	-
Acquisition of other business assets	0.8	4.6	-	-
Additions	6.0	5.7	1.0	1.6
Transfer of intangible assets on integration of subsidiary undertaking into the Society	-	-	-	1.8
Foreign exchange movements on translation	(1.4)	5.2	-	-
Disposals	(0.2)	(0.3)	-	-
Disposal of subsidiary undertakings	(6.1)	-	-	-
At 31 December	86.5	86.9	18.9	17.9
Amortisation and impairment				
At 1 January	61.0	48.9	15.3	13.4
Charge for the year	6.7	7.7	1.0	0.5
Transfer of intangible assets on integration of subsidiary undertaking into the Society	-	-	-	1.4
Foreign exchange movements on translation	(1.4)	4.7	-	-
Disposals	(0.1)	(0.3)	-	-
Disposal of subsidiary undertakings	(4.4)	-	-	-
At 31 December	61.8	61.0	16.3	15.3
Net book value at 1 January	25.9	19.3	2.6	1.1
Net book value at 31 December	24.7	25.9	2.6	2.6

The net book value of other intangible assets comprises:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Brands	6.5	6.5	-	-
Customer contracts and relationships	7.6	9.9	-	-
Computer software and databases	10.6	9.5	2.6	2.6
	24.7	25.9	2.6	2.6

21. Other assets

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Trade receivables	30.8	32.8	1.1	1.2
Prepayments	16.9	15.9	10.9	9.7
Accrued income	5.7	8.4	-	-
Undrawn advances to debt factoring clients	39.7	37.8	-	-
Contingent consideration	25.1	9.9	-	-
Other	4.6	2.9	1.1	0.4
	122.8	107.7	13.1	11.3

Undrawn advances to debt factoring clients represent the difference between the total of outstanding debts purchased by the Group under recourse agreements and the amounts already advanced to clients in relation to those debts, net of any charges and adjustments. Once recovered, these amounts are paid over to the clients in question and as a result a corresponding creditor is included within other liabilities (see note 26).

The Group has £1.7m (2016: £1.7m) of trade receivables that are individually impaired and £17.7m (2016: £13.8m) of trade receivables that are past due but not individually impaired. The Society has £0.1m of trade receivables that are individually impaired (2016: £0.1m) and £0.7m of trade receivables that are past due but not individually impaired (2016: £0.4m).

22. Shares

	Group and Society 2017 £m	2016 £m
Held by individuals	14,840.1	13,967.8
Other shares	134.2	125.7
Fair value adjustment for hedged risk	11.5	59.0
	14,985.8	14,152.5

A maturity analysis of shares is included in note 35.

23. Amounts owed to credit institutions

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Amounts owed to subsidiary undertakings	-	-	97.2	131.4
Other	1,483.2	655.3	1,482.9	655.1
	1,483.2	655.3	1,580.1	786.5

A maturity analysis of amounts owed to credit institutions is included in note 35.

At 31 December 2017, £37.2m (2016: £26.7m) of cash collateral has been received by the Group and £40.6m (2016: £34.3m) of cash collateral has been received by the Society against derivative contracts.

24. Amounts owed to other customers

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Amounts owed to subsidiary undertakings	-	-	570.7	794.1
Other	1,805.7	1,493.0	354.0	260.0
Fair value adjustment for hedged risk	(0.6)	0.2	-	-
	1,805.1	1,493.2	924.7	1,054.1

A maturity analysis of amounts owed to other customers is included in note 35.

Amounts owed to subsidiary undertakings include fair value adjustments of £0.6m (2016: £3.6m) which relate to deemed loans from Darrowby No. 3 plc (£1.1m; 2016: £2.7m) and Darrowby No. 4 plc (£(0.5)m; 2016: £0.7m) as a result of applying the fair value option on deemed loans from the Group's special purpose vehicles, in line with the accounting policy outlined in note 1f). The 2016 comparative figure also includes fair value adjustments of £0.2m which related to deemed loans from Darrowby No. 2 plc.

25. Debt securities in issue

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Certificates of deposit	15.7	14.6	15.7	14.6
Senior unsecured debt	348.5	-	348.5	-
Securitisation	306.4	519.6	-	-
Fair value adjustment for hedged risk	(4.2)	-	(4.2)	-
	666.4	534.2	360.0	14.6

A maturity analysis of debt securities in issue is included in note 35.

Group debt securities in issue include £306.4m (2016: £519.6m) of funding secured on certain loans and advances to customers through the Group's securitisation vehicles Darrowby No. 3 plc and Darrowby No. 4 plc. The 2016 figure included £121.9m of funding secured on loans and advances to customers through the Group's securitisation vehicle Darrowby No. 2 plc.

26. Other liabilities

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Trade payables	4.4	5.4	1.5	0.9
Fair value of put option obligation	9.9	11.7	-	-
Fair value of liability of subsidiary management incentive scheme	24.6	21.4	-	-
Debt factoring liabilities	39.7	37.8	-	-
VAT and employment taxes	16.3	15.9	2.1	2.0
Other	15.5	14.0	4.2	2.5
	110.4	106.2	7.8	5.4

The debt factoring liabilities of £39.7m (2016: £37.8m) represent the difference between the total of outstanding debts purchased by the Group under recourse agreements and the amounts already advanced to clients in relation to those debts, net of any charges and adjustments. Once recovered, these amounts are paid over to the clients in question.

Put option obligation

The movement in the fair value of the put option obligation is summarised below:

	Group 2017 £m	Group 2016 £m
At 1 January	11.7	11.9
Unwind of the discount factor	0.3	0.3
Revaluation of market values and changes to future exercise dates	(2.1)	(0.9)
Acquisition of subsidiaries during the year	-	0.4
At 31 December	9.9	11.7

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 2017 year end (2016: four of six), with the maximum option length being seven years from 31 December 2017. 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 2017 £m	Group 2016 £m
At 1 January	21.4	30.4
Exercise of share options during the year	(6.5)	(10.0)
Movement in fair value of the liability recognised in the Income Statement	9.7	1.0
At 31 December	24.6	21.4

27. Provisions for liabilities

The movements in provisions for liabilities during the year were as follows:

Group 2017	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks / rebates £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

27. Provisions for liabilities *(continued)*

Group 2016	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks / rebates £m	Survey and valuation claims £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	4.7	3.6	5.1	10.3	2.2	0.6	26.5
Charge for the year	-	2.1	5.8	0.1	2.9	-	10.9
Acquisition of subsidiary undertakings and business assets	-	-	-	-	-	0.2	0.2
Utilised during the year	(0.4)	(3.4)	(5.5)	(3.7)	(0.9)	(0.4)	(14.3)
At 31 December	4.3	2.3	5.4	6.7	4.2	0.4	23.3

Society 2017	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks / rebates £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

Society 2016	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks / rebates £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	0.5	3.6	-	1.8	0.2	6.1
Charge for the year	0.1	2.1	0.1	2.5	-	4.8
Transfer of provisions for liabilities on integration of subsidiary undertaking	-	-	0.5	-	-	0.5
Utilised during the year	(0.1)	(3.4)	(0.1)	(0.7)	-	(4.3)
At 31 December	0.5	2.3	0.5	3.6	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 £1.2m provision at 31 December 2017 relates to the estimated interest levy for scheme year 2017/2018, due to be invoiced in July 2018. The Society's provision does not include interest levies for any further scheme years nor capital levies which may arise from future claims made under the scheme.

Commission clawbacks / rebates

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 £3.3m (2016: £2.8m). 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 experienced an increase in PPI complaint levels during the year following the introduction of a deadline, by the FCA, for making PPI complaints. Despite uphold rates remaining low, 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 two years.

In addition the customer compensation provision includes £3.8m (2016: £nil) 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% (2016: 25%) for the Society and 17% (2016: 17%) for most other Group companies.

The movement in deferred tax during the year was as follows:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
At 1 January	18.2	10.3	10.7	8.0
Income Statement credit (note 11)	-	1.9	1.8	0.4
Items taken directly to Other Comprehensive Income	5.0	6.7	0.6	2.3
Acquired on acquisition of subsidiaries	(0.2)	(0.7)	-	-
At 31 December	23.0	18.2	13.1	10.7

Deferred tax assets and liabilities are attributable to the following items:

Deferred tax assets	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Fixed asset temporary differences	1.2	0.4	0.3	-
Pension obligations	21.0	23.2	12.8	13.5
Provisions	2.2	1.5	0.8	0.2
Corporation tax losses	0.1	0.2	-	-
Other	5.9	5.1	-	-
	30.4	30.4	13.9	13.7

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28. Deferred tax *(continued)*

Deferred tax liabilities	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Fixed asset temporary differences	1.5	1.2	-	0.8
Derivatives and loans	0.3	2.6	-	2.2
Available-for-sale financial assets	0.8	5.7	0.8	-
Contingent consideration	3.6	1.0	-	-
Other	1.2	1.7	-	-
	7.4	12.2	0.8	3.0
Net deferred tax asset	23.0	18.2	13.1	10.7

The deferred tax credit in the Income Statement comprises the following:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Fixed asset temporary differences	(0.7)	(1.0)	(0.3)	(0.5)
Provisions	(0.7)	0.6	(0.6)	0.4
Contingent consideration	2.6	1.0	-	-
Other	(1.2)	(2.5)	(0.9)	(0.3)
	-	(1.9)	(1.8)	(0.4)

Unrecognised deferred tax relating to trading losses carried forward at 31 December 2017 amounts to £4.7m (2016: £5.0m) for the Group and £nil for the Society (2016: £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 £8.3m for the Group (2016: £7.9m) and £5.0m for the Society (2016: £4.3m).

Defined benefit schemes

The Group sponsors two funded defined benefit arrangements:

- The Skipton (2015) Group Pension Scheme (the 'Skipton (2015) Scheme'). This scheme was established on 31 January 2016 by the merger of two existing schemes:
  - The Skipton Building Society Pension & Life Assurance Scheme (the 'Old Skipton Scheme'); and
  - The Scarborough Building Society Group Pension and Death Benefits Scheme (the 'Scarborough Scheme').
- The Connells (2014) Group Pension Scheme (the 'Connells (2014) 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 – 791 members
- Connells (2014) Scheme – 1,046 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 both 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.
- 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.

The schemes are all now 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 and the Old Skipton Scheme on 31 December 2009. The Skipton (2015) Scheme was open to accrual for one day, on 31 January 2016. 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	31 March 2014	11.2	7 years	0.6
Scarborough	31 December 2013	8.1	7 years	0.8
Connells (2014)	30 April 2014	25.7	7 years	2.7

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. The current best estimate of contributions to be paid by the Group to the schemes for the year commencing 1 January 2018 is £3.3m. A full actuarial valuation was carried out on the Skipton and Connells schemes at 31 December 2016 and 30 April 2017 respectively; these valuations will be finalised by 31 March 2018 and 31 July 2018 respectively and may increase the contributions paid by the Group to the schemes in 2018.

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 2017. The actuarial valuation deficits shown in the table above will always be different to the IAS 19 accounting deficit of £100.2m (2016: £110.9m) 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.

29. Pensions *(continued)*

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 two schemes are recognised in accordance with IAS 19. Whilst the Society is the principal employer for the Skipton (2015) Scheme, current and former employees of other Group companies are also members of this scheme and the Society makes recharges to these subsidiaries in relation to deficit contributions under an internal agreement based on the proportion of active members who were employees at the time of closure to future accrual. These companies were previously participating employers in the Old Skipton Scheme and account for the pension scheme on the basis of the deficit contributions paid by that company.

The Society accounts for the difference between the aggregate IAS 19 costs of the scheme and the aggregate contributions paid by the other entities.

The main financial assumptions used in the actuarial valuation are as follows:

	Group and Society	
	2017	2016
	%	%
Retail price inflation (RPI)	**3.25**	3.35
Consumer price inflation (CPI)	**2.25**	2.35
Discount rate	**2.55**	2.65
Increases to pension payment:		
in line with RPI, subject to a max of 5% pa	**3.17**	3.26
in line with RPI, subject to a min of 3% and max of 5% pa	**3.63**	3.67
in line with RPI, subject to a max of 2.5% pa	**2.23**	2.26
in line with CPI, subject to a max of 5% pa	**2.27**	2.36
in line with CPI, subject to a min of 3% and max of 5% pa	**3.26**	3.29
in line with CPI, subject to a max of 2.5% pa	**1.83**	1.88
Rate of increase for deferred pensions (in line with CPI, subject to a max of 5% pa)	**2.25**	2.35
Allowance for commutation of pension for cash at retirement	**100% 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 2017, 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 2016 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)	
	2017	2016
Male retiring in the current year	**23.0**	23.1
Female retiring in the current year	**24.0**	24.2
Male retiring in 15 years' time	**23.8**	24.0
Female retiring in 15 years' time	**24.9**	25.3

The table below shows the net pension liability recognised within the Statement of Financial Position:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Fair value of plan assets	**165.3**	168.9	**91.0**	94.0
Present value of defined benefit obligations	**(265.5)**	(279.8)	**(142.7)**	(147.8)
Net pension liability	**(100.2)**	(110.9)	**(51.7)**	(53.8)

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.

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. None of the schemes are in surplus as at 31 December 2017.

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 2017. As the schemes remain 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 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
At 1 January	**279.8**	228.4	**147.8**	117.8
Current service cost	**-**	-	**-**	-
Past service cost	**-**	-	**-**	-
Interest expense	**7.2**	8.6	**3.8**	4.4
Contributions by employees	**-**	-	**-**	-
Remeasurement (gains) / losses arising from changes in:				
Scheme experience	**(4.8)**	-	**(0.1)**	-
Demographic assumptions	**(3.1)**	-	**(1.7)**	-
Financial assumptions	**2.7**	54.5	**1.7**	29.3
Actual benefit payments	**(16.3)**	(8.3)	**(8.8)**	(3.1)
Liabilities extinguished on settlements	**-**	(3.4)	**-**	(0.6)
At 31 December	**265.5**	279.8	**142.7**	147.8

There have been no settlements, plan amendments or curtailments in the year.

The table below sets out the reconciliation of the fair value of scheme assets for the year:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
At 1 January	**168.9**	163.2	**94.0**	87.8
Interest income	**4.4**	6.2	**2.4**	3.4
Return on plan assets (excluding amounts included in interest income)	**5.0**	4.5	**2.8**	2.6
Contributions by employer	**3.3**	6.6	**0.6**	3.9
Contributions by employees	**-**	-	**-**	-
Benefits paid	**(16.3)**	(8.3)	**(8.8)**	(3.1)
Expenses paid by the schemes	**-**	-	**-**	-
Assets distributed on settlements	**-**	(3.3)	**-**	(0.6)
At 31 December	**165.3**	168.9	**91.0**	94.0

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29. Pensions *(continued)*

The actual return on the scheme assets, including interest income on plan assets, over the year ended 31 December 2017 was as follows:

- Group £9.4m (2016: £10.7m)
- Society £5.2m (2016: £6.0m)

The table below sets out the fair value of the scheme assets by each major category:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
UK equities	-	-	-	-
Diversified growth fund [1]	139.3	145.6	76.8	81.7
Property	-	-	-	-
Corporate bonds	-	-	-	-
Fixed interest bonds	-	-	-	-
Index linked bonds	-	-	-	-
Liability driven instruments [2]	25.3	22.9	13.9	12.3
Cash	0.7	0.4	0.3	-
	165.3	168.9	91.0	94.0

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 in an active market 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.

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, settlements for the year and administrative expenses are recognised in 'Administrative expenses', whilst the net interest expense is recognised in 'Other income'.

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Service cost:				
Current service cost	-	-	-	-
Past service cost	-	-	-	-
Gains on settlements	-	(0.1)	-	-
Administrative expenses	-	-	-	-
Net interest expense	2.8	2.4	1.4	1.0
Total recognised in Income Statement	2.8	2.3	1.4	1.0

29. Pensions *(continued)*

The table below sets out the remeasurements of retirement benefit obligations which have been recognised within the Statement of Comprehensive Income:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Remeasurements of retirement benefit obligations:				
Actuarial gains / (losses) arising from:				
Experience adjustments	4.8	-	0.1	-
Demographic assumptions	3.1	-	1.7	-
Financial assumptions	(2.7)	(54.5)	(1.7)	(29.3)
Return on plan assets (excluding amounts included in net interest cost)	5.0	4.5	2.8	2.6
Total amount recognised in other comprehensive income	10.2	(50.0)	2.9	(26.7)

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 2018, based on the most recent actuarial valuations. As outlined on page 145 the valuations will be updated in 2018 and this may cause the contributions to increase.

	Group 2018 £m	Society 2018 £m
Estimated employer contributions	3.3	0.6
Estimated employee contributions	-	-
Estimated total contributions	3.3	0.6

30. Subscribed capital

	Group and Society 2017 £m	2016 £m
6.875% Sterling Permanent Interest Bearing Shares	-	50.3
8.500% Sterling Permanent Interest Bearing Shares	15.3	15.3
12.875% Sterling Permanent Interest Bearing Shares	26.3	26.3
	41.6	91.9
Fair value adjustment for hedged risk	-	0.7
	41.6	92.6

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.

31. Financing activity

The table below shows the movement during the year of the Group and Society's financing activity liabilities, namely subordinated debt and subscribed capital.

	Group and Society 2017		
	Subordinated debt	Subscribed capital	Total
Balance at 1 January 2017	77.2	92.6	169.8
Changes from financing cash flow:			
Repayment	(75.4)	(50.0)	(125.4)
Interest paid	(2.6)	(6.3)	(8.9)
Total changes from financing cash flow	(78.0)	(56.3)	(134.3)
Changes in fair value	(0.6)	(0.7)	(1.3)
Liability-related changes:			
Interest expense	1.2	5.6	6.8
Total liability-related changes	1.2	5.6	6.8
Other changes:			
Reversal of unamortised discount on issue on repayment	0.2	-	0.2
Unwind of merger fair value adjustments	-	0.4	0.4
Total other changes	0.2	0.4	0.6
Balance at 31 December 2017	-	41.6	41.6

During the year the Society repaid and cancelled £50.0m of its Permanent Interest Bearing Shares (PIBS) on their call dates. The remaining PIBS are undated and as such cannot be repaid by the Society.

The Society also repaid and cancelled £10.0m of its subordinated notes on maturity. In addition, the Society repaid and cancelled the remaining £65.4m of its subordinated notes on their call dates. The notes were repaid at their nominal value plus accrued interest.

In the case of the notes that were repaid prior to maturity, the option for early repayment was exercised with the prior consent of the PRA.

32. Tax effects relating to each component of other comprehensive income

	Group					
	2017			2016		
	Before-tax amount £m	Tax benefit / (expense) £m	Net-of-tax amount £m	Before-tax amount £m	Tax (expense) / benefit £m	Net-of-tax amount £m
Available-for-sale financial assets	(34.9)	6.0	(28.9)	0.3	-	0.3
Cash flow hedges	(4.3)	1.1	(3.2)	8.7	(2.2)	6.5
Remeasurements of defined benefit obligations	10.2	(1.9)	8.3	(50.0)	10.2	(39.8)
Translation of foreign operations	(0.4)	-	(0.4)	2.2	-	2.2
Movement in reserves attributable to non-controlling interests	-	-	-	0.9	-	0.9
Other comprehensive income	(29.4)	5.2	(24.2)	(37.9)	8.0	(29.9)

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32. Tax effects relating to each component of other comprehensive income *(continued)*

	Society					
	2017			2016		
	Before-tax amount £m	Tax benefit / (expense) £m	Net-of-tax amount £m	Before-tax amount £m	Tax (expense) / benefit £m	Net-of-tax amount £m
Available-for-sale financial assets	(1.2)	0.3	(0.9)	3.4	(0.9)	2.5
Cash flow hedges	(4.3)	1.1	(3.2)	8.7	(2.2)	6.5
Remeasurements of defined benefit obligations	2.9	(0.7)	2.2	(26.7)	6.6	(20.1)
Other comprehensive income	(2.6)	0.7	(1.9)	(14.6)	3.5	(11.1)

33. 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	2017		2016	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Amounts falling due:				
Within one year	13.1	2.3	13.7	5.1
Within two to five years inclusive	33.5	0.5	34.3	2.2
Over five years	21.6	-	21.4	-
	68.2	2.8	69.4	7.3

Society	2017		2016	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Amounts falling due:				
Within one year	3.6	0.3	3.5	0.9
Within two to five years inclusive	8.4	0.1	8.7	0.3
Over five years	4.4	-	4.2	-
	16.4	0.4	16.4	1.2

£65.6m of the commitments at 31 December 2017 under non-cancellable operating leases for land and buildings for the Group relates to properties occupied by the Group used in the ordinary course of business. £1.7m relates to properties occupied by sub-tenants and £0.9m relates to buildings that were unoccupied.

The total commitments for the Society relates to branches used in the ordinary course of business, or former branches, £0.8m of which relates to former branches that were unoccupied at 31 December 2017.

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.

34. Financial instruments

The Group uses financial instruments to invest liquid asset balances and raise wholesale funding. The Group also 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.

Types of derivatives

The principal derivatives used by the Group are interest rate swaps and index swaps that are used to hedge Group Statement of Financial Position exposures.

The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the type of derivatives typically used in managing such risks. These risks may also be managed using Statement of Financial Position instruments as part of an integrated approach to risk management.

Activity	Risk	Type of hedge
Fixed rate savings products, funding activities, fixed rate mortgage lending and asset investment	Sensitivity to changes in interest rates	Interest rate swaps
Equity-linked investment products	Sensitivity to changes in equity indices	Equity-linked interest rate swaps
Equity release mortgages	Sensitivity to changes in interest rates, retail price inflation, house price inflation and longevity risk	Bespoke interest rate and inflation linked swaps

Controls over financial instruments

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).

The accounting policies for derivatives are described in note 1e) to the Accounts.

Hedge accounting

A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. For each main class of fair value, hedge documentation is produced in accordance with the requirements of IAS 39.

A cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. Cash flow hedge accounting is used primarily for interest rate swaps taken out to pre-hedge fixed mortgage completions and fixed savings products prior to advancement or receipt of funds. The weighted average maturity of interest rate swaps being cash flow hedged at 31 December 2017 is approximately 3.2 years (2016: 2.6 years).

Some ineffectiveness has occurred on those fair value and cash flow hedges for which hedge accounting has been achieved, resulting in a credit to the Income Statement of £5.1m (2016: £5.2m charge). As outlined in note 38b), these figures include ineffectiveness arising from swaps that are used to hedge our equity release mortgage book, and such ineffectiveness resulted in a £1.7m credit for the year (2016: £7.8m charge).

35. 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 short term retail customer balances. Mortgages typically have a contractual maturity date of around 25 years but in practice are frequently repaid early; conversely retail deposits, nominally repayable on demand or with short notice periods, actually 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 prudent 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

35. Liquidity risk *(continued)*

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 management of the Group's liquidity is 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 – where, as noted above, the Group models how far its liquid asset holdings would fall under a number of different stress scenarios.

The table below analyses 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	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	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**

Group	2016					
	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	1,212.7	-	-	-	-	1,212.7
Loans and advances to credit institutions	400.2	6.3	0.1	3.0	-	409.6
Debt securities	-	233.0	130.7	464.5	226.9	1,055.1
Derivative financial instruments	-	2.3	15.5	91.5	6.8	116.1
Loans and advances to customers	77.3	38.0	89.9	513.3	15,063.1	15,781.6
Equity share investments	-	-	-	-	36.4	36.4
Trade receivables	13.8	19.0	-	-	-	32.8
Contingent consideration	-	-	-	8.2	1.7	9.9
Total financial assets	1,704.0	298.6	236.2	1,080.5	15,334.9	18,654.2
Liabilities						
Shares	4,041.1	7,412.4	1,297.6	1,400.3	1.1	14,152.5
Amounts owed to credit institutions	36.6	274.1	21.5	323.1	-	655.3
Amounts owed to other customers	247.2	317.6	757.8	169.3	1.3	1,493.2
Debt securities in issue	-	123.3	13.5	397.4	-	534.2
Derivative financial instruments	-	3.7	24.5	119.3	264.8	412.3
Trade payables	-	5.4	-	-	-	5.4
Fair value of put option obligation	-	0.6	5.0	6.1	-	11.7
Subordinated liabilities	-	10.1	-	35.4	31.7	77.2
Subscribed capital	-	-	-	-	92.6	92.6
Total financial liabilities	4,324.9	8,147.2	2,119.9	2,450.9	391.5	17,434.4
Net liquidity gap	(2,620.9)	(7,848.6)	(1,883.7)	(1,370.4)	14,943.4	1,219.8

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 £306.4m (2016: £519.6m) of funding obtained through the Group's securitisation programme carried out through Darrowby No. 2 plc, Darrowby No. 3 plc and Darrowby No. 4 plc. The final maturity dates of these 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	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**

35. Liquidity risk *(continued)*

Group			2016		
	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities	£m	£m	£m	£m	£m
Shares	11,454.4	1,308.0	1,471.8	1.1	14,235.3
Amounts owed to credit institutions, other customers and debt securities in issue	999.5	802.3	913.8	1.3	2,716.9
Derivative financial instruments	20.4	61.4	147.2	235.5	464.5
Trade payables	5.4	-	-	-	5.4
Fair value of put option obligation	0.6	5.0	6.7	-	12.3
Subordinated liabilities	10.3	2.4	43.6	32.0	88.3
Subscribed capital	1.6	6.3	31.7	79.3	118.9
	12,492.2	2,185.4	2,614.8	349.2	17,641.6

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 under the tables on page 155 are exercised.

Society			**2017**		
	Up to 3 months	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Liabilities	**£m**	**£m**	**£m**	**£m**	**£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**

Society			2016		
	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities	£m	£m	£m	£m	£m
Shares	11,454.4	1,308.0	1,471.8	1.1	14,235.3
Amounts owed to credit institutions, other customers and debt securities in issue	823.9	180.9	880.2	-	1,885.0
Derivative financial instruments	20.8	63.3	152.1	235.6	471.8
Trade payables	0.9	-	-	-	0.9
Subordinated liabilities	10.3	2.4	43.6	32.0	88.3
Subscribed capital	1.6	6.3	31.7	79.3	118.9
	12,311.9	1,560.9	2,579.4	348.0	16,800.2

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 under the tables on page 155 are exercised. The 2016 comparatives also included deemed loans from the Group's securitisation vehicle Darrowby No. 2 plc.

36. 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.

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 2017	**Average 2017**	**High 2017**	**Low 2017**	As at 31 December 2016
	£m	**£m**	**£m**	**£m**	£m
Static earnings-at-risk	5.2	4.3	5.6	2.5	3.2
Historical value-at-risk	2.2	2.2	2.8	0.6	1.5
2% parallel interest rate shift	13.2	11.3	15.5	4.1	9.5

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

Both at 31 December 2017 and during the year, the Society and its subsidiaries had no material direct exposure to foreign currency exchange fluctuations. The currency risk appetite of the Group is low and any funding issues denominated in foreign currency are immediately swapped into Sterling.

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.

36. Market risk *(continued)*

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 2017 are not material.

c) Other price risk

The Group has a small number of savings products outstanding where the return is dependent on the performance of certain equity markets. Derivative contracts to eliminate this exposure are taken out by the Group that exactly match the terms of the savings products and the market risk on such contracts is therefore fully hedged.

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 no negative equity guarantee provided to customers of the equity release mortgage portfolio, as outlined further on page 175.

37. 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.

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 £227.3m (2016: £340.8m) is included within loans and advances to customers.
- 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. The total amount of such loans at 31 December 2017 is £828.8m (2016: £1,104.0m).
- At the end of 2016 the Group held £980.0m of liquidity representing short dated UK Treasury bills held as a result of FLS drawings. These Treasury bills become an on-balance sheet financial asset once converted into cash, and £793.1m of these Treasury bills were held off-balance sheet at the end of 2016. The Group holds no such Treasury bills at the end of 2017.

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. The performance of these portfolios has continued to improve over the reporting period assisted by the sale of a mortgage portfolio of non-performing and recently non-performing loans; for further details see page 118. The retail lending to customers in the Society includes the equity release mortgage portfolio. The risks relating to the specific nature of this portfolio are discussed in note 38.

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. 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 available-for-sale 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

The table below shows the mix of the Group and Society's loans and advances to customers at the reporting date:

	Group				Society			
	2017		2016		2017		2016	
	£m	%	£m	%	£m	%	£m	%
Total residential mortgages	16,351.6	97.3	15,046.5	97.1	14,406.1	98.0	12,906.0	97.5
Commercial mortgages*	293.8	1.8	326.7	2.1	293.8	2.0	326.7	2.5
Other lending:								
Debt factoring loans	79.9	0.5	75.4	0.5	-	-	-	-
Other loans and advances	61.9	0.4	49.0	0.3	0.1	-	0.1	-
Gross balances	16,787.2	100.0	15,497.6	100.0	14,700.0	100.0	13,232.8	100.0
Impairment provisions	(41.8)		(56.8)		(38.2)		(42.0)	
Fair value adjustment for hedged risk	227.3		340.8		224.8		332.6	
	16,972.7		15,781.6		14,886.6		13,523.4	

* Also known as loans fully secured on land.

i) Residential mortgages

The majority of loans and advances to customers are secured on UK residential properties and are geographically diverse.

The Group's portfolio of loans fully secured on residential property comprises lending by the Society, by SIL (which lends in the Channel Islands and in the UK) and the specialist mortgage books of Amber and NYM (closed to new lending since 2008). It also includes the equity release mortgage portfolio. The credit risk appetite explicitly considers geographic regions to manage concentration risk.

37. Credit risk *(continued)*

The tables below provide further information on the types of lending and geographical split.

Lending analysis	Group				Society			
	2017		2016		2017		2016	
	£m	%	£m	%	£m	%	£m	%
Prime:								
Residential	12,431.1	75.9	11,299.4	75.2	11,475.1	79.7	10,332.9	80.1
Buy-to-let	3,034.4	18.6	2,617.8	17.4	2,592.8	18.0	2,226.3	17.3
Self build	46.8	0.3	52.4	0.3	13.3	0.1	15.7	0.1
Fast track	45.9	0.3	56.8	0.4	45.9	0.3	56.8	0.4
Self certified	371.1	2.3	500.4	3.3	-	-	-	-
Sub-prime:								
Residential	28.0	0.2	49.4	0.3	-	-	-	-
Buy-to-let	30.1	0.2	40.6	0.3	-	-	-	-
Self build	0.5	-	0.5	-	-	-	-	-
Self certified	84.7	0.5	154.9	1.0	-	-	-	-
Equity release	279.0	1.7	274.3	1.8	279.0	1.9	274.3	2.1
	16,351.6	100.0	15,046.5	100.0	14,406.1	100.0	12,906.0	100.0

Sub-prime mortgages in the table above are defined as loans to borrowers that typically had weakened credit histories at the time the loan was advanced.

Geographical analysis	Group				Society			
	2017		2016		2017		2016	
	£m	%	£m	%	£m	%	£m	%
North	650.1	4.0	585.8	3.9	621.9	4.3	546.5	4.2
Yorkshire	1,581.8	9.7	1,528.1	10.2	1,510.5	10.5	1,439.8	11.2
East Midlands	1,166.7	7.1	1,084.0	7.2	1,103.7	7.7	1,002.1	7.8
East Anglia	520.8	3.2	548.7	3.6	485.5	3.4	469.3	3.6
London	2,253.7	13.8	1,884.5	12.5	1,949.1	13.5	1,625.3	12.6
South East	3,078.7	18.8	2,902.0	19.3	2,873.1	20.0	2,625.2	20.3
South West	1,626.6	9.9	1,434.6	9.5	1,547.1	10.7	1,335.2	10.3
West Midlands	1,183.9	7.2	1,037.8	6.9	1,120.9	7.8	952.5	7.4
North West	1,528.6	9.3	1,427.6	9.5	1,424.0	9.9	1,279.5	9.9
Wales	582.7	3.6	499.5	3.3	532.8	3.7	447.6	3.5
Scotland	1,253.5	7.7	1,212.8	8.1	1,216.5	8.4	1,159.1	9.0
Northern Ireland	32.8	0.2	42.2	0.3	21.0	0.1	23.9	0.2
Channel Islands	891.7	5.5	858.9	5.7	-	-	-	-
	16,351.6	100.0	15,046.5	100.0	14,406.1	100.0	12,906.0	100.0

Average indexed loan-to-value information on the Group's residential loan portfolio, together with further information on residential loans by payment due status, is set out as follows:

Loan-to-value	Neither past due nor individually impaired	Past due but not individually impaired (up to 3 months)	Individually impaired			
			Low risk	High risk	Possessions	Total
	£m	£m	£m	£m	£m	£m
Group 2017						
<40%	2,520.5	8.4	7.2	-	0.1	2,536.2
40% - 50%	2,109.7	7.9	8.9	-	-	2,126.5
50% - 60%	3,098.7	13.2	9.3	-	0.1	3,121.3
60% - 70%	3,356.2	13.9	12.5	-	0.2	3,382.8
70% - 80%	2,823.8	10.9	-	8.1	0.2	2,843.0
80% - 90%	2,050.7	5.7	-	6.6	0.3	2,063.3
90% - 100%	230.6	2.0	-	2.1	0.6	235.3
>100%	38.8	1.2	-	1.7	1.5	43.2
	16,229.0	63.2	37.9	18.5	3.0	16,351.6
Group 2016						
<40%	2,250.2	11.1	8.5	-	0.1	2,269.9
40% - 50%	1,742.5	9.6	10.4	-	-	1,762.5
50% - 60%	2,489.0	17.7	14.1	-	0.2	2,521.0
60% - 70%	3,211.1	25.5	27.8	-	-	3,264.4
70% - 80%	2,824.4	20.1	-	23.8	0.3	2,868.6
80% - 90%	1,799.0	15.0	-	16.8	1.6	1,832.4
90% - 100%	433.5	8.6	-	10.1	0.5	452.7
>100%	60.7	4.6	-	7.5	2.2	75.0
	14,810.4	112.2	60.8	58.2	4.9	15,046.5
Society 2017						
<40%	2,351.6	7.1	6.1	-	0.1	2,364.9
40% - 50%	1,929.2	5.7	5.5	-	-	1,940.4
50% - 60%	2,749.6	7.6	6.0	-	0.1	2,763.3
60% - 70%	2,901.9	7.3	8.7	-	0.1	2,918.0
70% - 80%	2,430.1	5.1	-	5.6	0.2	2,441.0
80% - 90%	1,781.4	1.6	-	3.2	0.1	1,786.3
90% - 100%	171.0	0.1	-	1.2	0.4	172.7
>100%	16.5	1.0	-	0.5	1.5	19.5
	14,331.3	35.5	26.3	10.5	2.5	14,406.1
Society 2016						
<40%	2,100.5	7.5	6.5	-	0.1	2,114.6
40% - 50%	1,586.8	5.7	5.7	-	-	1,598.2
50% - 60%	2,170.9	6.6	6.7	-	-	2,184.2
60% - 70%	2,754.2	7.2	10.2	-	-	2,771.6
70% - 80%	2,409.9	5.4	-	8.3	0.3	2,423.9
80% - 90%	1,472.3	2.1	-	4.1	-	1,478.5
90% - 100%	309.9	0.9	-	2.0	0.1	312.9
>100%	18.7	1.1	-	1.0	1.3	22.1
	12,823.2	36.5	29.1	15.4	1.8	12,906.0

37. Credit risk *(continued)*

The indexed loan-to-value is updated on a quarterly basis to reflect changes in the house price index which is applied to the portfolio on a regional basis. The new lending policy is currently a maximum loan-to-value ratio of 90% 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 2017, the average indexed loan-to-value of Group residential mortgages was 47.2% (2016: 47.9%) and for Society residential mortgages was 46.4% (2016: 46.5%).

Individually impaired accounts in the tables above relate only to accounts in arrears by three months or more. Low risk accounts in the tables above relate to loans with an indexed loan-to-value of less than or equal to 70%. High risk accounts relate to loans with an indexed loan-to-value of more than 70%.

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. Accounts that have had forbearance strategies applied do not necessarily require an impairment provision, for example where there is a low LTV or where there is a low risk of loss to the Group from the account in question.

Possession balances represent loans against which the Group has taken ownership of properties pending their sale. Possession is generally considered only as a last resort, once all other options for the customer have been exhausted. At 31 December 2017 the balance of residential loans where the property in question has been taken into possession represents less than 0.1% of total outstanding loans for the Group (2016: less than 0.1%) and less than 0.1% of total outstanding loans for the Society (2016: less than 0.1%). 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.

The following tables provide further information on residential mortgages by the type of account renegotiations applied to customers regarded as being in forbearance as at 31 December 2017. During the year the Group has updated its forbearance disclosures to align with the European Banking Authority's (EBA's) financial reporting definitions of forbearance. For the purposes of these disclosures, loans exit forbearance if they meet certain payment and arrears criteria including a two year probation period following the forbearance event. Previously the Group's disclosures comprised all outstanding residential mortgages that had been renegotiated in the two years prior to the reporting date where the customer had encountered payment difficulties, but did not include loans that were still on renegotiated terms where they were renegotiated prior to this two year period. The 2016 comparatives have been restated on a consistent basis. There has been no change to how customers in financial difficulty are treated.

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**

Group 2016 *Restated	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	14,810.4	3.3	52.3	34.6	9.0	99.2	0.7
Past due but not individually impaired:							
Up to 3 months	112.2	0.2	16.1	1.2	0.2	17.7	15.8
	14,922.6	3.5	68.4	35.8	9.2	116.9	0.8
Individually impaired:							
Low risk	60.8	0.6	16.3	4.2	0.7	21.8	35.9
High risk	58.2	0.3	12.3	1.5	0.3	14.4	24.7
Possessions	4.9	-	0.6	0.2	-	0.8	16.3
	15,046.5	4.4	97.6	41.7	10.2	153.9	1.0
Collective impairment	(35.0)	-	(0.3)	-	-	(0.3)	0.9
Individual impairment	(11.9)	-	(2.4)	(0.1)	(0.1)	(2.6)	21.8
	14,999.6	4.4	94.9	41.6	10.1	151.0	1.0

* The 2016 comparative figures have been restated as outlined on page 162, resulting in a £16.6m increase to reported total renegotiations and a 0.1% increase to the reported percentage of accounts subject to renegotiations, from 0.9% to 1.0%.

37. 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

Society 2016 *Restated	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	12,823.2	2.0	39.7	14.6	2.9	59.2	0.5
Past due but not individually impaired:							
Up to 3 months	36.5	0.2	10.2	0.5	0.1	11.0	30.1
	12,859.7	2.2	49.9	15.1	3.0	70.2	0.5
Individually impaired:							
Low risk	29.1	0.6	10.2	3.2	0.7	14.7	50.5
High risk	15.4	0.3	5.6	0.9	0.3	7.1	46.1
Possessions	1.8	-	0.4	0.2	-	0.6	33.3
	12,906.0	3.1	66.1	19.4	4.0	92.6	0.7
Collective impairment	(29.8)	-	-	-	-	-	-
Individual impairment	(2.9)	-	(0.5)	(0.1)	-	(0.6)	20.7
	12,873.3	3.1	65.6	19.3	4.0	92.0	0.7

* The 2016 comparative figures have been restated as outlined on page 162, resulting in an £8.6m increase to reported total renegotiations and no change to the reported percentage of accounts subject to renegotiations.

The factors considered by the Group in determining the level of individual impairment to be provided are outlined in note 1g) to the Accounts. A collective impairment allowance is made against performing loans where objective evidence indicates it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is calculated by applying various factors to our mortgage portfolio exposures and incorporates the relative credit risk assessment of the account renegotiation categories shown above.

Individual assessments are made of all mortgage loans where objective evidence indicates that losses are likely or the property is in possession or where fraud or negligence has been identified.

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 2017 £m	Group 2016 Restated* £m	Society 2017 £m	Society 2016 Restated* £m
Not individually impaired	16,286.7	14,914.5	14,363.6	12,856.6
Impaired	56.1	118.0	36.8	44.4
Possessions	2.8	4.5	2.3	1.5
	16,345.6	15,037.0	14,402.7	12,902.5
Gross loan balances	16,351.6	15,046.5	14,406.1	12,906.0
Negative equity	6.0	9.5	3.4	3.5

* The 2016 comparative figures previously excluded accounting adjustments which are included in the gross loan balances in the tables above and so have been restated to include these adjustments for consistency of reporting, resulting in a reduction of £75.8m in reported negative equity for the Group and Society.

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.

ii) Commercial mortgages

The commercial mortgage portfolio (also known as loans fully secured on land) is currently closed to new business. An analysis of loans secured on commercial property by industry type and geography is provided below:

Industry analysis	Group and Society 2017 £m	%	2016 £m	%
Leisure and hotels	30.1	10.2	34.1	10.4
Retail	9.6	3.3	11.4	3.5
Nursing / residential homes	13.8	4.7	15.0	4.6
Offices	3.7	1.3	5.6	1.7
Commercial investment and industrial units	230.2	78.3	251.1	76.9
Miscellaneous	6.4	2.2	9.5	2.9
	293.8	100.0	326.7	100.0

37. Credit risk *(continued)*

Geographical analysis	Group and Society			
	2017		2016	
	£m	%	£m	%
North	14.8	5.0	16.3	5.0
Yorkshire	25.1	8.5	27.6	8.4
East Midlands	22.1	7.5	23.7	7.3
East Anglia	6.6	2.2	7.2	2.2
London	67.4	23.0	79.5	24.3
South East	56.1	19.2	62.3	19.1
South West	36.6	12.5	40.2	12.3
West Midlands	21.2	7.2	23.5	7.2
North West	30.7	10.4	32.0	9.8
Wales	8.4	2.9	9.2	2.8
Scotland	4.8	1.6	5.2	1.6
	293.8	100.0	326.7	100.0

Loan-to-value information on the Group's commercial loan portfolio, together with further information on commercial mortgages and advances by payment due status, is set out below:

Loan-to-value	Group and Society 2017					
	Neither past due nor individually impaired	Past due but not individually impaired (up to 3 months)	Individually impaired			
			Low risk	High risk	Possessions	Total
	£m	£m	£m	£m	£m	£m
<40%	46.2	0.2	0.1	-	-	46.5
40% - 50%	41.4	0.1	-	-	-	41.5
50% - 60%	47.0	0.1	0.1	-	-	47.2
60% - 70%	58.6	0.4	-	-	-	59.0
70% - 80%	28.8	0.3	-	0.6	-	29.7
80% - 90%	19.9	-	-	0.3	-	20.2
90% - 100%	18.1	-	-	0.3	-	18.4
>100%	28.1	1.7	-	0.9	0.6	31.3
	288.1	2.8	0.2	2.1	0.6	293.8

Loan-to-value	Group and Society 2016				
	Neither past due nor individually impaired	Past due but not individually impaired (up to 3 months)	Individually impaired		
			Low risk	High risk	Total
	£m	£m	£m	£m	£m
<40%	46.6	-	-	-	46.6
40% - 50%	44.1	0.1	0.2	-	44.4
50% - 60%	52.4	-	-	-	52.4
60% - 70%	64.4	1.5	0.3	-	66.2
70% - 80%	33.7	0.9	-	-	34.6
80% - 90%	25.0	0.4	-	-	25.4
90% - 100%	15.0	0.3	-	-	15.3
>100%	36.1	2.4	-	3.3	41.8
	317.3	5.6	0.5	3.3	326.7

At 31 December 2017 the average loan-to-value of commercial mortgages was 52.5% (2016: 54.1%). The average loan-to-value is based on the latest external valuation of the properties within the portfolio.

Individually impaired accounts in the tables above relate only to accounts in arrears by three months or more. The non-standard nature of the properties within the commercial mortgage portfolio means that there are also a number of loans that are not past due or are past due by less than three months at the reporting date, but where objective evidence indicates that losses are likely (for example, due to significant financial difficulty of the borrower), as described in the Group's accounting policy in note 1g). A total individual impairment provision of £7.7m (2016: £8.4m), as shown in note 16 to the Accounts, is held against these accounts and the individually impaired loans in the above tables. The total gross balances against which this individual impairment provision has been made are £29.5m (2016: £33.2m).

Low risk accounts in the tables above relate to loans with a loan-to-value of less than or equal to 70%. High risk accounts relate to loans with a loan-to-value of more than 70%.

The Group's policy on forbearance for commercial mortgages is the same as the policy for residential mortgages, which is found on page 162.

The tables below provide further information on commercial mortgages by the type of account renegotiations applied to customers regarded as being in forbearance as at 31 December 2017. As described on page 162, during the year the Group has updated its forbearance disclosures to align with the EBA's financial reporting definitions of forbearance. Previously these disclosures comprised all outstanding commercial mortgages that had been subject to forbearance at any stage prior to the reporting date, including those that were no longer in forbearance. The 2016 comparatives have been restated on a consistent basis. There has been no change to how customers in financial difficulty are treated.

Group and Society 2017	Total	Capitalisation	Reduced payment	Transfer to interest only	Total renegotiations	
	£m	£m	£m	£m	£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

37. Credit risk *(continued)*

Group and Society 2016 *Restated	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	317.3	-	0.4	6.4	0.2	7.0	2.2
Past due but not individually impaired:							
Up to 3 months	5.6	-	2.6	0.2	-	2.8	50.0
	322.9	-	3.0	6.6	0.2	9.8	3.0
Individually impaired:							
Low risk	0.5	-	-	0.3	-	0.3	60.0
High risk	3.3	0.3	0.9	1.8	-	3.0	90.9
	326.7	0.3	3.9	8.7	0.2	13.1	4.0
Collective impairment	(0.9)	-	-	-	-	-	-
Individual impairment	(8.4)	-	(2.3)	-	-	(2.3)	27.4
	317.4	0.3	1.6	8.7	0.2	10.8	3.4

* The 2016 comparative figures have been restated as outlined on page 167, resulting in a £7.0m reduction to reported total renegotiations and a 2.2% decrease to the reported percentage of accounts subject to renegotiations, from 6.2% to 4.0%.

Individual impairment provisions are made to reduce the carrying value of commercial mortgages to the present value of the amount the Directors consider is ultimately likely to be received, based upon objective evidence.

A collective impairment allowance is made against performing loans where objective evidence indicates it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is generally based on the most recent external valuation of the mortgaged property or, where one is not available, calculated using third party valuation indices. The valuation is discounted further to assume a forced sale value in addition to default propensity modelling.

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 2017 £m	2016 £m
Not individually impaired	283.4	314.4
Individually impaired	1.6	2.4
Possessions	0.4	-
	285.4	316.8
Gross loan balances	293.8	326.7
Negative equity	8.4	9.9

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.

iii) Other loans and advances

	Group 2017 Gross £m	2017 Impairment £m	2016 Gross £m	2016 Impairment £m
Factored debt and invoice discounting	79.9	(0.8)	75.4	(0.6)
Other loans	61.9	-	49.0	-
	141.8	(0.8)	124.4	(0.6)

	Society 2017 Gross £m	2017 Impairment £m	2016 Gross £m	2016 Impairment £m
Other loans	0.1	-	0.1	-

The balances of those assets within our factored debt and invoice discounting business that are individually impaired amount to £2.4m (2016: £3.6m). The majority of these loans have an original maturity of less than one year. The factors considered in determining whether these assets are impaired include the existence of objective evidence to doubt ultimate recoverability of the Group's net exposure due to client insolvency.

There were no assets within other loans that were individually impaired at the end of 2017 or 2016 for the Group and Society. The factors considered in determining whether these assets are impaired include the existence of objective evidence that the customer is unable to honour their obligations as they fall due.

There were no other loans that are past due at 31 December 2017 in either the Group or the Society (2016: Group: £0.5m; Society: £nil).

The factored debt and invoice discounting advances in the table above are secured via a legal charge against the 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. The fair value of the total collateral held against the factored debt and invoice discounting advances is in excess of the value of the total advances made.

The collateral held on the £61.9m (2016: £49.0m) of other loans for the Group in the table above consists of shares in a property management holding company, which owns residential properties for which the loans were advanced to customers on. The fair value of the total collateral held against these loans is £92.4m (2016: £69.0m).

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 which are secured by pools of financial assets.

As at 31 December 2017 and 31 December 2016, none of the Group's treasury portfolio exposure was either past due or impaired. As such, no provision is held for impaired treasury assets (2016: £nil). In determining whether evidence of impairment exists, the Group considers, amongst other factors, current market conditions (including the disappearance of an active market), fair value volatility (including significant reduction in market value), any breach of contract or covenants, the financial stability or any financial difficulties of the counterparty and the country it is resident in (i.e. in order to take account of sovereign debt issues).

As at 31 December 2017, 98.7% (2016: 98.8%) of the Group's treasury investment assets (including cash in hand) were rated A3 or better. The Group continues to have no exposure to emerging markets and only limited exposure to non-investment grade debt.

37. Credit risk *(continued)*

The table below provides further details of the credit ratings of the Group's treasury investment portfolio:

Rating	2017 £m	2017 %	2016 £m	2016 %
Aaa	394.5	11.2	367.7	13.7
Aa1	39.1	1.1	1,621.0	60.5
Aa2	2,664.6	75.5	243.6	9.1
Aa3	191.7	5.4	132.8	5.0
A1	105.5	3.0	171.7	6.4
A2	22.4	0.6	23.0	0.9
A3	68.8	1.9	86.8	3.2
Unrated:				
Building societies	1.7	-	1.8	0.1
Other	45.0	1.3	29.0	1.1
	3,533.3	100.0	2,677.4	100.0

The above analysis does not include off balance sheet liquidity in 2016 of £793.1m, which represented short term Treasury bills held as a result of Funding for Lending Scheme (FLS) drawings, the credit ratings of which were Aa1. There were no such Treasury bills held as at the end of 2017 following repayment of FLS funding during the year.

'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.

Industry sector / asset class	2017 £m	2017 %	2016 £m	2016 %
Cash in hand and balances with the Bank of England	2,396.9	67.7	1,212.7	45.2
Loans and advances to banks and building societies	345.3	9.8	409.6	15.3
Gilts	153.2	4.3	377.5	14.1
Certificates of deposit	55.1	1.6	232.9	8.7
Fixed rate bonds	178.6	5.1	183.7	6.9
Floating rate notes	24.0	0.7	30.1	1.1
Treasury bills	94.0	2.7	-	-
Covered bonds	87.4	2.5	39.3	1.5
Residential mortgage backed securities	198.8	5.6	191.6	7.2
	3,533.3	100.0	2,677.4	100.0

Geographical exposure	2017 £m	2017 %	2016 £m	2016 %
UK	3,303.4	93.5	2,317.5	86.5
Rest of Europe	188.0	5.3	272.1	10.2
North America	38.1	1.1	74.1	2.8
Australasia	3.8	0.1	13.7	0.5
	3,533.3	100.0	2,677.4	100.0

c) 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. The only form of collateral accepted by the Group is cash. Derivatives are either transacted under International Swaps and Derivatives Association (ISDA) Master Agreements or Cleared Derivatives Execution Agreements. No Credit (CVA) or Debit (DVA) Value Adjustments have been made in respect of credit risk in determining the fair value of the Group's derivative financial instruments as the risk is significantly mitigated as all swaps are cash collateralised. 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.

Netting arrangements do not necessarily result in an offset of Statement of Financial Position 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.

38. Fair values

a) Classification and measurement

The table below summarises the classification of the carrying amounts of the Group's financial assets and liabilities:

	2017 Amortised cost £m	Held at fair value as available-for-sale assets £m	Fair value through profit or loss £m	Total £m
Cash in hand and balances with the Bank of England	2,396.9	-	-	2,396.9
Loans and advances to credit institutions	345.3	-	-	345.3
Debt securities	1.7	789.4	-	791.1
Derivative financial instruments	-	-	94.2	94.2
Loans and advances to customers	16,998.4	-	(25.7)	16,972.7
Equity share investments	-	0.4	-	0.4
Trade receivables	30.8	-	-	30.8
Contingent consideration	25.1	-	-	25.1
Total financial assets	19,798.2	789.8	68.5	20,656.5
Other non-financial assets				367.1
Total assets				21,023.6
Shares	14,985.8	-	-	14,985.8
Amounts owed to credit institutions and other customers	3,288.3	-	-	3,288.3
Debt securities in issue	666.4	-	-	666.4
Derivative financial instruments	-	-	318.5	318.5
Trade payables	4.4	-	-	4.4
Fair value of put option obligation	-	-	9.9	9.9
Subscribed capital	41.6	-	-	41.6
Total financial liabilities	18,986.5	-	328.4	19,314.9
Other non-financial liabilities				303.9
Total liabilities				19,618.8

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38. Fair values *(continued)*

	2016			
	Amortised cost £m	Held at fair value as available-for-sale assets £m	Fair value through profit or loss £m	Total £m
Cash in hand and balances with the Bank of England	1,212.7	-	-	1,212.7
Loans and advances to credit institutions	409.6	-	-	409.6
Debt securities	1.7	1,053.4	-	1,055.1
Derivative financial instruments	-	-	116.1	116.1
Loans and advances to customers	15,809.3	-	(27.7)	15,781.6
Equity share investments	-	36.4	-	36.4
Trade receivables	32.8	-	-	32.8
Contingent consideration	9.9	-	-	9.9
Total financial assets	17,476.0	1,089.8	88.4	18,654.2
Other non-financial assets				365.5
Total assets				19,019.7
Shares	14,152.5	-	-	14,152.5
Amounts owed to credit institutions and other customers	2,148.5	-	-	2,148.5
Debt securities in issue	534.2	-	-	534.2
Derivative financial instruments	-	-	412.3	412.3
Trade payables	5.4	-	-	5.4
Fair value of put option obligation	-	-	11.7	11.7
Subordinated liabilities and subscribed capital	169.8	-	-	169.8
Total financial liabilities	17,010.4	-	424.0	17,434.4
Other non-financial liabilities				307.8
Total liabilities				17,742.2

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.

The following tables provide an analysis of financial assets and liabilities held within the Group Statement of Financial Position at fair value, grouped into Levels 1 to 3 of the fair value hierarchy.

Group	2017			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	734.3	55.1	-	**789.4**
Equity share investments	-	-	0.4	**0.4**
Financial assets at fair value through profit or loss:				
Embedded derivatives within loans and advances to customers	-	-	(25.7)	**(25.7)**
Derivative financial instruments	-	92.8	1.4	**94.2**
	734.3	**147.9**	**(23.9)**	**858.3**
Financial liabilities				
Financial liabilities at fair value through profit or loss:				
Derivative financial instruments	-	84.6	233.9	**318.5**
Fair value of put option obligation	-	-	9.9	**9.9**
	-	**84.6**	**243.8**	**328.4**
	734.3	**63.3**	**(267.7)**	**529.9**

Group	2016			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	820.5	232.9	-	1,053.4
Equity share investments	36.0	-	0.4	36.4
Financial assets at fair value through profit or loss:				
Embedded derivatives within loans and advances to customers	-	-	(27.7)	(27.7)
Derivative financial instruments	-	112.2	3.9	116.1
	856.5	345.1	(23.4)	1,178.2
Financial liabilities				
Financial liabilities at fair value through profit or loss:				
Derivative financial instruments	-	161.5	250.8	412.3
Fair value of put option obligation	-	-	11.7	11.7
	-	161.5	262.5	424.0
	856.5	183.6	(285.9)	754.2

38. Fair values *(continued)*

The table below analyses the movements in the Level 3 portfolio during the year:

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 credit / (charge) on loans and advances to customers' line in the Income Statement.
3. Included in the 'Fair value gains / (losses) on financial instruments' line in the Income Statement. As noted below, the majority of these derivatives are held to hedge the Group's equity release mortgage book and a gain, largely offsetting the above amount, was recognised through the same line in the Income Statement in respect of the underlying mortgages that are 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.

Group 2016	Equity share investments £m	Embedded derivatives £m	Derivative financial instruments £m	Fair value of put option obligation £m	Total £m
At 1 January	0.7	(24.0)	(195.6)	(11.9)	(230.8)
Loss recognised in Income Statement	(11.3)[1]	(3.8)[2]	(51.3)[3]	(0.2)[4]	(66.6)
Losses written off during the year	-	0.1	-	-	0.1
Reclassification of associate investment	10.6	-	-	-	10.6
Revaluation of market values	-	-	-	0.8	0.8
Additions	0.4	-	-	-	0.4
Acquisition of subsidiary undertakings	-	-	-	(0.4)	(0.4)
At 31 December	0.4	(27.7)	(246.9)	(11.7)	(285.9)

Notes
1. Included in the 'Impairment losses on equity share investments' line in the Income Statement.
2. Included in the 'Impairment credit / (charge) on loans and advances to customers' line in the Income Statement.
3. Included in the 'Fair value gains / (losses) on financial instruments' line in the Income Statement. As noted below, the majority of these derivatives are held to hedge the Group's equity release mortgage book and a gain, largely offsetting the above amount, was recognised through the same line in the Income Statement in respect of the underlying mortgages that are being hedged. However, some hedge ineffectiveness resulted during the year and this resulted in an overall charge to the Income Statement of £7.8m.
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.

Equity share investments

The Group holds a 13.9% (2016: 13.9%) holding in Hearthstone Investments Limited and an 8.7% (2016: 8.7%) holding in Tactile Limited. The Directors have reviewed the carrying value of these investments at the year end. The Directors believe it is appropriate to continue to hold the Group's investment in Tactile at its cost of £0.4m as, in the absence of any observable inputs or other relevant information, the fair value of the Group's shareholding in this company cannot be reliably measured, and the Directors do not consider that any reasonably possible alternative valuation assumptions exist.

The carrying value of Hearthstone was fully written down in 2016 resulting in £0.7m impairment being recognised in the Income Statement. During 2017 the Group subscribed to a rights issue of shares in Hearthstone, increasing the carrying value by £0.1m, which was immediately written off resulting in £0.1m impairment being recognised in the Income Statement.

During the year the Group disposed of its entire shareholding in ZPG Plc. The movement in fair value of the investment in ZPG Plc was by reference to its quoted share price and therefore was classified as a Level 1 fair value movement.

Embedded derivatives

The Group holds an equity release mortgage book under the terms of which the Group is required to provide a 'no negative equity guarantee' to its customers. This guarantee means that the Group's maximum return is limited to the value of the customer's property on redemption.

In accordance with the accounting policy as described in note 1e), this guarantee is accounted for as an embedded derivative as the characteristics and risks of the guarantee are not closely related to the economic characteristics and risks of the underlying mortgages. The guarantee is impacted by the interaction of a number of factors, not all of which also impact on the performance of the underlying equity release book. These factors include future expected house prices, future expected inflation, mortality rates and estimated redemption profiles. As a result, the embedded derivatives are bifurcated from the underlying mortgage book and measured at fair value, with any changes in fair value recognised within the 'Impairment credit / (charge) on loans and advances to customers' line in the Income Statement. As certain of these inputs are not market observable, the fair value of the embedded derivatives is regarded as a Level 3 valuation technique.

The following table outlines the impact of reasonably possible alternative assumptions of certain inputs outlined above. Each sensitivity considers one change in isolation and the combined impact on the valuation of the embedded derivatives of all sensitivities occurring would not necessarily be the sum of the impact of the individual sensitivities.

		Group and Society 2017 (Decrease) / increase in fair value £m	2016 (Decrease) / increase in fair value £m
Future change in house prices	+/- 10% in any one year*	**(8.1) / 12.0**	(8.1) / 11.8
Redemption rates	+/- 1% pa	**(3.0) / 3.5**	(3.3) / 3.8
Retail Price Index (RPI)	+/- 0.1% pa	**2.4 / (2.2)**	2.4 / (2.3)

* For example, the impact on an assumption of a 3% increase in house prices would be a 13% increase or 7% fall.

There would be a corresponding credit / charge to the Income Statement within the 'Impairment credit / (charge) on loans and advances to customers' line arising from the decrease / increase in the fair value of the embedded derivatives as shown in the table above.

Derivative financial instruments

Some of the derivative financial instruments included in the tables on page 174 comprise derivatives used to hedge the Group's interest rate risk arising from its equity release mortgage book (this is separate to the no negative equity guarantee described above, i.e. the embedded derivative, for which the Group holds no natural hedging instrument). These derivatives that hedge equity release mortgages 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 that are based on historical data and reviewed periodically to ensure forecasts remain broadly in line with actual data.

These redemption profiles are not market observable, therefore these derivatives are categorised as Level 3 financial instruments within the fair value hierarchy.

Two of the derivative financial instruments described above contain contractual 'boundaries', within which any change in fair value of the derivatives will be offset by a corresponding but opposite change in the value of the associated hedged item within loans and advances to customers. These boundaries exist in order to alleviate risk to the counterparty. If these boundaries are forecasted to be crossed, hedge ineffectiveness and therefore Income Statement volatility can arise and during the year this resulted in an Income Statement credit of £0.6m (2016: £2.1m charge), which is included in the 'Fair value gains / (losses) on financial instruments' line in the Income Statement. Further ineffectiveness arises on this portfolio due to the change made during 2016 to discount the swaps using discount factors derived from an OIS (Overnight Indexed Swap) curve in line with market practice. In 2017, this resulted in an income statement credit of £1.1m (2016: £5.7m charge).

38. Fair values *(continued)*

In addition, as described above, certain inputs into the valuation of these derivatives are not market observable and the effect on the fair value of these derivatives of reasonably possible alternative valuation assumptions of certain of these inputs is outlined below. Each sensitivity considers one change in isolation and the combined impact on the valuation of the derivatives of all sensitivities occurring would not necessarily be equal to the sum of the impact of the individual sensitivities.

		Group and Society 2017 Increase / (decrease) in liability £m	2016 Increase / (decrease) in liability £m
Retail Price Index (RPI)	+/- 0.1% pa	**6.8 / (6.8)**	7.8 / (7.7)
Redemption rates	+/- 1% pa	**(20.1) / 23.6**	(21.7) / 26.0

Any change in fair value of the derivative liabilities as shown above would be largely offset by a corresponding but opposite change in the value of the associated hedged item within loans and advances to customers. A 0.1% increase in RPI would result in an Income Statement charge of £0.2m (2016: £0.2m), whilst a 0.1% decrease in RPI would result in an Income Statement credit of £0.2m (2016: £0.2m). A 1% increase in redemption rates would result in an Income Statement charge of £0.3m (2016: £nil), and a 1% decrease in redemption rates would result in an Income Statement charge of £nil (2016: £0.4m).

As can be seen, the valuation of these swaps is very sensitive to the underlying assumptions such as redemption rates; however, as described above, changes in the fair value of these derivatives are generally offset to a significant degree by changes in the fair value of the associated hedged item within loans and advances to customers.

Fair value of put option obligation

Key inputs into the calculation of the fair value of the put option obligation include an estimate of the market value of the non-controlling shareholding and an estimate of when the put option will be exercised by the non-controlling shareholders. As these inputs are based on the judgement of management, the valuation of the put option obligation is considered to be a Level 3 valuation technique.

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 2017 Carrying value £m	Group 2017 Fair value £m	Society 2017 Carrying value £m	Society 2017 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	-	-
	19,798.2	**19,736.7**	**17,695.1**	**17,634.5**
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**

	Group 2016 Carrying value £m	Group 2016 Fair value £m	Society 2016 Carrying value £m	Society 2016 Fair value £m
Financial assets				
Cash in hand and balances with the Bank of England	1,212.7	1,212.7	1,212.7	1,212.7
Loans and advances to credit institutions	409.6	409.6	309.0	309.0
Debt securities	1.7	1.7	266.1	266.4
Loans and advances to customers	15,809.3	15,613.2	13,551.1	13,380.3
Trade receivables	32.8	32.8	1.2	1.2
Contingent consideration	9.9	9.9	-	-
	17,476.0	17,279.9	15,340.1	15,169.6
Financial liabilities				
Shares	14,152.5	14,238.0	14,152.5	14,238.0
Amounts owed to credit institutions	655.3	666.4	786.5	797.6
Amounts owed to other customers	1,493.2	1,498.8	292.3	292.6
Debt securities in issue	534.2	541.1	14.6	14.6
Trade payables	5.4	5.4	0.9	0.9
Subordinated liabilities and subscribed capital	169.8	190.4	169.8	190.4
	17,010.4	17,140.1	15,416.6	15,534.1

38. 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.

Subordinated liabilities and 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.

39. Group segmental reporting

The Group's structure and reportable segments are outlined in the Strategic Report on page 16.

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, £39.2m (2016: £36.7m) was generated outside the UK.

A breakdown of the allocation of goodwill to each segmental area is included within note 20.

	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**

Notes to the Accounts *(continued)*

39. Group segmental reporting *(continued)*

	2016				
	Mortgages and Savings	Estate Agency	Investment Portfolio	Sundry incl. inter-divisional adjustments	Total
	Restated*				Restated*
	£m	£m	£m	£m	£m
Net interest income	209.5	0.3	1.8	4.0	215.6
Net non-interest income	30.1	397.6	27.0	(9.0)	445.7
Fair value losses on financial instruments	(3.7)	-	-	-	(3.7)
Profit on treasury assets	1.4	-	-	-	1.4
Profit / (loss) on disposal of Group undertakings	-	17.0	(0.9)	15.8	31.9
Dividend income from equity share investments	-	0.7	-	-	0.7
Share of profits / (losses) from joint ventures and associates	-	1.8	(2.4)	-	(0.6)
Total income	237.3	417.4	25.5	10.8	691.0
Administrative expenses	(135.9)	(337.7)	(25.8)	0.3	(499.1)
Impairment and provisions for liabilities	(4.8)	(6.3)	(11.9)	-	(23.0)
Profit / (loss) before tax	96.6	73.4	(12.2)	11.1	168.9
Taxation	(23.3)	(15.2)	(0.9)	0.3	(39.1)
Profit / (loss) after tax	73.3	58.2	(13.1)	11.4	129.8
Total assets	18,736.3	289.1	129.6	(135.3)	19,019.7
Total liabilities	17,540.7	154.0	124.1	(76.6)	17,742.2
Capital expenditure	7.8	18.5	2.0	-	28.3

* The comparative figures have been restated due to a change in accounting policy relating to the netting of gains on and costs arising from the sale of treasury assets. Further details are provided in note 1b).

Total income can be analysed as follows:

	2016				
	Mortgages and Savings	Estate Agency	Investment Portfolio	Sundry incl. inter-divisional adjustments	Total
	£m	£m	£m	£m	£m
External income	236.1	405.8	26.3	22.8	691.0
Income from other segments	1.2	11.6	(0.8)	(12.0)	-
Total income	237.3	417.4	25.5	10.8	691.0

40. Capital management

Page 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 35 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.

41. Adoption of new and revised International Financial Reporting Standards

Disclosed below are amendments to existing standards which have been adopted during the year, all of which are effective for accounting periods starting on or after 1 January 2017. There are no new accounting standards which have been adopted during the year.

- Amendments to IAS 7 *Statement of Cash Flows*. These amendments enhance disclosure requirements to enable users of financial statements to better evaluate changes in liabilities arising from financing activities. This has resulted in further disclosures on the movements during the year (see note 31) in the liabilities that the Group categorises as being held for financing activities for the purposes of presentation in the Statements of Cash Flows.
- Amendments to IAS 12 *Income Taxes*, which clarify how to account for deferred tax assets related to debt instruments measured at fair value and this has had no impact on these financial statements.

Amendments to accounting standards effective but not yet EU endorsed

The Group notes amendments to accounting standards which are effective for accounting periods starting on or after 1 January 2017 but have not yet been EU endorsed. These are 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*. These amendments are not expected to have a material impact on the Group's financial statements.

Standards issued but not yet effective

The Group notes a number of new accounting standards which will be effective for future reporting periods. The Group has not early adopted the following new standards in preparing these consolidated financial statements.

Estimated impact of the adoption of IFRS 9 and IFRS 15

The Group is required to adopt IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* for accounting periods commencing on or after 1 January 2018. In preparation for implementation on 1 January 2018, the Group developed extensive new systems, procedures and controls. The Group has assessed the estimated impact that the initial application of IFRS 9 and IFRS 15 will have on its consolidated financial statements. The estimated impact of the adoption of these standards on the Group's reserves as at 1 January 2018 is based on assessments undertaken to date and is summarised below. These assessments are preliminary because not all transition work has been finalised and therefore may be subject to adjustment. The actual impacts of adopting the standards at 1 January 2018 may change because:

- The Group is refining and finalising its IFRS 9 models, including validation, notably its equity release fair valuation model and its expected credit loss models; and
- The new accounting policies, assumptions, judgements and estimation techniques are subject to change until the Group presents its first financial statements that include the date of initial application.

Estimated impact of adoption of IFRS 9 and IFRS 15

	As reported at 31 Dec 2017	Estimated adjustments due to adoption of IFRS 9	Estimated adjustments due to adoption of IFRS 15	Estimated adjusted opening balance at 1 Jan 2018
	£m	£m (approx.)	£m (approx.)	£m (approx.)
General reserve	1,396.4	(38.4)	-	1,358.0

The total estimated adjustment to the opening balance of the Group's reserves at 1 January 2018 is a decrease of approximately £38.4m (net of tax). The principal components of the estimated adjustment are as follows:

- A decrease of approximately £37.0m (net of tax) in the general reserve due to reclassification of the Group's equity release portfolio from amortised cost to fair value through profit or loss (see IFRS 9 below); and
- A decrease of approximately £1.4m (net of tax) in the general reserve due to impairment losses on financial assets (see IFRS 9 below).

The Group expects no material impact on initial application of IFRS 15 (see IFRS 15 below).

IFRS 9 Financial Instruments

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. IFRS 9 is effective for accounting periods commencing on or after 1 January 2018, with early adoption permitted. The Group will first adopt IFRS 9 in its half-yearly report for the six months ending 30 June 2018, with an initial application date of 1 January 2018.

In October 2017, the IASB issued *Prepayment Features with Negative Compensation (Amendments to IFRS 9)*. Subject to EU endorsement, the amendments are effective for accounting periods beginning on or after 1 January 2019, with early adoption permitted. The Group plans to first adopt these amendments in its half-yearly report for the six months ending 30 June 2019 and expects no significant impact.

41. Adoption of new and revised International Financial Reporting Standards *(continued)*

The Group has assessed the expected impact of IFRS 9 application on its consolidated financial statements, the results of which are summarised below.

i) Financial assets - classification

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their contractual cash flow characteristics.

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The standard eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available-for–sale. Financial assets are classified into the appropriate category on initial recognition.

A financial asset is measured at amortised cost 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 to hold assets to collect contractual cash flows; 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.

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; 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.

All financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL.

The Group has performed a detailed assessment of the impact of applying the new classification requirements of IFRS 9 to the Group's financial assets. With the exception of certain debt securities, the Group's financial assets are typically held within business models whose objective is to hold assets to collect contractual cash flows. With the exception of the Group's equity release portfolio and certain treasury instruments, the Group's financial assets typically contain contractual cash flows that are solely payments of principal and interest.

Based on its assessment, the Group's financial assets will broadly be reclassified under IFRS 9 as follows:

IAS 39 (existing)		IFRS 9 (expected)		Significant impact expected
Classification	**Measurement**	**Classification**	**Measurement**	
Loans and receivables (excluding equity release portfolio) (note 1)	Amortised cost	Amortised cost	Amortised cost	No
Loans and receivables – equity release portfolio	Amortised cost (with some fair value adjustments)	FVTPL	FVTPL	Yes (see below)
Available-for-sale (note 2)	FVOCI	FVOCI	FVOCI	No
FVTPL (note 3)	FVTPL	FVTPL	FVTPL	No

Notes

1. Financial assets held by the Group which are classified as loans and receivables under IAS 39 include loans and advances to customers (excluding the no negative equity guarantee relating to the equity release portfolio), loans and advances to credit institutions, cash in hand and balances with the Bank of England and certain debt securities.
2. Financial assets held by the Group which are classified as available-for-sale under IAS 39 comprise most debt securities and equity share investments.
3. Financial assets held by the Group which are classified as FVTPL under IAS 39 comprise the no negative equity guarantee relating to the equity release portfolio and derivative financial instruments.

For the year ended 31 December 2017, the Group's equity release portfolio is accounted for under IAS 39. The loan balances are held at amortised cost and the no negative equity guarantee, an embedded derivative, is bifurcated and held at fair value. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are not bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification. The Group has assessed the characteristics of the equity release cash flows and considers 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 will be classified as FVTPL under IFRS 9. To address this requirement, the Group has designed and built a fair valuation model for the equity release portfolio. The key estimates and judgements incorporated into this model 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. The estimated impact of this reclassification is to reduce the Group's general reserve at 1 January 2018 by approximately £37.0m (net of tax).

There are three key drivers behind this reduction in reserves. The first is a revision to the Group's assessment of the illiquidity premium to be incorporated into the rate at which cash flows are discounted to present value. When the Group initially acquired the equity release portfolio, on merger with Scarborough Building Society, the fair value of the portfolio was assessed in accordance with IFRS 3 *Business Combinations* and was subsequently held at amortised cost; the illiquidity premium at this time was assessed by the Group to be zero. This illiquidity premium has been reassessed by the Group as a result of the change in measurement from amortised cost to FVTPL on transition to IFRS 9, increasing the discount rate and resulting in a fair value that is lower than the current carrying value. The second key driver is that hedge accounting will no longer apply to the equity release portfolio when it is fair valued under IFRS 9, resulting in a further reduction in carrying value. The third driver is a change in methodology for valuing the no negative equity guarantee (NNEG). Under IAS 39 the NNEG is treated as an embedded derivative and is fair valued separately from the rest of the portfolio; under IFRS 9 the whole portfolio is fair valued and the NNEG is not bifurcated. Going forward, the change in classification and measurement of the equity release portfolio under IFRS 9 to FVTPL is expected to result in Income Statement volatility, which will be outside of management control. Therefore ahead of the end of the next reporting period consideration will be given as to whether to exclude the impact of these fair value movements from the underlying profit metric.

ii) Financial assets – impairment

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. This new impairment model will apply to the Group's financial assets measured at amortised cost or FVOCI, except for investments in equity instruments. Whilst the IFRS 9 ECL model for accounting purposes is not equivalent to the IRB 'expected loss' model which the Group applies for regulatory capital purposes, the Group has been able to leverage its existing understanding of forward-looking credit loss models to aid its preparations for IFRS 9.

The new ECL model in IFRS 9 involves a number of factors that will require significant judgement. These factors include, for example, assessing probability of default, determining when the risk of default has significantly increased and forming a view as to the future direction of relevant economic variables. To implement its IFRS 9 methodologies, the Group has designed and built an appropriate suite of models. The modelling techniques vary according to the characteristics of each impacted portfolio of financial assets, ranging from complex statistical models for the Group's residential loan portfolios, to a more simplified approach for trade receivables.

IFRS 9 requires a 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, whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date.

For residential loans, the Group will align its definition of default for IFRS 9 purposes to its existing IRB definition of default for regulatory capital purposes, including a backstop based on delinquency of 90 days past due.

The Group will recognise loss allowances at an amount equal to lifetime ECLs, except in the following cases for which the amount recognised will be 12-month ECLs:

- Debt investment securities that are determined to have low credit risk at the reporting date. The Group considers a debt security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment-grade'; and
- Other financial instruments for which credit risk has not increased significantly since initial recognition (except trade receivables, for which the Group will always recognise lifetime ECLs).

Under IFRS 9, when determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Group will consider reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information and analysis based on the Group's historical experience, expert credit assessment and forward-looking information. The Group will primarily identify whether a significant increase in credit risk has occurred for an asset by comparing:

- The remaining lifetime probability of default (PD) as at the reporting date; with
- The remaining lifetime PD for this point in time that was estimated on initial recognition of the asset.

41. Adoption of new and revised International Financial Reporting Standards *(continued)*

For loans and advances to customers, the Group has established a framework that incorporates both quantitative and qualitative information to determine whether the credit risk on a particular loan has increased significantly since initial recognition. The criteria for determining whether credit risk has increased significantly will vary by portfolio and will include a backstop based on delinquency of 30 days past due.

For treasury assets, the Group will apply criteria that consider the relative increase in lifetime PD, by reference to external ratings where available. Treasury assets held by the Group include cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and derivative financial instruments.

The Group's impairment losses will increase on application of IFRS 9, and are also expected to become more volatile. The Group estimates that application of the impairment requirements of IFRS 9 at 1 January 2018 results in an increase in impairment losses (before tax) as follows:

	Estimated increase in impairment at 1 Jan 2018 £m (approx.)
Loans and advances to customers	0.7
Treasury assets	0.9
Gross increase in impairment losses (before tax)	**1.6**

The Group estimates that this expected increase in impairment losses will result in a decrease in the general reserve at 1 January 2018 of approximately £1.4m (net of tax).

iii) Financial liabilities - classification

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

However, under IAS 39 all fair value changes in liabilities designated as at FVTPL are recognised in profit or loss, whereas under IFRS 9 these fair value changes are generally 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; and
- The remaining amount of change in the fair value is presented in profit or loss.

Based on its assessment, the Group does not expect to designate any financial liabilities at FVTPL and expects no material impact regarding the classification of financial liabilities at 1 January 2018.

iv) Hedge accounting

When initially applying IFRS 9, the Group may choose as its accounting policy to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements in IFRS 9. The Group has chosen to apply the new requirements of 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 to apply a more qualitative and forward-looking approach to assessing hedge effectiveness. IFRS 9 also introduces new requirements on rebalancing hedge relationships and prohibiting voluntary discontinuation of hedge accounting. Under the new model, it is possible that more risk management strategies, particularly those involving hedging a risk component (other than foreign currency risk) of a non-financial item, will be likely to qualify for hedge accounting. The Group does not currently undertake hedges of such risk components.

In accordance with IFRS 9, the new hedge accounting requirements will be applied prospectively from the initial application date. The Group has performed a detailed assessment of the impact of applying the hedge accounting requirements of IFRS 9 to financial instruments held by the Group at 31 December 2017 and does not expect the impact to be material. The types of hedge accounting relationships that the Group currently designates meet the requirements of IFRS 9 and are aligned with the Group's risk management objectives and strategy. In preparation for implementation, the Group has enhanced its hedging documentation procedures in line with IFRS 9's requirements. As the hedge accounting requirements of IFRS 9 will not be applied retrospectively, there is no impact on the Group's reserves as at 1 January 2018.

v) Disclosures

IFRS 9 will require extensive new disclosures, in particular for hedge accounting, credit risk and expected credit losses. The Group is implementing appropriate systems and controls changes to capture the required data.

vi) Transition

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively, with certain exceptions. As noted above, the hedge accounting requirements of IFRS 9 will be applied prospectively. The Group plans to take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 generally will be recognised in reserves as at 1 January 2018.

In addition, the following assessments have to be made on the basis of the facts and circumstances that exist at the date of initial application.

- The determination of the business model within which a financial asset is held;
- The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL;
- The designation of certain investments in equity instruments not held for trading as at FVOCI; and
- For a financial liability designated as at FVTPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.

If a debt security has low credit risk at 1 January 2018, then the Group will determine that the credit risk on the asset has not increased significantly since initial recognition.

vii) Impact on capital planning

The principal impacts on the Group's regulatory capital of the implementation of IFRS 9 will arise from the following:

- The reclassification of the Group's equity release portfolio from amortised cost to FVTPL; and
- The new impairment requirements.

The PRA has announced transitional provisions under which some of the capital impact that arises from implementing the new impairment requirements of IFRS 9 may be phased in over a five year period; the Group intends to apply these transitional provisions.

The Group estimates that the impact of IFRS 9 implementation will reduce its CET 1 ratio at 1 January 2018 by approximately 0.8% to approximately 32.4% (before transitional reliefs) and will reduce its total capital ratio at 1 January 2018 by approximately 0.8% to approximately 33.5% (before transitional reliefs).

IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition requirements, including IAS 18 *Revenue*. IFRS 15 is effective for accounting periods beginning on or after 1 January 2018, with early adoption permitted. The Group will first adopt IFRS 15 in its half-yearly report for the six months ending 30 June 2018, with an initial application date of 1 January 2018.

The Group has assessed the expected impact of IFRS 15 application on its consolidated financial statements, the results of which are summarised below.

i) Financial advice fees and commissions

The Group has performed a detailed assessment of the impact of IFRS 15 for each of the financial advice services offered by the Society. Based on its assessment, the Group does not expect the application of IFRS 15 to result in significant change to its existing revenue recognition practices for financial advice services and therefore does not expect the impact to be material.

ii) Estate agency services

Revenue from estate agency services includes estate agency commissions, property management income, insurance commissions and survey and valuation income. The Group has performed a detailed assessment of the impact of IFRS 15 application for each estate agency income stream. Based on its assessment, the Group does not expect the application of IFRS 15 to result in significant change to its existing policies for the timing or measurement of revenue from estate agency services and therefore does not expect the impact to be material.

41. Adoption of new and revised International Financial Reporting Standards *(continued)*

iii) Software products and services

The Group has assessed the impact of IFRS 15 for each of the products and services offered by the Jade group of companies. The Group has identified a limited number of situations where the requirements of IFRS 15 require an amendment to existing revenue recognition practices. The Group does not expect the impact to be material.

iv) Invoice discounting and debt factoring services

Income from invoice discounting and debt factoring services includes interest receivable and service charges. The Group has performed a detailed assessment of the impact of IFRS 15 for this service charge income. Based on its assessment, the Group does not expect the application of IFRS 15 to result in significant change to its existing revenue recognition practices for this income and therefore does not expect the impact to be material.

v) Transition

The Group plans to adopt IFRS 15 using the cumulative effect method and the effect of initially applying this standard will be recognised at the date of initial application. As a result, the Group will not apply the requirements of IFRS 15 to the comparative periods presented. The impact of initially applying IFRS 15 will be recognised in reserves at 1 January 2018.

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 is assessing the potential impact of IFRS 16 application on its consolidated financial statements and has not yet completed its detailed assessment. 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. As at 31 December 2017, the Group's future minimum lease payments under non-cancellable operating leases amounted to £71.0m on an undiscounted basis (see note 33b)). 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. The quantitative impact of adopting IFRS 16 on the consolidated financial statements in the period of initial application is not yet known and cannot yet be reliably estimated. The quantitative effect will depend on, inter alia, the transition method chosen, the extent to which the Group uses practical expedients and recognition exemptions, the composition of the Group's lease portfolio at the initial application date and the Group's latest assessment of whether it will exercise any lease renewal options. The Group expects to disclose further information prior to adopting IFRS 16.

42. Subsequent events

On 27 February 2018, the Society agreed heads of terms for a merger with Holmesdale Building Society. The merger is subject to approval by the members of Holmesdale Building Society and confirmation by the Prudential Regulation Authority. If approval and confirmation is received, the merger is expected to become effective through the transfer of all of the Holmesdale Building Society's engagements to Skipton on 1 October 2018.

There have been no other material subsequent events between 31 December 2017 and the date of approval of this Annual Report and Accounts by the Board.

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 31.12.17
Jade Software Corporation Limited	Provider of software development services	New Zealand	99.9
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. In addition, the Jade group operates one branch in Switzerland.

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 and has subsidiaries in Australia, Canada, USA and the UK.

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.

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**

2016 £m	UK	Australia	United Arab Emirates	Guernsey	Netherlands	New Zealand	Switzerland	USA	Total
Total income by country	652.2	3.0	(0.2)	19.8	1.4	14.7	-	0.6	691.5
Inter-country adjustments	0.6	0.5	0.2	(0.2)	0.1	(1.9)	-	0.2	(0.5)
Consolidated income	652.8	3.5	-	19.6	1.5	12.8	-	0.8	691.0
Profit before tax by country	154.3	0.3	(0.4)	15.2	0.1	(0.8)	-	0.2	168.9
Inter-country adjustments	0.3	1.0	0.5	0.5	0.6	(2.4)	(0.5)	-	-
Consolidated profit before tax	154.6	1.3	0.1	15.7	0.7	(3.2)	(0.5)	0.2	168.9

2016 £m	UK	Australia	United Arab Emirates	Guernsey	Netherlands	New Zealand	Switzerland	USA	Total
Current tax expense	39.4	0.2	-	1.4	-	-	-	-	41.0
Corporation taxes paid	35.4	0.1	-	1.5	-	-	-	-	37.0
Public subsidies received*	-	-	-	-	-	0.3	-	-	0.3
Average number of employees	8,247	15	6	42	5	174	2	5	8,496

* Public subsidies received relate to cash payments received from governments in the form of grants.

The 2016 figures were previously presented on the basis that total gross income and total gross profit before tax reflected an aggregation of the entities within each of the countries above. This has now been revised within the 2017 disclosures so that total gross income and total gross profit before tax, for each country above, represents consolidated income or profit before tax for that country. Similarly, intra-Group adjustments previously represented an aggregation of all intra-Group transactions within income or profit before tax; these lines now represent inter-country adjustments, i.e. only transactions between entities that are in different countries in the Group. The 2016 comparatives have been re-presented to be shown on a consistent basis with 2017.

Annual Business Statement

1. Statutory percentages

	As at 31 December 2017 %	Statutory limit %
Lending limit	5.36	25.00
Funding limit	15.42	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

	2017 %	2016 %
As a percentage of shares and borrowings:		
(i) Gross capital	7.64	8.60
(ii) Free capital	6.44	7.28
(iii) Liquid assets	18.65	15.90
As a percentage of mean total assets:		
(i) Group profit after taxation	0.79	0.71
(ii) Group management expenses	2.61	2.73
(iii) Society management expenses	0.71	0.62
As a percentage of closing total assets:		
(i) Group profit after tax	0.75	0.68

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 available-for-sale reserve, cash flow hedging reserve, translation reserve, subordinated liabilities, subscribed capital and non-controlling interests, 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 2017 and 2016 total assets.

Management expenses represent administrative expenses.

3. Information relating to Directors at 31 December 2017

The Board of Directors at 31 December 2017, 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
M J Lund	1 July 1957	25 April 2016
R S D M Ndawula*	24 February 1974	23 February 2015
G E Picken	21 April 1949	17 January 2012
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 2017 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 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 Skipton Group Holdings Limited
J R Coates	Non-Executive Director	Police Mutual Assurance Society Limited Skipton Group Holdings Limited TPT Retirement Solutions

Other Information

D P Cockrem	Non-Executive Director	Good Energy Brynwhilach Solar Park Limited Good Energy Carloggas Solar Park (009) Limited Good Energy Cedar Windfarm Limited Good Energy Creathorne Farm Solar Park (003) Limited Good Energy Cross Road Plantation Solar Park (028) Limited Good Energy Delabole Windfarm Limited Good Energy Development (No.1) Limited Good Energy Development (No.3) Limited Good Energy Development (No.4) Limited Good Energy Development (No.5) Limited Good Energy Development (No.6) Limited Good Energy Development (No.7) Limited Good Energy Development (No.8) Limited Good Energy Development (No.9) Limited Good Energy Development (No.10) Limited Good Energy Development (No.12) Limited Good Energy Development (No.14) Limited Good Energy Development (No.15) Limited Good Energy Development (No.16) Limited Good Energy Development (No.17) Limited Good Energy Development (No.20) Limited Good Energy Development (No.21) Limited Good Energy Development (No.22) Limited Good Energy Development (No.24) Limited Good Energy Development (No.25) Limited Good Energy Development (No.26) Limited Good Energy Development (No.27) Limited Good Energy Development (No.28) Limited Good Energy Development (No.29) Limited Good Energy Development (No.30) Limited Good Energy Gas Limited Good Energy Generation Assets No. 1 Limited Good Energy Generation Limited Good Energy Group Plc Good Energy Hampole Windfarm Limited Good Energy Holding Company No. 1 Limited Good Energy Lanyon Solar Park (011) Limited Good Energy Limited Good Energy Lower End Farm Solar Park (026) Limited Good Energy Mapperton Solar Park (007) Limited Good Energy Rook Wood Solar Park (057) Limited Good Energy Tidal Limited Good Energy Woolbridge Solar Park (010) Limited Homegrown Energy Limited Llangyfelach Community Solar Farm C.I.C. Skipton Group Holdings Limited Worminster Down Somerset Community Solar Farm C.I.C.
I M Cornelius	Building Society Commercial Director	BCHT Development Company Limited Giggleswick School Incommunities Group Limited Skipton Group Holdings Limited Skipton International Limited Skipton Trustees Limited

D J Cutter	Building Society Group Chief Executive	Bailey Computer Services Limited Connells Limited Craven Educational Trust Leeds Share Shop Limited Malsis School Trust 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 Moneytopia Bank Limited 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
M J Lund	Non-Executive Director	Adam & Company Group Public Limited Company Adam & Company Public Limited Company 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
G E Picken	Non-Executive Director	Connells Limited Skipton Group Holdings Limited
H C Stevenson	Non-Executive Director	Henley Business School NHW Consultancy Limited One Smart Star UK Limited Skipton Group Holdings Limited St Ives Plc The Wellington College International Limited Trinity Mirror Plc

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.

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.
Delinquency	A debt or financial obligation is considered to be in a state of delinquency when payments are overdue.
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 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.
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.
Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England and HM Treasury in August 2012 which provided funding to participating banks and building societies with the aim of stimulating lending within the economy.
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, available-for-sale reserve, cash flow hedging reserve, subscribed capital, subordinated liabilities and non-controlling interests.
Help to Buy	A government-backed scheme in the UK that aims to help first time buyers, whereby the Government effectively provides an equity loan to assist the purchase of new-build properties.
Impaired loans	Loans where the Group expects to collect the contractual cash flows later than they are contractually due.
Individually / collectively assessed	Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.
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 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.
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.

Glossary *(continued)*

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.
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.
Subordinated debt / liabilities	A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors and investing members (other than holders of PIBS).
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 regulated subordinated liabilities and 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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