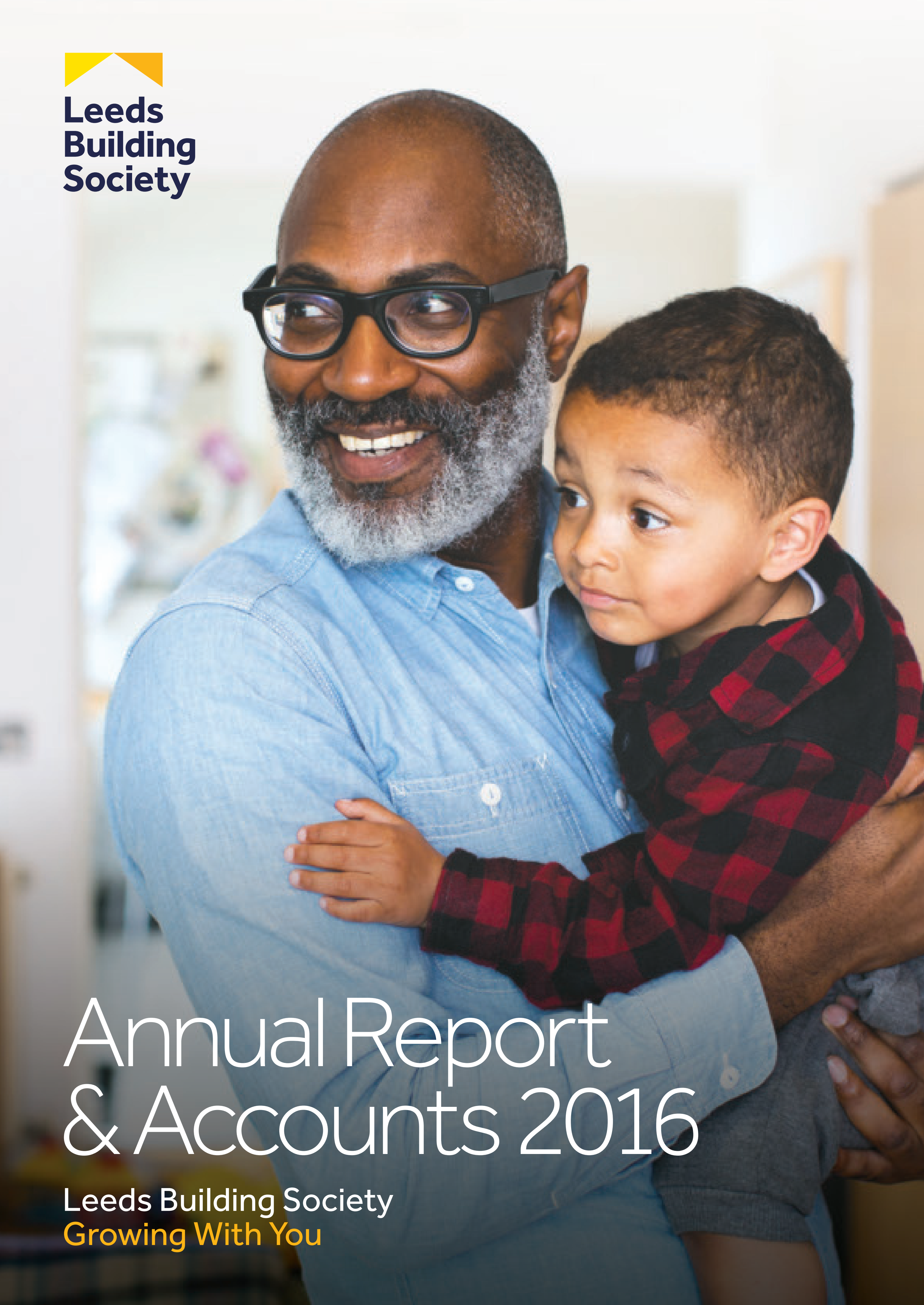


Leeds Building Society

Annual Report & Accounts 2016

Leeds Building Society
Growing With You

2016: a year in review

Gross residential lending exceeded
£4.0bn
(2015: £3.1bn)

We helped **53,700** more people have the home they want.

We paid an average of
1.66%
to our savers compared to the rest of market average of 0.97%

An annual benefit to all our savers of over **£69m**.

Record savings balances up 13% to
£11.2bn
(2015: £9.9bn)

We've helped **57,700** more people save for their future.

Total assets up 17.9% to
£15.9bn
(2015: £13.5bn)

Pre-tax profit up 7% to
£116.6m
(2015: £108.5m)

Common Equity Tier 1 Capital is
15.2%
(2015: 15.5%)

Reserves available to protect us from future problems.

Customer satisfaction up 1% to
92%
(2015: 91%)

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

Leeds Building Society

Colleague engagement score up 2% to
78%
(2015: 76%)

We're committed to being a great place to work.

Contents

Board of Directors
Robin Ashton
(Chairman)
Peter Hill
(Chief Executive Officer)
Philippa Brown
Susan Cooklin
Richard Fearon
David Fisher
Andrew Greenwood
Gareth Hoskin
John Hunt
Philip Jenks
Robin Litten
Les Platts
Karen Wint

Chairman's Statement

Year ended
31 December 2016

Leeds Building Society continued to perform strongly in 2016, despite economic and political uncertainty both here and abroad. Our success in attracting new members and savings balances, and increasing our mortgage lending, all records for the Society, is testament to the value, security and service we provide.

Our strong and sustained lending growth, combined with reduced losses from historical lending activity, has resulted in a record profit of £116.6m. This means we are able to carry on investing in system and service improvements to enable colleagues to continue to meet our members' changing needs.

Economic background

Despite the uncertainty and market volatility caused by the result of the EU referendum, the UK's economic growth remained resilient, with latest market data pointing to only a modest slowdown in economic activity[i].

Globally however, the picture remains mixed. In December 2016, the US Federal Reserve increased interest rates for only the second time in a decade, citing stronger economic growth and rising employment. In contrast, the European Central Bank extended its financial stimulus programme in an attempt to boost economic growth in the Eurozone.

Following the referendum, the Bank of England announced a package of measures including reducing Bank Base Rate to a new historic low of 0.25%, launching the Term Funding Scheme and expanding its asset purchase scheme for UK government bonds by £60 billion. Indicators of UK economic activity and business sentiment recovered from the lows experienced immediately after the EU referendum. Unemployment levels remained at 4.8% in the three months to December[ii] and Gross Domestic Product growth was 2% in 2016[iii]. However, the Bank's Financial Policy Committee warned the outlook remains challenging.

The decline in the value of sterling during the second half of 2016 is expected to exert upward pressure on inflation, which rose to 1.8% in the year to January[iv], reaching its highest level since June 2014.

Gross mortgage lending in the UK was £245bn[v] for the 12 months to December 2016, up 11% year-on-year. The pace of house price inflation slowed in 2016 but remains positive. Halifax's House Price Index grew 6.5% compared to 9.5% in 2015[vi].

Competition within the mortgage market has continued to intensify, resulting in a reduction in the average new mortgage rate. Market rates paid to savers have also fallen – however, on average we pay 0.69%[vii] more to savers than our competitors.

i. Source: Office for National Statistics – 2016 GDP 2.0% vs. 2015 GDP 2.2%
ii. Source: Office for National Statistics – ILO Unemployment rate October-December 2016
iii. Source: Office for National Statistics – Q4 2016 q4-on-q4 annual growth rate was 2.0%
iv. Source: Office for National Statistics – CPI inflation
v. Source: Council for Mortgage Lenders – Gross mortgage lending estimate for the 12 months up to December 2016
vi. Source: Halifax HPI, December 2016
vii. Source: CACI CSDB, Stock, January – November 2016. CACI is an independent company that provides financial services benchmarking data and covers 85% of the high street cash savings market.

Regulation and industry developments

The regulatory agenda continues to evolve from both a conduct and prudential perspective. At the start of 2016, we implemented the Financial Conduct Authority's (FCA) Senior Managers' Regime, which aims to raise standards of governance and increase individual accountability in the banking sector. The Mortgage Credit Directive came into effect in March and introduced a framework of conduct rules across the European Union.

The FCA is now conducting an in-depth mortgage market study to determine whether borrowers have access to the right tools to be able to make effective decisions, with interim findings expected this summer and a final report due in early 2018. We will continue to monitor any developments.

In December 2016, the FCA's guidance following its cash savings market study became effective. This is designed to improve the way the market works for savers and I am pleased that many elements of our existing approach were recommended as best practice.

The Prudential Regulation Authority issued its final policy statement requiring stricter affordability assessments for buy to let mortgages and the Society had all necessary changes operating in advance of the rules coming into effect at the beginning of this year.

Board composition and corporate governance

To continue the Society's success we make sure we have the appropriate skills and expertise to run the business in the long term best interests of our members.

Richard Fearon joined the Board as Chief Commercial Officer in February 2016 and is responsible for product development, marketing and brand, digital, customer insight and distribution. His input and knowledge of the savings and mortgage markets has been invaluable as we continue to support our members.

In line with best practice recommended by the UK Corporate Governance Code, all directors are subject to election or re-election each year. A summary of their details can be found on pages 42 and 43. I ask you to support the nominations.

Susan Cooklin will retire from the Board at the AGM following promotion and an increase in the responsibilities of her executive role. Susan, who is a member of the Audit Committee, has served as a non executive director for three years and I would like to thank her for the valuable contribution she has made to the Society during her time on the Board.

Our Chief Executive Officer, Peter Hill, has done an excellent job of representing UK mortgage lenders as Chairman of the Council of Mortgage Lenders. I am pleased to report he will continue in this role until the new Financial Services Trade Association is formed later this year.

In accordance with EU audit reforms, and as explained in the 2015 Annual Report and Accounts, we placed our external audit engagement out to tender. Following a rigorous process, the Audit Committee made a recommendation to the October Board meeting that Deloitte LLP be reappointed. The Board agreed and this is being proposed to members at the April 2017 Annual General Meeting.

Summary

We do not expect the economic environment to get any easier in 2017. Interest rates are likely to remain low and there will be continued uncertainty around the process for leaving the European Union.

Nonetheless your Society remains in a very strong position and we will continue to focus on meeting the needs of our members, growing sustainably and investing in our long term future. Members will remain at the centre of everything we do and our skilled and dedicated colleagues will continue to deliver outstanding personal service. On behalf of the Board, I would like to thank them all for their passion and commitment.

Finally I would like to thank you, our members, for choosing to be part of a successful and independent building society.

Robin Ashton
Chairman

21 February 2017

Chief Executive Officer's Review

Year ended
31 December 2016

2016 key highlights:

Supporting the aspirations of borrowers and savers

- Helped a record 53,700 more people have the home they want – total mortgage balances now exceed £13.2bn
- Helped over 57,700 more people save for their future – total savings balances now exceed £11.2bn
- Total membership now more than 756,000, the highest in our history

Continuing financial security

- Savings balances increased by £1.3bn, the highest in our history
- Record net mortgage lending of £1.9bn
- Losses and charges reduced by £27.2m to £3.5m
- Record profit before tax of £116.6m
- Our Common Equity Tier 1 capital ratio of 15.2% continues to demonstrate strong financial security

Delivering outstanding personal service

- Independent member surveys show overall customer satisfaction improved to 92%
- Our colleagues deliver outstanding service to members and score highly for engagement, which increased to 78% in 2016
- Retained our 1* Best Companies rating, highlighting the Society as an 'employer of choice'

Investing in the Society

- Created 120 more high quality roles in 2016, taking the total workforce to over 1,420
- Launched Corporate Responsibility Framework and published targets for the first time
- Refurbished 24 branches as part of our ongoing programme to modernise our branch network

I'm once again very proud to report that we've delivered on our mission as a member-owned building society and helped more people than ever save and have the home they want.

Throughout 2016, we consistently provided security and value through attractive products and excellent service to meet the expectations and needs of our growing membership, who remain at the centre of everything we do.

As a result, your Society now has more savers and borrowers than at any time in its history, and total assets now exceed £15.9bn. We'll carry on growing responsibly and sustainably and investing for the long term benefit of the business.

We're committed to delivering our Vision, to be 'Britain's most successful building society', which is built on our four pillars, and I'm pleased that we've made excellent progress against all of these in 2016.

Supporting the aspirations of borrowers and savers

In August, the Bank of England reduced Base Rate to a new historic low of 0.25%, from 0.5%, where it had been for over seven years. Our role is to balance the needs of all our members and whilst the prevailing interest rate environment has benefited borrowers, we've taken a number of actions to help savers.

We paid an average of 1.66% to our savers compared to the rest of market average of 0.97%, which equates to an annual benefit to our savers of over £69m[i]. Our consistent approach to supporting savers was recognised with the 'Best Building Society Savings Provider' award for 2016 from the independent comparison site Moneyfacts. In addition, we were named 'Best Regular Savings Account Provider 2016' for the second consecutive year by the independent consumer advice website Savings Champion.

Furthermore, we pay a minimum of 0.4% to all our saving members[ii], 0.15% higher than the current Base Rate and, because of all the actions we've taken, balances are now over £11.2bn, their highest-ever level.

In 2016, we increased our market share[iii] of savings and grew deposits by more than £1bn for the first time. Our success at attracting funds means we've been able to keep growing our mortgage lending. We also increased our mortgage market share for the sixth consecutive year and lent more than £4bn, an increase of 28% compared to a year earlier, helping a record 53,700 more people have the home they want.

We remained focused on helping borrowers who are not well served by the wider market, by supporting first time buyers, Shared Ownership, Affordable Housing, Help to Buy and Interest Only. During the year, we lent over £1.42bn in these key segments and helped over 17,500 people, including 12,500 first time buyers, who might otherwise have found it more difficult to have the home they want.

Combining this with our mainstream and Buy to Let lending, our record mortgage performance in 2016 was achieved across a balanced product range.

Our support for borrowers was recognised again, with the 'Innovation in Personal Finance' award from Moneyfacts, for our Interest Only offering, and the 'Best Shared Ownership Mortgage Lender' award from What Mortgage magazine.

Continuing financial security

Our strong and sustainable mortgage growth over the past five years, combined with a reduction in impairment provisions, led to a record profit performance of £116.6m.

This enabled us to maintain strong Common Equity Tier 1 and Leverage Ratios of 15.2% and 5.2% respectively and increase reserves to a record £874.3m. So we're well-placed to withstand economic uncertainty, continue to protect our members' money and keep on growing.

i. Source: CACI CSDB, Stock, January – November 2016. CACI is an independent company that provides financial services benchmarking data and covers 85% of the high street cash savings market
ii. As long as the account is operated in line with the Terms and Conditions
iii. Leeds Building Society defines market share as follows:
Mortgages – Council of Mortgage Lenders market share statistics
Savings – Mutual sector net retail savings as published by the Building Societies Association
iv. 1.5% or more of outstanding mortgage balances

The resilient UK economy resulted in fewer borrowers experiencing financial difficulty and residential arrears[iv] reduced from 1.43% in 2015 to 1.02% in 2016. We continued to manage down our commercial lending portfolio. Total losses and charges reduced by £27.2m in 2016 to £3.5m. Thanks to our strong financial performance, the Society was able to maintain strong credit ratings (long term 'A' ratings from Moody's and Fitch).

Competition among mortgage lenders remained strong in 2016, resulting in downward pressure on our net interest margin, which we expect to continue in 2017. This, combined with Bank Base Rate at a historic low and uncertainty following the decision to leave the EU, looks set to make 2017 more challenging.

Delivering outstanding personal service

Listening to our members and understanding what they want from their Society helps us make the right decisions in the long term best interests of current and future members.

We've launched a Customer Closeness Programme for our Senior Leadership Team to gain a detailed insight into our members' experience when they interact with the Society. Our online members' forum, TalkingPoint, now has over 1,900 contributors taking part in regular research and discussions.

We ask our members how we can improve, and your feedback has helped us redesign our postal and email customer communication to be clearer, more straightforward and jargon-free and we've made the process simpler when changing account details.

We've reduced the time between mortgage application and offer, so people can be in their home sooner, and 92% of all customer instructions are processed on the day they're received. We carry out regular independent member surveys and overall customer satisfaction improved to 92%[v].

I'd like to thank all my colleagues for their passion and commitment – regular surveys show they're highly engaged and for the second year running we've achieved accreditation from Best Companies, which is an industry accolade for employers.

We're also the first financial services organisation to achieve Investors in Diversity status, which further promotes Leeds Building Society as an 'employer of choice'.

Investing in the business

We've delivered record growth in recent years and, to support this, have continued to invest in talent, skills and infrastructure.

During 2016, we created 120 career opportunities and now employ over 1,420 colleagues. We moved our North East processing centre to a new, energy-efficient building, with more room for our larger workforce.

Branches play an important role in attracting the retail savings that enable us to grow mortgage lending. We've started a carefully considered cost-effective refurbishment programme of our network, which will be completed this year, creating a modern, more comfortable environment for members. As part of this, we'll significantly reduce our impact on the environment by using energy-efficient technology.

We'll continue to adapt so our branch network remains relevant and in appropriate locations to meet the ever-changing needs of our members. We're also developing our online account opening process to ensure members can contact us how and when they want – whether by phone, in branch, online, email or by post.

This investment means our cost to income ratio increased to 43% from 36% a year earlier but we maintained our cost to mean asset ratio at 0.62%. Our investment to deliver the products and service you expect from your Society includes a keen focus on cost control and we expect these ratios to remain amongst the best in the building society sector.

We also launched our new Corporate Responsibility Framework in 2016 and published targets for the first time. The Framework shows how we operate responsibly and sustainably for the long term benefit of our members, colleagues, communities and the environment. Our published targets help us plan how we can continue to do the right thing and show what progress we're making.

Outlook

Leeds Building Society has again delivered strong results and helped a record number of people save and have the home they want. We've done this by focusing on meeting our members' needs and membership numbers, savings and mortgage balances, profit and capital are all at the highest levels in our history.

We expect Bank Base Rate to remain low this year and competition to intensify in our core markets. Despite this, and the economic uncertainty surrounding the UK's exit from the EU, our successful sustainable business model means we're well-placed to deal with the challenges that may arise in 2017 and beyond.

We remain committed to investing in the long term interests of our members and further growing the Society by delivering value, security and outstanding service.

Thank you for your continued support.

Peter Hill
Chief Executive Officer
21 February 2017

v. Customer Satisfaction rating based on the views of 4,649 customers

We remain committed to investing in the long term interests of our members and further growing the Society by delivering value, security and outstanding service.

Strategic Report

Year ended
31 December 2016

The Strategic Report reviews the Society's mission, business model and strategy, together with its performance in 2016 and future outlook.

Business Model

Leeds Building Society is the fifth largest building society in the UK, with assets of £15.9 billion. As a member-owned mutual, the Society's mission is to help people save and have the home they want. This is delivered using a straightforward business model:

The Society borrows from savers via:
Branch
Online
Post

Building societies fund the majority of mortgage lending with members' savings. The Society offers products through a network of 62 branches, by phone, post and online.

The Society aims to increase the recognition of its brand and reach in younger demographics.

A range of competitive products is offered to over half a million saving members which offer long term value when compared to the wider savings market.

As well as:
Raising long term, stable and diverse funds from the wholesale markets.

The balance of funding required for lending and maintaining an appropriate level of liquidity is obtained from the wholesale money markets. The amount of wholesale funding the Society receives varies on a daily basis, and is typically managed to around a fifth of total funding.

The Society has a long term 'A' credit rating, which is amongst the strongest in the sector. This allows the Society to access wholesale funds on competitive terms and across a number of instruments and durations.

And lends to mortgage borrowers:
Vanilla residential mortgages
First time buyers
Shared ownership
Buy to let

The Society provides mortgages secured on residential property including for shared ownership and buy to let purposes.

Mortgage business is sourced through a network of approved mortgage brokers, as well as via the branch network, online and direct telephone services.

The Society has total mortgage assets of £13.2 billion and a prudent approach to credit risk is reflected in the overall weighted indexed loan to value on the mortgage portfolio being 56%.

Lending across a number of segments allows the Society to manage credit risk across the whole mortgage portfolio whilst achieving appropriate margins.

The Society's approach to business delivers member value

- A strong capital base is maintained to ensure long term security for members. A prudent approach to lending helps ensure the Society can meet the necessary capital requirements.
- Competitive products are offered with savings rates that are currently higher than the market average.
- The highest standards of trust and integrity are observed in all our engagement with members. This, along with competitive products and investment in the Society, helps build member satisfaction and strong long term relationships with members.
- Families and first time buyers are helped to purchase homes through competitive products. A focus on customer needs means the Society can lend to borrowers in smaller segments which are typically less well served by other banks and building societies (but not expose itself to too much risk).
- High levels of customer service are maintained and the customer lies at the centre of the Society's operational processes with a single contact point delivered where possible.

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

Remaining financially stable by:
Maintaining liquid investments with strong credit rated institutions and central banks.

The Society maintains a portfolio of liquid investments, used to ensure there is sufficient cash available to meet the requirements of savers, investors and other creditors.

Assets are invested conservatively, in a range of high quality investment instruments, in a spread of counterparties.

The Society also retains access to contingent liquidity facilities to help ensure sufficient liquidity is held at all times in excess of regulatory requirements.

Investing to:
Continually improve the products and services we offer to help existing members and attract new ones.

The Society is investing in its digital capability so that savers can access products more easily and manage savings through the internet and mobile devices, as well as through traditional channels. The mortgage application process is being streamlined for brokers and customers.

A strong focus on customer experience and digital channels will help the Society attract new saving and mortgage members.

And is financially secure:
Making sufficient profit to maintain a strong capital base.

The Society aims to generate sufficient profit to maintain a strong capital position, so it can continue to grow, invest and enhance its customer proposition.

This requires a strong focus on cost efficiency and management of the net interest margin. This means the Society can price competitively to provide value to existing members, while attracting new borrowers and savers.

Society values

Society values explain the behaviours all colleagues are expected to display in everything they do, underpinning delivery of the Society's business model and strategy. They are as follows:

Collaborative – nurturing positive relationships

Straightforward – doing the right thing

Progressive – always moving forward

Integrity – trusted custodians

Passionate – determined to succeed

Responsible – taking personal ownership

Strategic priorities

The Society has a vision of becoming Britain's most successful building society and focuses on four strategic pillars. 2016 has been a year of very good progress, the key areas are highlighted below.

Strategic pillars	How this is delivered	Progress in 2016
Customer focused To support the aspirations of a wide range of borrowers and savers, in particular those who are not well served by the wider market.	The Society has been a mutual organisation for over 140 years, which means customers are also members. The Society does not have the distraction of separate shareholders and is able to have a customer centric focus on everything it does. Competitive products are developed which meet customer needs. The Society's flexible systems and risk management capabilities are used to meet customer needs in areas which have historically been undeserved, while competitive savings products offer members long term value.	• Savings rates in the market reduced further in 2016, yet the Society continued to offer a compelling product proposition and was able to pay higher savings rates than the market average. Savings balances increased to a record level. • The Society has refreshed its internal programme to put the customer at the heart of everything it does. This will help provide a good customer experience for all members. • The customer complaint process was fully reviewed and a number of enhancements made. These changes reduced the time taken to respond to complaints and aim to satisfy our customers. • Gross mortgage lending was a record £4.0bn and was above our natural market share.
Secure To generate strong levels of profit which are retained in the business to build a solid platform for growth.	The Society is well capitalised and retains capital and leverage ratios in excess of the regulatory minima. This provides the Society with the resources to grow mortgage lending, invest and meet future regulatory changes, whilst maintaining a secure Society for members. Risks are managed through investing in resources and technology. The Society continues to develop Internal Ratings Based (IRB) capabilities for the assessment and management of credit risk for residential mortgages. Legacy portfolios are proactively managed to reduce the credit risk associated with these loans.	• A strong profit performance has provided capital to grow. The Society maintained strong CET1 and leverage ratios as the Society increased lending in low risk residential loans. The Society's capital management plans incorporate the PRA's latest policies. • The Senior Managers Regime came in to being in early 2016. The Society was well prepared for these changes and these are fully embedded in its risk and control processes.
Service driven To deliver outstanding personal service to all our members.	Strong relationships exist with the Society's approved network of mortgage brokers. Competitive products and a dedicated relationship management team help to deliver an industry leading broker experience. Customer centric processes are being developed, supported by flexible systems, so that members can engage with the Society across their chosen method of communication: web, email, smartphone, telephone or mail. Outstanding personal service is delivered by over 1,400 highly engaged colleagues employed by the Society.	• Colleague engagement and leadership scores continued to be in the top quartile for the financial services industry. The Society again participated in the Best Companies survey and retained its one star award. • Over 120 new roles were created across the Society in 2016 as it continued to grow and invest. • Work is progressing on a programme to maintain resilient IT systems and mitigate the risks associated with developing cyber threats.
Efficient To continue to reinvest in the business to improve efficiency, whilst being intolerant of waste.	The Society maintains a resilient and scalable core administration system platform on which future developments can be made. The investment programme over recent years increased capacity and capability across the Society. This enables growth, whilst meeting the requirements associated with a highly regulated business.	• The Society has established a continuous improvement team to lead initiatives, to deliver efficiencies in customer administration processing. These efficiencies include: – A reduction in the number of days to issue mortgage offers. – An increase in customer administration being processed the same day. – A number of technology system development projects have continued which, when delivered, will provide further improvements to how customers interact with the Society.

Key performance indicators

Performance is measured against a number of key performance indicators, shown below.

KPI (strategic pillar)	What is measured	Performance	2016 update
New residential lending (Customer focused)	The value of residential lending advanced by the Society during the year, including loans for house purchases, further advances and remortgages.	**2016** £4.0bn **2015** £3.1bn **2014** £2.7bn **2013** £2.2bn **2012** £1.7bn	The Society's strong product proposition in a favourable mortgage market led to record gross lending of £4.0 billion. Gross lending was significantly above the Society's market share[i].
Net residential lending (Customer focused)	Gross residential lending, less repayments of principal and redemptions. This represents the change in residential mortgage balances outstanding.	**2016** £1.9bn **2015** £1.4bn **2014** £1.1bn **2013** £1.0bn **2012** £0.7bn	Redemptions as a proportion of the mortgage book were level with the previous year. A strong performance in gross lending helped deliver record net lending growth of £1.9 billion, an increase of 35%.
Savings balances (Customer focused)	The value of shares and deposits held by the Society's members and other customers.	**2016** £11.2bn **2015** £9.9bn **2014** £9.2bn **2013** £8.6bn **2012** £7.7bn	The Society continued to offer a compelling range of savings products which helped increase balances to £11.2 billion, paying on average a rate of 1.66%, compared to the market average of 0.97%.
Change in membership (Customer focused)	The number of Society members. Increasing the number of members is part of achieving the Society's vision.	**2016** 756,000 **2015** 719,000 **2014** 697,000 **2013** 690,000 **2012** 675,000	The strong performance on new lending and the increase on savings balances resulted in membership rising to a record 756,000.
Operating profit (Secure)	Represents profit before tax, creating capital to support future business growth.	**2016** £116.6m **2015** £108.5m **2014** £80.9m **2013** £64.2m **2012** £54.6m	A reduction in net interest income and an increase in management expenses were more than offset by a reduction in impairment provisions. This strong profit provided additional capital to fund increased lending.
Net interest margin (Secure)	The difference between interest received on assets and interest paid on liabilities, measured as a percentage of mean assets. This is the Society's main source of income.	**2016** 1.37% **2015** 1.62% **2014** 1.58% **2013** 1.52% **2012** 1.32%	The net interest margin for the year was 137 bps, a decrease of 25 bps compared to the previous year. This results from lower margins on new business and more customer retention activity.

i Leeds Building Society defines market share as follows:
Mortgages – Council of Mortgage Lenders market share statistics.
Savings – Mutual sector net retail savings as published by the Building Societies Association.

Year ended
31 December 2016

Continued

KPI (strategic pillar)	What is measured	Performance	2016 update
Liquidity Coverage Ratio (LCR) (Secure)	LCR is a measure of liquid assets which can be converted to cash to meet cash outflows in the event of a stress scenario. The Society is required to maintain a minimum of 100% to meet the regulatory minimum set by the Bank of England.	**2016** 179% **2015** 194% **2014** 196% **2013** **2012**	The Society maintained a strong level of liquidity which is in excess of the regulatory minimum. The Society continues to balance the need to hold liquidity in excess of the regulatory minimum and the cost associated with this.
Common Equity Tier 1 ratio (Secure)	The highest quality form of capital that mainly comprises retained earnings and other reserves as a proportion of Risk Weighted Assets. This is measured to ensure the Society retains an excess over the regulatory minimum.	**2016** 15.2% **2015** 15.5% **2014** 15.6% **2013** 14.5% **2012** 14.4%	The CET1 ratio has decreased to 15.2% during 2016. This reflects the increase in Risk Weighted Assets associated with the increase in lending, partly offset by the increase in retained profit.
Credit ratings (Secure)	The creditworthiness ratings assigned to the Society by Moody's and Fitch. Credit ratings are assigned following detailed analysis and can impact the amount the Society pays for new funding.	**Moody's:** Long term: A2 (2015:A2) Short term: P1 (2015: P1) **Fitch:** Long term: A- (2015: A-) Short term: F1 (2015: F1)	The ratings from Moody's and Fitch remained unchanged. Following Brexit, Moody's placed the Society on negative outlook along with a number of other UK banks and building societies. The Society has a strong, long term 'A' credit rating which is amongst the strongest in the sector.
Number of days from mortgage application to offer (Service driven)	The number of days it takes to provide a mortgage offer after an application is received. Efforts are being made to reduce the time taken to process offers and an internal target of 13 days has been set.	**2016** 9 **2015** 12 **2014** 13 **2013** 16 **2012**	The further reduction is due to improvements in systems and processes and highlights the Society's commitment to appropriately streamlined processes.
% of customer administration processing completed on the same day (Service driven)	The percentage of customer instructions received and processed on the same day. The target of 90% reflects the expected mix of processing activities.	**2016** 92% **2015** 86% **2014** 89% **2013** 84% **2012** 88%	The continued improvement reflects the Society's investment in customer service capacity and capability.
Customer satisfaction (Service driven)	The percentage of customers surveyed who described themselves as quite, very or extremely satisfied with the service received from the Society.	**2016** 92% **2015** 91% **2014** 92% **2013** 93% **2012** 96%	Customer satisfaction remained high and continues to benchmark favourably against other financial services organisations.

> "Colleague engagement increased during the year which is pleasing given the pressure on colleagues from high business volumes and the pace of business change. The score continues to be within the top quartile for financial services organisations."

KPI (strategic pillar)	What is measured	Performance	2016 update
Colleague engagement score (Service driven)	Colleague engagement is measured annually across all colleagues. Society goals are delivered by highly engaged colleagues.	**2016** 78% **2015** 76% **2014** 76% **2013** 70% **2012** 75%	Colleague engagement increased during the year which is pleasing given the pressure on colleagues from high business volumes and the pace of business change. The score continues to be within the top quartile for financial services organisations.
Cost to income ratio (Efficient)	A cost efficiency ratio which measures costs in relation to the Society's income. It is calculated as the percentage of the Society's total income spent on administrative expenses and depreciation and amortisation.	**2016** 43.3% **2015** 36.4% **2014** 33.4% **2013** 31.1% **2012** 33.1%	A combination of increased management expenses, arising from the Society's investment in capability and capacity, and a reduction in income caused the ratio to increase to 43.3%.
Cost to mean assets ratio (Efficient)	A further cost efficiency ratio which measures costs in relation to the Society's total assets. It is calculated as administrative expenses plus depreciation and amortisation divided by the average total assets.	**2016** 0.62% **2015** 0.62% **2014** 0.57% **2013** 0.52% **2012** 0.49%	The ratio remains at 0.62% reflecting the increase in management expenses, offset by the increased size of the Society balance sheet. The Society maintains a strong focus on cost management.
Colleague turnover (Efficient)	The proportion of colleagues who leave the Society during the year. The Society seeks to attract and retain the best people to deliver its goals.	**2016** 15% **2015** 14% **2014** 17% **2013** 19% **2012** 17%	Colleague turnover remains within the Society's internal target. High colleague engagement and development opportunities for colleagues are helping to ensure the Society remains an employer of choice.

Strategic Report

Year ended
31 December 2016

Continued

Income statement overview

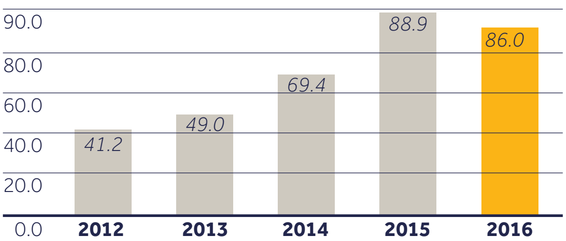
The income statement summary for the year is set out below:

	2016 £m	2015 £m	Change
Net interest income	201.8	207.5	(3%)
Fees, commissions and other income	11.5	12.3	(7%)
Fair value gains less losses	(1.3)	(0.9)	44%
Total income	**212.0**	**218.9**	**(3%)**
Management expenses	(91.9)	(79.7)	15%
Impairment losses and provisions	(3.5)	(30.7)	(89%)
Profit before tax	**116.6**	**108.5**	**7%**
Tax expense	(30.6)	(19.6)	56%
Profit for the financial year	**86.0**	**88.9**	**(3%)**

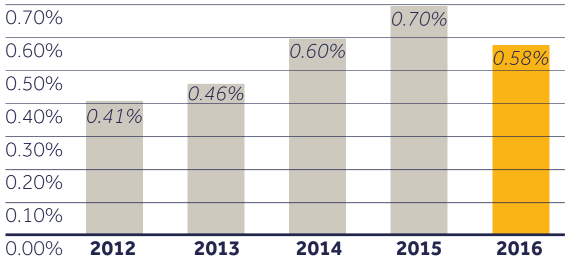
The record pre-tax profit of £116.6m in 2016 included the expected reduction in net interest income driven by reduced margins on lending, offset partly by a further reduction in the Society's funding costs. Management expenses increased as the Society has continued to invest in the business. The losses realised during the year were adequately covered by provisions which led to a significant reduction in the charge for impairment losses and provisions.

The Society's profit after tax for 2016 was £86.0 million, down 3% compared to the previous year (2015: £88.9 million). Profit after tax as a percentage of mean assets reduced due to the lower net interest margin and an increase in the tax charge.

Profit after tax £m



Profit after tax as % of mean assets



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

Net interest income

The net interest income summary for the year is set out below:

	2016 £m	2015 £m	Change
Net interest income	201.8	207.5	(3%)
Mean assets	14,718	12,819	15%
	%	**%**	**Change**
Net interest margin (NIM)	1.37	1.62	(0.25)

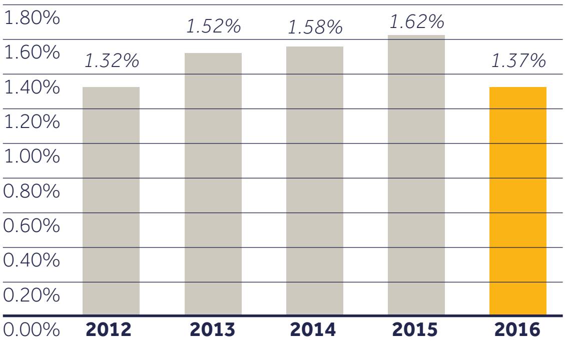
Net interest income for the year was £201.8 million, a decrease of 3% compared to the previous year (2015: £207.5 million) as a result of reduced margins on new lending and more customer retention activity, partially offset by growth in net residential lending and a reduction in the cost of funding. The net interest margin reduced to 1.37% (2015: 1.62%). Net interest income is the Society's main source of income. The Society continues to balance the need to offer competitive rates to new and existing borrowers and savers.

"The Society remained competitive compared to the overall savings market. On average the Society paid 1.66% (2015: 1.78%) on its savings range, compared to the market average of 0.97% (2015: 1.20%)."

The key features of the decrease in net interest income in 2016 are:

- Low interest rates and increased competition have reduced margins on new lending and increased customer retention activity has reduced the margin on existing mortgage balances.
- Savings rates in the market reduced further during 2016 and the Society adjusted rates to manage retail funding requirements. Despite a reduction in the average savings rate, the Society increased savings balances by £1.3 billion, which resulted in a net increase in interest payable.
- The Society remained competitive compared to the overall savings market. On average the Society paid 1.66% (2015: 1.78%) on its savings range, compared to the market average of 0.97%[i] (2015: 1.20%). The Society's simple good value product proposition has led to retail savings balances increasing by a further £1.3 billion and there were 57,700 new savings members.
- Funding from wholesale markets increased by £0.9 billion to support the growth in lending and this resulted in an increase in interest payable.

Net interest income as % of mean assets



The trend of a reduction in net interest margin is expected to continue, with competition for mortgage products continuing and reduced scope to reduce already low savings rates.

Other income

This consists of income from mortgage related insurance products and other investment products, together with rental income and other ancillary fees.

In 2016, other income reduced to £11.5 million (2015: £12.3 million) due mainly to a reduction in commission on the general insurance and investment products. The Society has a number of third party partnerships and continues to develop new product propositions for members. During 2016 the Society launched a new probate service. There was also a reduction in rental income due to a disposal of an investment property in the previous year.

Management expenses

The management expenses summary for the year is set out below:

	2016 £m	2015 £m	Change
Colleague costs	53.9	44.8	20%
Other administrative expenses	34.8	32.2	8%
Depreciation and amortisation	3.2	2.7	19%
Total management expenses	**91.9**	**79.7**	**15%**
	%	**%**	**Change**
Cost / income ratio	43.3	36.4	6.9
Cost / mean asset ratio	0.62	0.62	–

Management expenses have grown over recent years as the Society has sought to balance the need to invest in the business, with the need to maintain a low cost base. Investment is helping the Society grow and meet the changing needs of our customers, in particular a move towards a more customer centric digital business, and the infrastructure required to operate in a highly regulated environment.

Management expenses in 2016 increased by 15% to £91.9 million (2015: £79.7 million). A combined result of the cost increases and reduced income has meant the cost to income ratio increased to 43% (2015: 36%). The cost to mean assets ratio was maintained at 0.62% (2015: 0.62%) as total assets grew in proportion to management expenses. Notwithstanding the cost increases, the Society's expense ratios remain among the lowest in the building society sector.

i CACI CSDB, Stock, January – November 2016, latest available data – CACI is an independent company that provides financial services benchmarking data and covers 85% of the high street cash savings market.

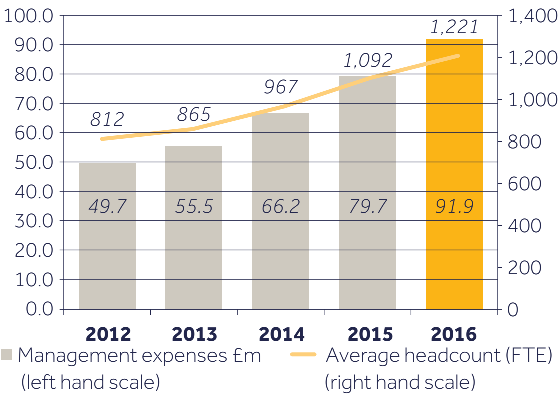
Year ended
31 December 2016

Continued

Colleague costs represent the main driver for the increase in administration expenses. The main features of the increase are the full year impact of additional people recruited in 2015, coupled with further increases in 2016 caused by:

- The continued growth in lending in 2016, as well as the full year impact of 2015's new lending, which required an increase in the Society's service capacity;
- Additional roles have been created in the IT Function to support the delivery of a number of system and digitisation projects, as well as ensuring we have adequate resources to ensure the Society maintains resilient technology systems and processes;
- Additional colleagues have joined the sales and marketing teams to provide insight into changing customer needs and the resultant new product development and distribution.

Management expenses and headcount £m



The sustained investment over recent years has supported the Society's growth and the capability added will help ensure it is well placed for the future though the rate of cost increase is expected to reduce.

Fair value gains less losses from derivative financial instruments

Fair value movements are changes in the value of certain assets and liabilities, mainly derivatives, to reflect their current market value. The movements are primarily due to timing differences, which will trend to zero as the asset or liability reaches maturity. Fair value changes in 2016 resulted in a loss of £1.3 million compared to a loss of £0.9 million in 2015.

Impairment losses and provisions

The impairment losses and provisions summary for the year is set out below:

	2016 £m	2015 £m	Change
Residential loans	(4.9)	(6.2)	(21%)
Commercial loans	5.8	(12.3)	–
Provisions charge	(3.9)	(8.8)	(56%)
Impairment losses on land and buildings	(0.5)	–	–
Investment property fair value movement	–	(3.4)	–
Total impairment losses and provisions	**(3.5)**	**(30.7)**	**(89%)**

The charge for impairment losses and provisions in the year was £3.5 million, a significant reduction compared to the previous year charge of £30.7 million, mainly due to the reduction in the impairment charge on the commercial loan portfolio and a decrease in the FSCS levy.

“Sustained improvements in the economy and continued low interest rates are the main drivers of an improvement in the arrears ratio.”

Residential lending

Sustained improvements in the economy and continued low interest rates are the main drivers of an improvement in the arrears ratio (measured as those either in possession or arrears of more than 1.5% of the balance), which reduced to 1.02% compared to 1.43% at the end of 2015. This, combined with increases in house prices caused total losses and impairment charges for residential loans to reduce to £4.9 million (2015: £6.2 million).

The Society has total balance sheet impairment provisions against residential mortgages of £26.0 million (2015: £25.9 million). The specific provision of £14.1 million as a percentage of loans in arrears and possession is 10.5% (2015: 9.3%).

Commercial lending

The Society does not make new commercial loans and is actively managing down the legacy commercial lending portfolio. The actions taken have reduced exposure to commercial loans to £125 million (2015: £194 million). Realised losses were lower than anticipated and consequently there was a credit of £5.8 million compared to a charge of £12.3 million in the previous year.

The Society has balance sheet impairment provisions against commercial mortgages of £25.7 million (2015: £36.0 million). The specific provision of £20.1 million as a percentage of impaired loans is 40% (2015: 43%). The negative equity in the portfolio remains fully covered by provisions.

Provisions charge

As a regulated deposit taker, the Society is a member of the Financial Services Compensation Scheme (FSCS), which compensates savers and investors for losses incurred when other institutions fail. The Society, in common with other building societies, raises a higher proportion of its funding from retail deposits and so pays a disproportionate share of any compensation paid by the FSCS.

During 2016 the FSCS charge reduced to £2.3 million (2015: £5.5 million) as the capital element levied in previous years was not repeated.

The charge relating to customer redress payments has decreased to £1.6 million (2015: £3.3 million). The charge reflects the expected cost of customer redress relating, for example, to an error on a small number of mortgages to which the incorrect interest rate was applied, as well as the ongoing volume of speculative cases (primarily relating to mortgage payment protection insurance claims) and the associated costs involved in dealing with them.

Taxation

The income tax expense of £30.6 million (2015: £19.6 million) represents 26% (2015: 18%) of the profit before tax and is in line with the prevailing rate of corporation tax. The effective tax rate has increased during the year due to the Government having introduced a surcharge to corporation tax paid by banks and building societies. This increase became effective in April 2016 and consequently a further small rise in the effective tax rate is expected next year as the Society will have a full year of the surcharge.

The Society has adopted the Code of Practice on Taxation for Banks and has established appropriate procedures, controls and oversight to ensure it meets its obligations under the Code. The Society manages its tax obligations to ensure full compliance with all statutory requirements and does not structure transactions to give a result which is contrary to the intentions of Parliament. The Society maintains an open and transparent relationship with HMRC. A Tax Policy has been agreed by the Audit Committee which provides a framework for the operation, planning and oversight of tax and tax risk to ensure compliance with relevant legislation. Updates are provided to the Audit Committee in line with the Tax Policy.

Year ended
31 December 2016

Continued

Balance sheet

Total balance sheet assets increased by 11% to £15.9 billion. This is a record for the Society, reflecting an increase in core residential lending.

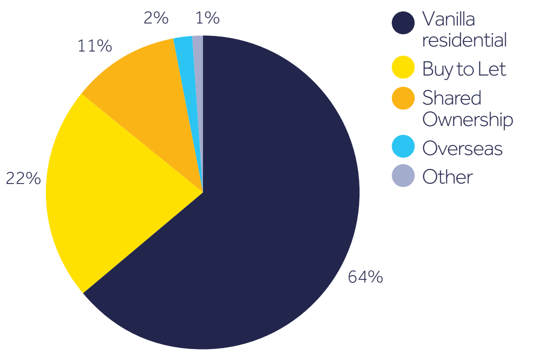
	2016 £m	2015 £m	Change
Residential loans	13,082	11,151	17%
Commercial loans	125	194	(36%)
Other loans and adjustments	325	263	24%
Impairment provision	(54)	(64)	(16%)
Loans and advances to customers	**13,478**	**11,544**	**17%**
Liquid assets	1,904	1,677	14%
Derivative financial instruments	263	105	150%
Fixed and other assets	285	181	57%
Total assets	**15,930**	**13,507**	**18%**

Asset quality			
Residential mortgages:	**%**	**%**	**Change**
Proportion of mortgages in arrears	1.02	1.43	(0.41)
Balance-weighted average indexed LTV of mortgage book	56.8	58.3	(1.5)
Balance-weighted average LTV of new lending	65.2	67.7	2.5
Commercial lending:	**£m**	**£m**	**Change**
Total commercial lending	125	194	(36%)
Impaired balances	50	56	(11%)
	%	**%**	
Total impairment as % of total balances	40	29	(13)

Residential lending

The majority of the Society's lending is residential, which includes prime owner-occupied properties, buy to let and shared ownership loans within the UK. Gross lending during the year was £4.0 billion, an increase of £0.9 billion compared to the previous year. The Society's share of new mortgage lending was 1.61% (2015: 1.43%), significantly higher than its natural market share of 0.94% (2015: 0.84%)[ii].

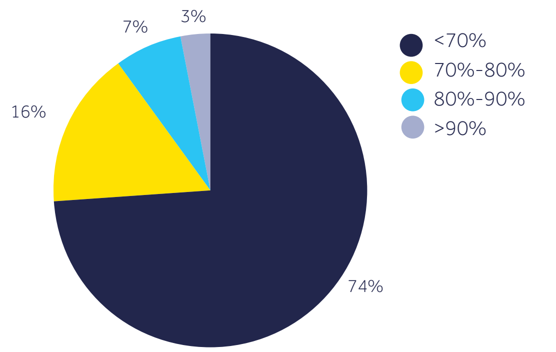
2016 UK residential mortgage balances by type



The Society's residential loans include some overseas balances relating to historic legacy lending activity. The Society is no longer active in these markets.

The rise in both gross and net lending reflects the Society's strategy of supporting a wide range of borrowers by taking advantage of the Society's funding capacity and strong capital position. This helps further strengthen its proposition for existing and future members.

2016 UK residential mortgage balances by LTV

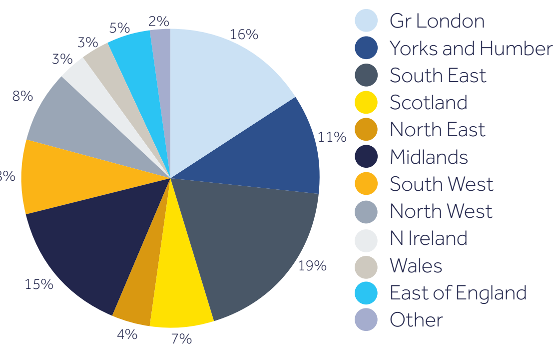


The Society has a conservative lending policy, which is reflected in the distribution of Loan to Value (LTV) ratios. The average LTV of new lending reduced to 65.2% (2015: 67.7%). The rise in UK house prices has continued in 2016. As a result, the weighted average indexed LTV of the mortgage portfolio has reduced to 56% (2015: 58%).

ii Leeds Building Society defines market share as follows:
Mortgages – Council of Mortgage Lenders market share statistics
Savings – Mutual sector net retail savings as published by the Building Societies Association

"The liquidity ratio has reduced over recent years as the Society has sought to manage this cost, whilst better matching the timing of fundraising with lending activities."

2016 UK residential mortgage balances by region

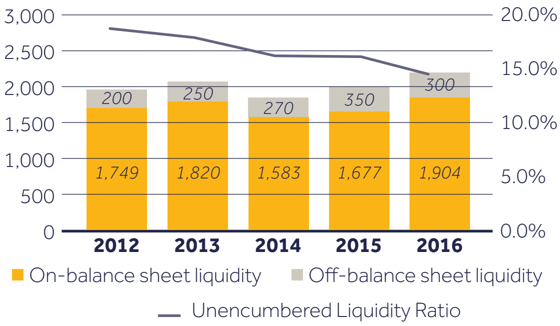


The portfolio is geographically diverse with the largest exposures in Yorkshire, London and the South East. This reflects the higher property prices in the South East and London areas and the higher lending volumes in the Society's heartland of Yorkshire.

Liquid assets

The Society holds liquid assets (principally cash and government debt) of an appropriate level and quality to ensure it can meet its financial obligations under both normal and stressed scenarios. Whilst there is a need to maintain sufficient liquidity at all times there is a cost of holding excess liquidity since earnings on liquid assets are typically lower than the cost of funding. On-balance sheet liquidity has reduced over recent years as the Society has sought to manage this cost, whilst better matching the timing of fundraising with lending activities. The Society's liquidity is made up of on-balance sheet liquid assets and instruments received as part of the Bank of England's Funding for Lending Scheme (FLS), which are off-balance sheet. During 2016 the Society maintained a level of liquidity in excess of the regulatory minimum.

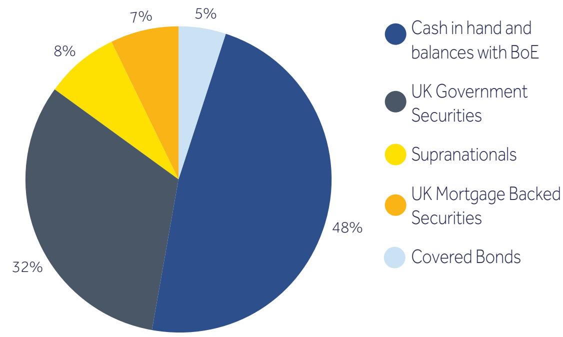
Liquidity £m / %



Total liquid assets at the end of 2016 were £2.2 billion compared to £2.1 billion at the end of 2015. This included £2.0 billion of Liquid Asset Buffer investments (2015: £1.9 billion), considered to be the highest quality investment instruments, readily realisable as cash when required. The credit quality of the liquid asset portfolio is high with 99% of assets rated 'A' or better (2015: 99%).

At 31 December 2016 the Society held £300 million (2015: £350 million) of drawn funding from the FLS. The Society also has access to additional liquidity through the Bank of England's Sterling Monetary Framework and the European Central Bank.

Liquidity portfolio 2016



The Prudential Regulation Authority (PRA) monitors liquidity under the CRD IV framework using two measures. The Liquidity Coverage Ratio (LCR) is a measure of short term liquidity and the Net Stable Funding Ratio (NSFR) is a measure of resilience over a longer horizon.

Based on the final LCR rules, the Society's LCR is 179% (2015: 194%), compared to the regulatory minimum of 100%.

In October 2014, the Basel Committee on Banking Supervision published its final NSFR standard with a minimum requirement of 100% to be introduced from 1 January 2018. Based on the Society's current interpretation, the NSFR is 131% (2015: 133%), compared to an expected regulatory minimum of 100%.

Year ended
31 December 2016

Continued

Liabilities

A summary of the Society's liabilities is below:

	2016 £m	2015 £m	Change
Shares	11,233	9,933	13%
Wholesale funding	3,401	2,531	34%
Derivative financial instruments	214	136	57%
Other liabilities	208	116	79%
Total liabilities	**15,056**	**12,716**	**18%**
Equity attributable to members	874	791	10%
Total liabilities and equity	**15,930**	**13,507**	**18%**
Key ratios	**%**	**%**	**Change**
LCR	179	194	(15%)
NSFR	131	133	(2%)
Wholesale funding ratio	21.7	20.3	1.4%
Total unencumbered liquidity	14.0	15.8	(1.8%)

Achieving an appropriate level, mix and duration of retail savings and wholesale funding is essential to ensure the Society has the necessary resources to meet its lending growth aspirations.

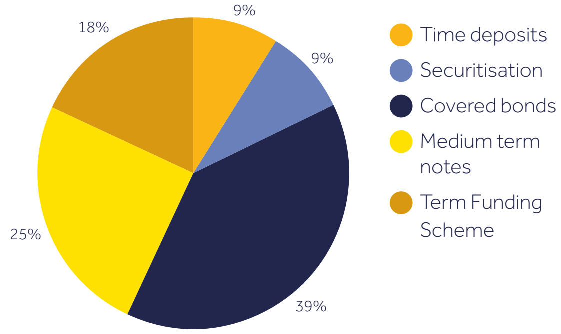
Shares

Savings balances increased by 13% to a record £11.2 billion (2015: £9.9 billion). This strong performance reflected the competitive savings rates the Society has continued to offer members.

Borrowings

The Society continues to access wholesale markets and has a portfolio of wholesale funding totalling £3.4 billion (2015: £2.5 billion). The Society benefited from favourable funding conditions in the first half of 2016 and raised a further €500 million under the Society's covered bond programme. The Bank of England responded to changes in wholesale market conditions by launching the Term Funding Scheme (TFS). The Society has drawn down a total of £550 million under the TFS. As a result, the Society's wholesale funding ratio increased to 21.7% (2015: 20.3%).

Wholesale funding portfolio 2016



The Society maintains strong credit ratings from two key agencies. The ratings from both Moody's and Fitch remained unchanged during 2016.

	Long Term	Short Term	Outlook
Moody's	A2	P-1	Negative
Fitch	A-	F1	Stable

Capital

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

	2016 £m	2015 £m	Change
Capital resources			
Common Equity Tier 1 (CET1) capital	871	783	11%
Additional Tier 1 capital	15	18	(17%)
Total Tier 1 capital	886	801	11%
Tier 2 capital	28	29	(3%)
Total regulatory capital resources	914	830	10%
Risk-weighted assets (RWAs)	5,731	5,046	14%
CRD IV capital ratios	**%**	**%**	**Change**
CET1 ratio	15.2	15.5	(0.3%)
Leverage ratio	5.2	5.5	(0.3%)

A strong capital position was maintained throughout the year with all capital ratios significantly in excess of regulatory minima.

"Delivering outstanding personal service to all our members is one of the Society's four strategic priorities."

CET1 capital resources have increased by £88 million during 2016 as a result of the strong profit performance. RWAs also increased during the year, as a result of the growth in residential lending. The CET1 capital ratio decreased to 15.2% (2015: 15.5%). The total solvency ratio (including other eligible capital items) was 15.9% (2015: 16.4%). The leverage ratio, a non risk-based capital measure, reduced to 5.2% from 5.5%. The reduction in these measures reflects the growth in the balance sheet, which is at a slightly faster rate than the growth in capital resources.

The Society continues to develop Internal Ratings Based (IRB) capabilities for credit risk management. In due course, this approach should allow the Society to apply internally determined risk weights to determine capital adequacy, reflecting the specific risks of the Society's mortgage book, following regulatory authorisation.

CRD IV will be implemented over the next five years. There are a number of transitional rules that apply over this period and these have been applied in the calculation of the above CET 1 measures. If the full rules were in force at the end of 2016 the CET 1 ratio would have been 15.2% (2015: 15.5%). The leverage ratio has been presented on a fully implemented basis, in line with market practice.

In November 2016, the PRA released their final policy on minimum requirements for own funds and eligible liabilities (MREL) that could be 'bailed in' at the point of failure of an institution. The Society's current capital position and future planned capital positions incorporate MREL, and other expected changes to the capital regime for banks and building societies. Consequently, the Society remains well placed to meet regulatory capital requirements as they continue to evolve.

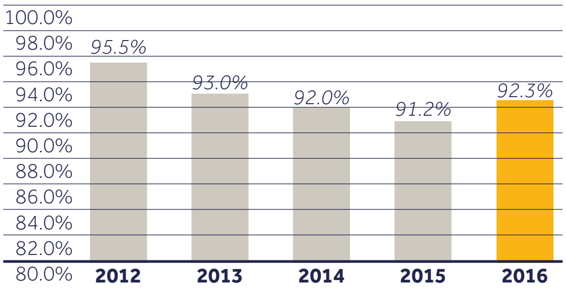
Members

Delivering outstanding personal service to all our members is one of the Society's four strategic priorities.

Member satisfaction is measured through independent surveys. Overall customer satisfaction was 92.3% (2015: 91.2%) .

The increase reflects the impact of a number of initiatives to improve customer experience as the Society responds to increasing expectations of members. The Society benchmarks favourably against other financial services organisations.

Customer satisfaction %



The Society also measures the total number of members, as a growing membership base is a reflection of the attraction of our customer proposition. Total membership increased to a record 756,000 (2015: 719,000).

Colleagues

Recruiting and retaining the best talent is key to delivering the Society's vision and is reflected in the Society's people strategy. The continued growth over 2016 has meant the Society has again increased the number of colleagues employed. The total number of colleagues at the end of the year now stands at 1,428 (2015: 1,300).

The Society has maintained and developed systems during the year for effective communication with colleagues. The communication is used to ensure colleagues are aware of the Society's performance and objectives and the business environment in which it operates. There is a Staff Association, through which colleagues make their views known on matters that affect their employment and, in addition, there is a regular colleague survey. In the 2016 survey, overall colleague engagement increased to 78% (2015: 76%). The Society also participates in the annual Best Companies survey and, in 2016, retained its one star award. Colleague turnover for the year increased slightly to 15% compared to 14% in 2015. The results represent a strong performance when taken with the degree of organisational change and stretch as the Society delivers its growth plans. The colleague engagement index remains well above financial services industry benchmarks.

The Society remains committed to training and career development for all colleagues demonstrated by our continuing Investors in People accreditation.

Strategic Report

Year ended
31 December 2016

Continued

Equality and diversity

The Society is committed to providing an environment in which colleagues feel valued and respected so that everyone can contribute to creating the UK's most successful building society.

It is the Society's policy to consider employment applications, provide access to training, career development and promotion opportunities to all regardless of their gender, sexual orientation, marital or civil partner status, gender reassignment, race, religion or belief, colour, nationality, ethnic or national origin, disability or age, pregnancy, trade union membership, or part-time or fixed term status.

Wherever possible, colleagues who develop a disability continue their employment with appropriate training or redeployment where necessary and reasonable adjustments are accommodated.

Information on the composition of the workforce at the end of the year is shown below:

		2016 Females	**2016 Males**	2015 Females	2015 Males
Colleagues	Number	837	505	784	446
	Percentage	62%	38%	64%	36%
Managers	Number	25	48	19	38
	Percentage	34%	66%	33%	67%
Directors	Number	3	10	3	10
	Percentage	23%	77%	23%	77%

The ethnic diversity is shown below:

		2016 Ethnic minority employees	2015 Ethnic minority employees
Colleagues	Number	91	75
	Percentage	6%	6%
Managers	Number	–	–
	Percentage	–	–
Directors	Number	–	–
	Percentage	–	–

Outlook

2016 has been another successful year for the Society and represents solid progress in delivering its vision to be the UK's most successful building society. The Society has further increased its profits and remains financially strong, having attracted record levels of savings balances and new mortgage business and having a record number of members.

The vote to leave the EU has created political and economic uncertainty for the UK. Whilst in the second half of 2016 the economy has performed positively, Office for Budget Responsibility forecasts predict a slowdown in growth in the coming period. Inevitably any slowdown will impact both house prices and the number of house purchase transactions taking place. Coupled with increased competition margins are likely to reduce further which may constrain the Society's ability to grow. However, the Society will continue to grow whilst market conditions allow it to do so profitably. The overriding objective remains to deliver sufficient profit to support growth, whilst ensuring a strong and sustainable financial position. The Bank of England is expected to continue its programme of stimulus, notably the Term Funding Scheme. This will provide low cost funding, which may further reduce market rates paid to savers over 2017 and beyond.

Further information regarding the principal risks and uncertainties faced by the Society, together with a summary of mitigating controls, is set out in the separate Risk Management Report on pages 28 to 39.

Against this backdrop, the Society plans to increase its residential lending activity funded by growing members' savings balances and accessing wholesale funding. The Society's investment programme will continue, enabling delivery of the key initiatives required to achieve its vision and ten year strategy.

The continuing financial strength of the Society ensures it can continue to invest and grow, without compromising the financial security that is so important to members' confidence.

"2016 has been another successful year for the Society and represents solid progress in delivering its vision to be the UK's most successful building society."

Viability Statement

In accordance with the revised UK Corporate Governance Code, the directors have assessed the longer term viability of the Society over a three year period to 31 December 2019. The three year review period was selected with regard to the duration of the Society's corporate planning horizon and the degree of certainty that can reasonably be relied upon beyond 31 December 2019, regarding the economic and competitive environments.

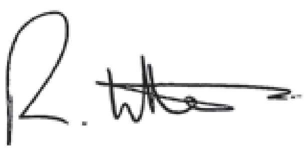
During 2016, the directors conducted a robust assessment of the Society's principal risks, as outlined on pages 31 to 39 of the Risk Management Report. The corporate planning process assessed the projected financial performance of the Society over the corporate planning period, including the impact of a range of stress scenarios, against the Society's strategic risk appetite.

The directors also reviewed the Society's longer term viability from a capital and liquidity perspective through the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP). These processes assessed the Society's ability to withstand severe capital and liquidity stresses and also considered a range of management actions, including their impact and credibility in mitigating the potential impacts of the stress scenarios. Overall, it was concluded that the Society should be able to withstand the severe capital and liquidity stresses applied.

On this basis, the directors have a reasonable expectation that the Society will be able to continue in operation and meet its liabilities as they fall due over the three year period to 31 December 2019.

Approval

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



Robin S P Litten
Chief Financial Officer

21 February 2017

Corporate Responsibility Report

Year ended
31 December 2016

Sharing our ambition
For the last 140 years we've been helping people to save for their future and have the home they want. We're proud of our purpose and the role we play in society; and over the last year we've been working hard to develop a plan to ensure we continue operating responsibly well into the future.

We know that acting responsibly goes hand in hand with developing products and services that meet the ever-changing needs of our members, being an attractive employer and supporting the communities which we serve. We also know that operating transparently underpins trust in business.

I'm therefore delighted to share our new Corporate Responsibility (CR) Framework with you. This shows how we operate responsibly for the long term benefit of our members, colleagues, communities and the environment.

Alongside our Framework, for the first time in our history, we've publicly set out a range of stretching targets for 2017 to 2020. These include helping more first time buyers, reducing our carbon emissions and maintaining our customer satisfaction scores.

We'll be reporting our progress against our targets each year so our members can see exactly how we're performing and what we're focusing on.

Richard Fearon
Chief Commercial Officer
21 February 2017

Key CR highlights:

- We increased the number of new members that we helped to have the home they want from 35,000 in 2015 to 53,700 in 2016.
- We increased the number of new members helped to save for their future from 47,000 in 2015 to 57,700 in 2016.
- We invested £345,000 into our communities.
- We maintained 1* Best Companies accreditation.

Overview of our approach
Our Corporate Responsibility Framework is closely linked to the Society's values and core business objectives. It is built around four themes which reflect both the breadth of the Society's business operations and key stakeholders.

- Money & Homes means helping our members save for the future and buy the home they want.

- Members & Communities focuses on caring for members and the communities they live in.

- People & Places means looking after the Society's colleagues and the places where the Society operates.

- Sustainable & Responsible means running the Society in the long term interest of our members.

Governance of corporate responsibility
The Society's Corporate Responsibility Framework and targets were signed off at Board level in 2016. A Steering Group chaired by the Society's Chief Commercial Officer, Richard Fearon, is in place to provide ongoing strategic direction. Meeting quarterly, its role is to ensure the Society is on track to deliver on its targets and to champion responsible business across the Society and with our colleagues.

Over the next year we'll continue to consult our members and stakeholders to better understand the responsible business issues that matter to them.

"In 2016 the Society helped 12,500 people to buy their first home."

1. Money & homes

Whether it's buying a home or saving for life's big moments, the Society exists to help members do more with their money and save for their future.

2016 Performance

Helping more people into homes
In 2016, the Society helped 53,700 people secure the home they want through a range of mortgage products.

Supporting first time buyers
In 2016 the Society helped 12,500 people to buy their first home. The Society continued to offer shared ownership options and access to the Help to Buy scheme, alongside its Welcome Mortgage, giving home buyers an interest free period of up to six months before starting a fixed rate mortgage.

Saving for the future
In 2016 the Society helped 57,700 people save for their future and paid an average of 1.66% to our savers compared to the rest of market average of 0.97%, which equates to an annual benefit to our savers of over £69m.

Achievements

Knowledge Base
Full of useful articles, Knowledge Base was set up to help to reduce some of the complexity surrounding managing money and buying a home. Over 40 articles were published in 2016 and, since its launch in 2015, over 69,000 people have visited the site. Knowledge Base continues to evolve as we learn more about our members.

Increasing age limits
People now have much greater flexibility over when they choose to retire, and mortgages should reflect this. In 2016 the Society increased the flexibility of lending into retirement, increasing its maximum age for residential mortgage applications from 75 to 80.

Our 2017 to 2020 money and homes targets:
- help over 225,000 people to save for their future;
- help over 175,000 people to have the home they want; and
- help 30,000 first time buyers into a home of their own.

2. Members & communities

Members are central to everything the Society does. This means more than just a commitment to giving them the best possible service, but also making a positive difference in the communities where they live.

2016 Performance

Increased customer satisfaction
The Society's customer satisfaction score increased to 92% in 2016, up slightly from 91% in 2015. This reflects the Society's ongoing commitment to be customer focused in its way of doing business.

Doubling colleague volunteering
30% of Society colleagues volunteered their time in 2016, more than doubling the 2015 figure and supporting 70 community projects across the country.

Members' pence have gone a long way
A total of over 44,000 accounts were opened in 2016 where the customer opted into the Your Interest in Theirs Scheme, agreeing to donate the pence amount of their interest received to charity, up to a maximum of 99p. In total £99,000 was donated to our partner charities Age UK, Marie Curie and Variety, The Children's Charity – alongside the Leeds Building Society Charitable Foundation.

Achievements

Charitable Foundation
In 2016 Leeds Building Society Charitable Foundation celebrated a significant milestone in its history with over £1.5m being donated to over 2,000 charities since its inception in 1999. In December 2016 the Society hosted an event where members heard directly from charities that the Foundation had supported. The Foundation has also launched an online form making it easier for charities to apply for funding.

Members hearing directly how they have supported charities.

Corporate Responsibility Report

Year ended
31 December 2016

Continued

Facts and figures: Foundation

- The Foundation shared £142,000 among 143 charities in 2016. To mark the £1.5m milestone the Foundation donated £10,000 to Sense, a charity which supports people who are deafblind, have sensory impairments or complex needs. This donation enabled them to refurbish the rooms of their Rotherham Resource Centre.

Facts and figures: Charitable Giving

- In 2016 the Society, its colleagues and members donated over £345,000 to charities and good causes.

Walking 127 miles along the Liverpool to Leeds Canal in aid of NSPCC and Macmillan.

Supporting vulnerable customers

Whether it's the loss of a loved one or a health diagnosis, everyone can be vulnerable at some point in their lives. The Society is committed to supporting vulnerable members to get on with life, and money shouldn't be an additional complication or stress.

All colleagues in the Society have undertaken training and we have set up a working group, formed of specialists from across the business. Their role is to develop the Society's current procedures to be able to help a customer with a special circumstance and to give colleagues advice, support and the right training, empowering them to make decisions which put the customer in a better position.

Our 2017 to 2020 members and communities targets:

- achieve customer satisfaction scores of at least 90% in our regular customer feedback surveys;
- provide 8,000 colleague-volunteering hours for our local communities; and
- donate £1.2m to charities and the community, through colleague fundraising, donations and sponsorship.

3. People & places

The Society is committed to giving its colleagues great working environments and the opportunity to achieve their potential, whilst also playing its part in the wider world by making branches and offices more energy efficient.

2016 Performance

Nurturing talent

In 2016, 100% of people starting an apprenticeship with the Society continued into a permanent role. In that same year, more than 160 colleagues achieved a professional qualification and the Society introduced career transition workshops, aimed at supporting people who are ready to take the next step in their career.

Colleague engagement

In 2016 the Society retained its Best Companies accreditation. Engagement across the business has risen from 70% in 2013 to 78%, reflecting the Society's commitment to being a great place to work.

Head Office Branch colleagues are pleased with the new look.

Investing to reduce our energy use

In 2016 the Society moved to its new Cobalt office in the North East of England. Featuring solar thermal panels and rainwater harvesting, it has a BREEAM rating of 'very good'. We also started the process of installing energy-efficient LED lighting across all branches, which uses around 80-90% less energy than regular lighting.

"The Leeds Building Society Charitable Foundation has donated over £1.5m to over 2,000 charities since 1999."

Achievements

Investors in Diversity
In 2016, the Society achieved Investors in Diversity Stage 1 accreditation, demonstrating its commitment to equality, diversity and inclusion in the workplace. The Society also signed up to the Women in Finance Charter, committing to achieving 33% female Board representation and a 33% female Senior Management Team by 2021.

Boosting wellbeing
In 2016 we launched Bupa Boost to all colleagues. This is a wellbeing app which focuses on four core areas of health and wellbeing – mindfulness, nutrition, relaxation and fitness, allowing colleagues to track their fitness and health.

Our 2017 to 2020 people and places targets:
- achieve above-average colleague engagement scores of over 70%;
- recycle all paper and use 100% green tariff energy from our energy suppliers; and
- reduce carbon emissions across the business by 150,000 kg of CO_2.

4. Sustainable & responsible

As a mutual, it's always been our responsibility to do business in a sensible way that puts our members' interests first. That means always operating to the highest levels of trust and integrity in everything we do, whether that's making considered lending decisions, or working with borrowers in financial difficulty.

2016 Performance

Planning for all eventualities
The Society's CET1 Capital ratio for 2016 was 15.2%. This is a key indicator showing the level of reserves available to the Society to protect it from future problems.

FOS complaints
The Society remains committed to putting the needs of its members first and resolving complaints before they are escalated to the Financial Services Ombudsman. In 2016 complaints upheld in favour of the customer fell from 25% in 2015 to 18% in 2016.

TalkingPoint – The voice of our customers
Since we first started our new online members' forum, TalkingPoint, in 2015 over 1,900 members have signed up to share their views on a range of topics relating to the Society and the wider financial sector. Member feedback has helped us make changes to the letters that are sent out when a product matures. It has also helped us decide which charities members support through their AGM vote.

Fact:
- 78% of members believe it is important or very important that the Society acts responsibly (TalkingPoint 2016).

Achievements

Financial crime prevention
The Society takes a proactive approach when it comes to protecting its members' money. Over the last year we've been raising awareness of crime prevention, helping members to spot scams, and making changes to our processes, by introducing enhanced warnings when large transfers are being made. Our Financial Crime Awareness Week took place in November 2016 with leaflets being made available to members.

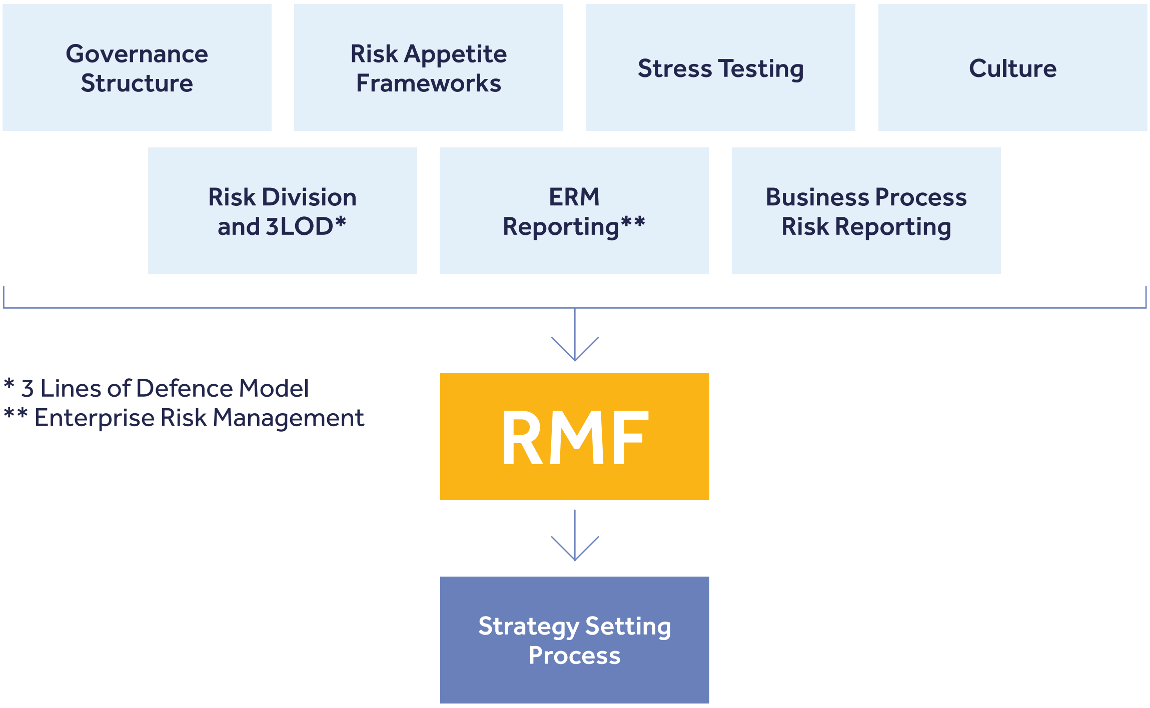
Supporting borrowers in financial difficulty
The Society works hard to help people have the home they want and support is in place to help members who find themselves in difficulty to make repayments. As part of this commitment, the Society has continued its relationship with StepChange, a charity that helps people get their finances under control. With a dedicated direct line we are able to refer all customers in financial difficulty to a specialist team of independent financial advisors.

Our 2017 to 2020 sustainable and responsible targets:
- keep our CET1 Capital ratio above 14%;
- achieve a below industry average number of upheld complaints from the Financial Ombudsman Service; and
- increase the number of active TalkingPoint members to 2,500.

To find out more, visit:
leedsbuildingsociety.co.uk/your-society/corporate-responsibility

Risk Management Report

Year ended
31 December 2016



Purpose

The purpose of this report is to:

- highlight the key aspects of the Society's Risk Management Framework (RMF); and
- set out the principal risks and uncertainties facing the Society.

Risk Management Framework

The RMF explains how the Society applies a structured approach to risk management and an enterprise wide view of risks across the Society. This ensures an aligned and consistent approach to the aggregation and management of all risks, which are used to inform business management and decision making, at both strategic and operational levels.

The RMF is an integral part of the Society's strategy, providing a framework for the long term viability of the Society. The Board Risk Committee (BRC) conducts an annual review of the Framework, on behalf of the Board, and the Chief Risk Officer (CRO) has responsibility for the effectiveness of its implementation.

Risk governance

The Society maintains a robust governance framework which:

- allows the Board to maintain oversight of the risk universe;
- facilitates independent challenge from non executive directors;
- delegates appropriate powers and mandates to committees and individuals;
- clearly cascades and articulates Board risk appetite through tiered policies and standards;
- promotes personal accountability; and
- ensures that corporate objectives are delivered within agreed risk appetite.

Risk infrastructure

The risk governance infrastructure of the Society operates on three levels:

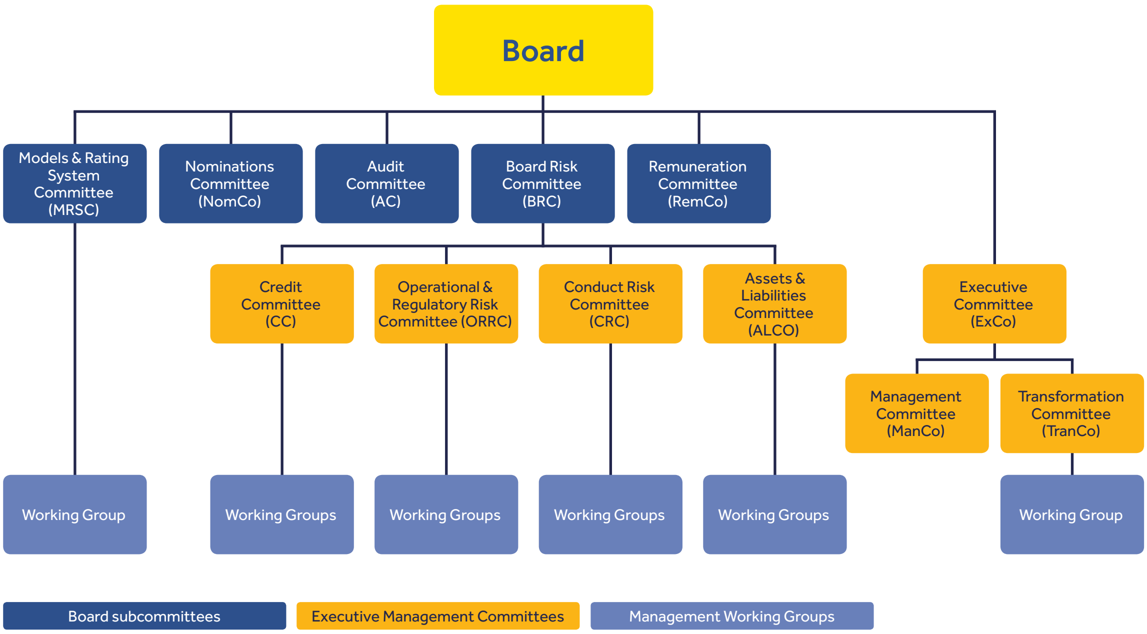
Level 1	Infrastructure
Board governance infrastructure	• Matters reserved for the Board. • Board level committee Terms of Reference (ToR) for: – Board Risk Committee (BRC); – Remuneration Committee (RemCo); – Audit Committee (AC); – Nominations Committee (NomCo); and – Models and Rating Systems Committee (MRSC).

Level 2	Infrastructure
Executive management governance infrastructure	• Executive management level committee ToR for: – Executive Committee (ExCo); – Transformation Committee (TranCo); – Management Committee (ManCo); – Assets & Liabilities Committee (ALCO); – Credit Committee (CC); – Conduct Risk Committee (CRC); and – Operational & Regulatory Risk Committee (ORRC).

Level 3	Infrastructure
Risk management infrastructure documentation	• Risk Management Frameworks. • Standardised committee reporting/management information. • Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), Liquidity Contingency Plan (LCP) and Recovery Plan and Resolution Information Pack. • Society policies. • Delegated Authorities Manual.

Committee structure

During 2016, the Society completed the transition to a new committee structure. As a result, BRC is now the Society's main Board risk related subcommittee, responsible for oversight of the enterprise wide risk universe. The BRC is supported by four Executive Risk Committees, each focusing on a particular discipline of risk. Working Groups further support Executive Risk Committees, operating with restricted mandates. The Society's committee structure is outlined below:



Risk Management Report

Year ended
31 December 2016

Continued

The Corporate Governance Report (pages 42 to 54) outlines the activities of the Board subcommittees detailed above. The Directors' Remuneration Report features on pages 64 to 77 and the Audit Committee Report is located on pages 56 to 63.

Risk Function

The Risk Function is independent from the operational business divisions. It ensures the Society follows a consistent approach to risk management and is led by the CRO, who reports directly to the Chief Executive Officer and is accountable to the Chairman of the BRC. The Risk Function comprises specialist teams, aligned to key risk disciplines, which provide oversight and independent challenge of first line activities.

Three lines of defence model

The Society's approach to risk management is based upon the three lines of defence model, which is standard practice in the financial services sector. The model, which is depicted below, is ultimately a partnership between the operational business areas, the Risk Function and Internal Audit.

Management
– 1st line of defence –
Day to day risk ownership, identification, assessment and management, through implementation of the RMF.

Oversight
– 2nd line of defence –
Risk governance, frameworks and oversight of the 1st line.

Assurance
– 3rd line of defence –
Internal Audit provide independent assurance of the adequacy and effectiveness of 1st and 2nd line risk management.

Strategic Risk Appetite

A key element of the RMF is Strategic Risk Appetite (SRA). This comprises qualitative statements and quantitative metrics to provide the boundaries within which the Society must operate to deliver its strategy. The Society's SRA is reinforced through policies and standards, to ensure consistency and alignment to Board defined parameters.

The Board defines SRA across the Society's seven principal risk categories (credit, market, funding and liquidity, capital, operational, conduct and business/strategic). The metrics are reviewed by the Board annually and are stress tested to confirm the long term viability of the Society, under both plausible and more severe scenarios. They are also forecast on a forward looking basis, within the corporate planning process.

The Board receives monthly management information on risk exposures and the Society has developed appropriate early warning indicators and escalation procedures to address any deterioration in its risk profile.

Risk culture

A sound risk culture is a key element of effective risk management. The Society's risk culture is embedded into the Society's values, which form a key part of the RMF. The risk culture is also promoted through:

- Tone from the top – the Board and senior management are responsible for articulating the Society's values and encouraging colleagues to act with integrity.
- Accountability – all colleagues understand the core values of the Society and its approach to risk management, are capable of performing their prescribed roles and are aware that they are held accountable for their actions.
- Effective communication and challenge – an environment of open communication and effective challenge in which decision making processes encourage a range of views.
- Incentives – performance and talent management processes encourage and reinforce maintenance of the Society's desired risk management behaviour.

During 2016 initiatives were progressed to define and steer the Society's corporate and risk culture. This included advancements in risk maturity across the control environment and the development of a framework, underpinned by the Society's values, to manage culture in the Society. The new framework will be embedded into business reporting in 2017, to support further Board oversight in this area.

"A sound risk culture is a key element of effective risk management. The Society's risk culture is embedded into the Society's values, which form a key part of the RMF."

Stress Testing Framework

The Society's Stress Testing Framework (STF) is a risk management process that supports decision making at strategic and operational levels. Stress and scenario testing is an intrinsic component of risk governance and the Board has ultimate responsibility for its application and ensuring it is embedded throughout the Society.

The STF provides:

- a sound understanding of internal and external influences on the Society and its principal risks;
- enhanced risk management and complementary stress testing approaches/scenario analyses (including reverse stress testing);
- assistance to the Board in strategic business planning and in setting SRA; and
- management of capital and liquidity resources against SRA and regulatory expectations.

The Society has developed an annual programme of stress testing activity, which informs the planning process and the calibration of SRA. The key components of the programme are as follows:

Activity	Description
Corporate planning	Sensitivity analysis and a suite of alternative scenarios are used to assess the Corporate Plan under a range of severe, but plausible, stresses.
ICAAP	An internal assessment of whether the Society has sufficient capital to withstand a severe stress.
ILAAP	An internal assessment of whether the Society has sufficient liquidity and stable funding to withstand a severe stress.
Recovery plan	Scenario analysis is used to inform the development of a suite of recovery actions (primarily capital and liquidity) to be used under extreme stresses.
Reverse stress testing	An assessment of the stress scenarios under which the Society would potentially become unviable. This examines potential weakness in the Society's business model under extreme events so that mitigating actions can be identified.

Principal risks

The Society defines principal risks as those risks that are inherent within its business model and strategy. During 2016, the Society reviewed its risk classification system, which resulted in changes to the suite of principal risks namely; the inclusion of capital risk and the removal of pension obligation risk, which is now viewed as a subset of market risk. The current suite of principal risks and key uncertainties are outlined below.

Credit risk

Credit risk is the risk that customers or counterparties will not meet their financial obligations when they are due. The Society faces this risk from its lending operations to retail mortgage customers, commercial mortgage customers and wholesale counterparties.

Retail credit risk

Background and outlook

The key driver of retail credit risk within the Society is the performance of the UK economy. Deterioration in the UK economic environment could result in increased levels of unemployment, an erosion of real household income and reductions in the value of residential property. The combination of these factors may lead to increased levels of mortgage arrears and, in some cases, losses.

During 2016, the UK economy remained resilient to economic headwinds caused by the referendum result. Following a deterioration in economic indicators immediately after the referendum outcome, the Bank of England loosened monetary policy to support economic activity. Since this time, economic performance has remained broadly stable, driven by the services sector and, in particular, consumer spending. Unemployment has moderated further during 2016 and real incomes have increased following a period of relatively low wage inflation. Overall, economic conditions have continued to provide a supportive environment for housing market activity.

Market commentators are expecting a moderation in economic growth during 2017, and into 2018, as the UK enters into formal EU exit negotiations. This reflects a drag on business investment due to the ongoing political and economic uncertainty and reduced consumer spending, as the real spending power of households is reduced. Further downside risks that could also affect economic performance remain. These include the level of household indebtedness; the size of the UK current account and budgetary deficits; volatility in the

UK commercial real estate market and other geopolitical risks. As a consequence of the ongoing uncertainty, the Society retains a prudent stance to new retail mortgage lending.

The buy to let market has continued to expand over recent years, partly fulfilling the increased housing needs in the UK. However, charges introduced in 2016 to stamp duty tax and, from 2017, to landlord tax relief, alongside enhanced regulatory requirements for lenders to adopt as part of underwriting buy to let mortgages, are expected to suppress growth levels observed over recent years. The Society continues to ensure compliance with emerging regulatory requirements applicable to buy to let lending and maintains a prudent appetite in the market, in terms of credit risk profile and market share.

Retail credit risk within the Society is also influenced by the performance of the Irish and Spanish economies through legacy residential lending portfolios (less than 2% of total loan balances). During 2016, the recovery in the Irish and Spanish economies continued to gain momentum. Whilst the economic outlook for each remains stable in 2017, recoveries within both remain vulnerable to downside risks.

Retail credit risk mitigation
Exposure to this risk is managed by the Operations Division and overseen by a specialist Credit Risk Function, reporting to the CRO. Further oversight is provided by CC and BRC, along with a number of dedicated working groups.

The Society's lending policy is formally approved annually by the Board and reviewed on an ongoing basis by CC. This policy defines current limit structures for mortgage lending and reflects the Society's current credit risk appetite. CC, BRC and the Board receive management information detailing the performance of the Society's mortgage portfolio.

Retail credit risk for new lending is managed using the following tools:

- credit scoring;
- credit bureau data (reviewing the credit history of a customer);
- affordability assessment based on income and expenditure under current and stressed interest rates;
- independent expert appraisal of the suitability and value of a property; and
- underwriting processes, which are a combination of quantitative scoring systems and suitably qualified underwriters.

The Society's Credit Risk Function monitors and forecasts the performance of the portfolio, including stress testing, on an ongoing basis. This identifies trends which help build an understanding of the portfolio to assess whether the current risk appetite remains appropriate, or, if not, what changes may be required. In addition, the Risk Function also conducts quality assurance on the underwriting process. This ensures that processes and controls are effective and do not result in the unintended origination of new residential loans that are outside of policy/appetite.

If a borrower's financial situation starts to deteriorate, the Society has established procedures to respond appropriately. A dedicated Collections Function engages with customers at an early stage and discusses financial difficulties. The Society is able to offer customers a range of forbearance options including: an extension of the mortgage term; a temporary change to interest only; deferral of interest; reduced monthly repayments; transfer to an alternative product; or a special interest rate (subject to meeting specific criteria). Forbearance options are determined on a case by case basis, with the aim of working with borrowers to clear arrears. After all other options have been exhausted, the Society may take possession of the mortgaged property.

Oversight of the Society's arrears management activity is conducted by CC and a dedicated working group. In addition, the Risk Function conducts regular assessments to ensure that customers are treated fairly.

An analysis of the Society's residential portfolio and forbearance activity is used to inform the provisioning policy to ensure losses are properly recognised, in accordance with relevant accounting policies.

Commercial credit risk

Background and outlook
The UK economic environment also affects the performance of the Society's legacy commercial loan portfolio. Following the referendum vote in June, activity in the commercial real estate market slowed and prices declined due to heightened levels of uncertainty and significant outflows from open-ended real estate funds, albeit market conditions stabilised towards the end of 2016.

The Society stopped advancing new commercial loans in 2008 and has successfully deployed a strategy to reduce its exposure to this activity. In 2016, the portfolio reduced by a further £69m to £125m, with provisions covering any remaining negative equity in the portfolio. The Society is seeking to further reduce its commercial asset exposure in 2017.

Commercial risk mitigation

The Society employs a team of appropriately skilled colleagues to implement its exit strategy from this asset class. This team is supported by the Risk Function, which provides second line oversight of the performance and management of the portfolio.

Portfolio performance is monitored closely and overseen by the CC and a dedicated working group. All loans are assessed on a case by case basis, using a broad range of potential impairment indicators. If a loan is deemed impaired, the Society uses a combination of formal recovery actions and appropriate forbearance options, including loan extensions, restructures or property sales, to reduce the size of the loan book and minimise losses.

The performance of the commercial portfolio and use of forbearance measures inform the Society's provisioning calculations.

Wholesale credit risk

Background and outlook

Wholesale credit risk emanates from the Society's liquidity investments and hedging activities. Following the financial crisis, the Society has retained a prudent approach for selecting wholesale counterparties. This has resulted in limits and exposures being mainly UK-centric, with limits extended to only a small number of highly-rated counterparties based outside the UK. The Society's UK exposure is diversified through holdings of UK Government securities, holdings in highly-rated financial institutions and asset-backed securities, along with deposits at the Bank of England. The Society has no direct wholesale credit exposure to sovereign or financial institutions in Cyprus, Greece, Ireland, Italy, Portugal, Spain, or Russia.

The Society will retain a prudent approach to wholesale credit risk during 2017, due to the ongoing uncertainties in the global economy.

Wholesale credit risk mitigation

Liquidity portfolio

The Board approved wholesale credit and liquidity policies define an appropriate limit structure. This ensures that its liquidity portfolio consists of a well-diversified portfolio of high quality assets (99.8% rated 'A' or better) that remain readily realisable. Each wholesale counterparty is subject to a formal review by the Treasury Credit Risk Working Group (TCRWG) at least annually, to ensure that counterparty exposures remain compliant with Board-approved wholesale credit limits and policy. Credit lines are based on a combination of internal assessment, credit default swap-spreads, the jurisdiction in which the counterparty is domiciled and other market intelligence.

Operationally, dedicated resource within the first line Treasury Function monitors the Society's exposures on a daily basis, reporting market developments as appropriate. Oversight is provided by the Risk Function and TCRWG. ALCO and BRC also receive management information covering wholesale credit exposures.

Risk Management Report

Year ended
31 December 2016

Continued

Derivative exposures
The Society only enters into derivative contracts for hedging market risk, not for trading or speculative purposes. The same oversight and governance approach for the liquidity portfolio is applied to assess the creditworthiness of a derivative counterparty.

During 2016, the Society continued to reduce its derivative bilateral counterparty exposures through the centralised clearing of interest rate swaps. Derivative exposures arising from swaps not currently eligible for clearing, are mitigated through netting arrangements, allowing the Society to net off individual transactions in the event of a default. Credit Support Annexes limit potential exposures through the exchange of collateral between the Society and its swap counterparties.

Market risk
Market risk is the risk that the value of, or income arising from, the Society's assets and liabilities changes adversely due to movements in market prices, or rate changes.

Background and outlook
Financial markets experienced heightened volatility during 2016, due to concerns regarding the strength of the global economy and geopolitical events. Following the outcome of the UK referendum sterling depreciated significantly against major currencies, reflecting investor uncertainty about the UK's prospects outside of the EU. In response to the immediate effects of the referendum result, the Bank of England loosened monetary policy further by reducing its Bank Rate to 0.25%, expanding its quantitative easing programme and introducing the Term Funding Scheme (TFS). It is expected that financial markets will experience further volatility in 2017, as the UK enters into formal negotiations with the EU regarding its departure.

During 2016, the increasing trend of customer preference for fixed-rate mortgages continued, as mortgage rates declined to record lows. Conversely, retail savers' preference for variable rate savings remains. It is anticipated that this trend will continue during 2017, in line with current interest rate expectations.

During 2015, the Society's triennial review of the Pension Scheme's funding position was updated as at 31 December 2014. Based on this valuation, the Scheme remains well funded, with a plan agreed to recover the deficit within the next four years. This funding plan is an extension of existing arrangements and, as such, does not represent a commercial stress to the Society. Given the inherent volatility of valuation assumptions, the Society is aware that future liabilities may change positively or negatively and, as a consequence, during 2016, the Trustees undertook a review of the Scheme's investment strategy to reduce future volatility. Following the review, the Trustees amended the Scheme's investments, in order to diversify the return generating assets as well as improving the efficiency of the risk reducing assets. These changes were fully implemented by the end of 2016.

Interest rate risk
The Society is exposed to interest rate risk due to the differing interest rate characteristics and maturity profile of its mortgage and savings products. From an earnings perspective, in the event of an upward or downward movement in interest rates, the Society is exposed to net interest income variances, the extent of which depends on the interest rate characteristics of the balance sheet at the time of any rate change.

The Society is also exposed to other variations of interest rate risk such as basis risk (as a consequence of changes in the relationship between different interest rates, which have similar but not identical characteristics, for example Libor and the Bank of England Bank Rate) and product option risk (as a consequence of customer behaviour, arising from certain product features).

Interest rate risk mitigation
All interest rate exposures are managed through the use of Board-approved policy limits, offsetting assets and liabilities, along with the use of financial derivative instruments, such as interest rate and basis swaps. Board limits are reviewed annually, with ALCO and BRC receiving regular management information on interest rate risk exposures. The Society also utilises stress testing to assess the impact of different interest rate environments on its profitability, as well as the fair value of its assets and liabilities.

Treasury is responsible for managing the Society's interest rate and basis risk exposures, with oversight by the Risk Function.

Foreign currency risk
Foreign currency risk is the risk of loss emanating from movements in foreign exchange rates. The Society is exposed to appreciation in the value of foreign currency denominated liabilities, or depreciation in foreign currency denominated assets. Whilst the Society's assets and liabilities are mainly denominated in sterling, these exposures arise from the Society's wholesale

funding operations, liquidity holdings and legacy Irish and Spanish residential portfolios.

A subset of foreign currency risk is redenomination risk. This is the risk of loss resulting from a reduction in the value of foreign currency denominated assets, which is not matched by a reduction in the value of foreign currency liabilities, for instance if a jurisdiction were to leave the Euro and alter its currency. The Society is exposed to this risk through its legacy lending operations in Ireland and Spain.

Foreign currency risk mitigation
Foreign currency risk is managed through Board-approved limits, offsetting assets and liabilities, and the use of financial derivative instruments, such as foreign currency derivatives. Treasury is responsible for managing the Society's foreign currency risk exposures, with oversight provided by the Risk Function, ALCO and BRC.

The Society has reduced its exposure to redenomination risk through holding a retained securitisation, which can be used to provide funding from the European Central Bank in the event of such a scenario in Ireland. ALCO is primarily responsible for managing this risk, which is also subject to oversight from BRC.

Pension obligation risk
The Society has funding obligations for a defined benefit pension scheme, which is closed to future accrual. Pension obligation risk is the risk that the value of the Scheme's assets will be insufficient to cover obligations over the remaining life of the Scheme. The return on the Scheme's assets will vary, depending on the movement in the value of its investments, whilst the projection of the Scheme's liabilities is based on estimates of mortality and inflation. In practice, the actual outcome may differ to the estimates and any shortfall will be borne by the Society.

Pension obligation risk mitigation

This risk is managed through regular meetings of the Pension Trustee Board and Investment Working Group. The Pension Trustee Board receives quarterly investment monitoring updates, prepared by the Scheme's independent advisers and annual actuarial updates, which may lead to a course of appropriate action, such as altering asset allocations. The Society conducts annual stress testing of the Scheme's assets and liabilities under various severe scenarios as part of the ICAAP.

Funding and liquidity risk
Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due. Funding risk is the risk that the Society is unable to access funding markets, or can do so only at excessive cost.

Background and outlook
As a mutual, the Society is predominantely funded through retail deposits. Although retail markets remained competitive during 2016, the Society's savings portfolio continued to grow, accounting for 78% of total funding by the year end. The Society also accesses funding via the UK and international wholesale markets and successfully issued a €500m covered bond during 2016.

Following the referendum result, the Bank of England introduced TFS, which has moderated competitive pressures and spreads in both retail and wholesale markets. It is expected that TFS will continue to influence demand within the Society's funding markets during 2017 and markets will remain susceptible to volatility caused by uncertainty in the global economy.

The introduction of Basel III requires the Society to be compliant with new liquidity standards. These include a requirement to maintain a Liquidity Coverage Ratio (LCR) and a Net Stable Funding Ratio (NSFR), to underpin the quality and quantity of liquidity under stressed conditions and the stability of the Society's funding profile. Implementation of the LCR is being phased in between October 2015 and 2018, with requirements for the NSFR likely to apply from 2019 onwards. As at 31 December 2016, the Society's LCR stood at 179% and NSFR 131%, both significantly above the regulatory minima.

Funding and Liquidity risk mitigation
This risk is managed through Board approved limits and policy to determine the overall level, composition and maturity of liquidity and funding balances. Treasury is responsible for the day-to-day management of liquidity and wholesale funding, with policy compliance being monitored daily by the Finance and Risk functions. This is reported at ALCO, BRC and the Board.

The Society also manages liquidity risk through the use of sale and repurchase agreements. These agreements facilitate the exchange of treasury assets in return for cash for a defined period, to provide readily realisable liquidity if required. The Society also has pre-positioned collateral with the Bank of England and European Central Bank, to provide additional liquidity, which can be drawn upon if required.

The adequacy of the Society's liquidity is determined through its annual Internal Liquidity Adequacy Assessment Process (ILAAP). This process determines the minimum level of liquid assets and contingency resources required under multiple severe stressed environments. To satisfy this requirement, the Society maintains a pool of high quality liquid assets (for example, UK Government securities and deposits held with the Bank of England) and also has access to central banking funding. The Board approved the most recent ILAAP in October 2016 and concluded that the Society's liquid asset buffer holdings comfortably covered the assumed effects of a prolonged severe stress. As at the end of December 2016, the Society's liquid buffer eligible assets totalled £1.8bn and accounted for 93% of total liquidity.

Capital risk

The risk that the Society has insufficient quality or quantity of capital resources to meet current/ future regulatory or business requirements.

Background and outlook

Capital is held by the Society to protect its depositors, by ensuring that liabilities are fully covered by assets in the event of a severe stress scenario.

During 2016, the transitioning of certain CRD IV requirements continued. From a Society perspective, these include the phased implementation of capital buffers and the transitioning of Permanent Interest Bearing Shares (PIBS) from Tier 1 into Tier 2 capital (3% of capital as at 31 December 2016).

In November 2016, the Bank of England released a policy statement detailing proposals in relation to Minimum Requirements for Own Funds and Eligible Liabilities (MREL). These new requirements seek to ensure that financial institutions have enough liabilities to absorb losses in the event of failure. Transitional MREL requirements will be implemented from 1 January 2020, with full MREL requirements applying from 1 January 2022. The Society is currently assessing the potential implications of the new requirements, which will be considered as part of the corporate planning process on an annual basis.

The Society uses the standardised approach to determine its Pillar 1 capital requirements for credit and operational risk exposures. The Society continues to develop its Internal Rating Based (IRB) capabilities for the residential credit portfolios. In due course, this approach should allow the Society to apply internally determined risk weights to determine capital adequacy, reflecting the specific risks of the Society's mortgage book, following regulatory authorisation.

During 2016, the size of the Society's capital base grew to £914m, predominately as a result of retained earnings generated in the year. From a capital adequacy perspective, the Society's Common Equity Tier One ratio and leverage ratio stood at 15.2% and 5.2% respectively. Both ratios remain significantly above regulatory minima.

Further information on capital adequacy is included in the Society's Pillar 3 disclosure, available on the Society's website.

Capital risk mitigation

This risk is managed through Board-approved limits and a capital policy, to determine the overall capital adequacy and capital management of the Society. The Society has a dedicated Capital Management Team that is responsible for monitoring capital positions, with oversight provided by the Risk Function. Capital reporting is provided to ALCO, BRC and the Board.

The Society also utilises stress testing to assess capital adequacy under a range of severe but plausible scenarios. As part of this program of stress testing, the Society undertakes an Internal Capital Adequacy Assessment Process (ICAAP), at least annually. This process is used to determine the level of capital the Society needs to support current and future business activities. The ICAAP assesses the Society's risk universe and ensures that it meets regulatory capital requirements, under business as usual and severe stressed environments. The Board approved the most recent ICAAP in November 2016 and concluded that the Society has sufficient capital to mitigate against the effects of the stress, in relation to appetite and regulatory requirements. In addition, BRC reviews a refresh of the ICAAP quarterly, to ensure capital adequacy remains sufficent on an ongoing basis.

Operational risk

Operational risk is the risk of financial or reputational loss, as a result of inadequate or failed processes, people and systems, or from external events. The principal risk drivers for operational risk at the Society are as follows:

Risk driver	Overview of risk
Legal and regulatory	Failures arising out of internal regulatory, statutory or legal non-compliance, including codes of conduct and associated risks from engagement with third parties.
Business continuity	Failure to establish resilient processes, adequate business continuity and recovery arrangements.
People	Inability to attract, retain and develop people resources appropriately for the delivery of customer expectations and Society objectives.
IT and information security	Failure to establish, develop and maintain an IT environment that secures customer data and Society information.
Financial crime	Internal or external financial crime events relating to money, financial services or markets including: offences involving fraud or dishonesty (including bribery), handling the proceeds of crime, and/or the financing of terrorism.

The Society also manages and monitors operational risks associated with process (outsourcing risk; systems of control risk; corporate insurance risk; infrastructure risk and model risk) and financial reporting (management information risk and data risk).

Background and outlook

Legal and regulatory risk

The volume and scale of regulatory change continues to shape the Society's operating environment. During 2016, the Society finalised its preparations for the European Mortgage Credit Directive (MCD) and the Senior Managers' Regime (SMR), both of which came into force from March 2016. The outlook for the medium term suggests that the pace of change in prudential and conduct related regulation looks set to continue.

The Society remains firmly committed to complying with its regulatory and legal responsibilities. A Working Group, reporting to ORRC, is responsible for identifying regulatory developments and assists colleagues in the delivery of required legislative changes, within requisite timescales. The Risk Function provides oversight of regulatory compliance on an ongoing basis.

Business continuity risk

The development of business continuity plans is an integral component of the Society's operational risk control environment. The Risk Function works with colleagues to develop appetite, plans and testing strategies, to allow for the management of unexpected events, for example the loss of business critical systems. During 2016, the Society performed a number of recovery tests and scenario-based exercises across the business. ORRC and BRC also provide oversight regarding the suitability of the Society's business continuity arrangements.

People risk

During 2016, the Society continued to embed its people strategy. The Society aims to mitigate this risk through a rigorous recruitment process, new colleague inductions, and internal training. Personal development plans are put in place to ensure colleagues continue to develop their expertise and experience throughout their employment with the Society. Resilience to people risk is achieved through documented succession plans, which support the longer term viability of the Society.

IT and information security risk

In recent years, the Society has outsourced its IT service provision for its core system to Hewlett Packard Enterprise (HPE). Under the combined oversight of HPE and LBS senior management, the Society is developing short, medium and longer term technology strategies that will ensure customer facing services will be available in a well controlled environment, aligned to members' needs, aspirations and expectations.

Following an independent, external IT Resilience Review, the Society has invested further in its technology infrastructure, so that it can maintain and develop resilient services suitable for the evolving needs and expectations of members, in the markets in which it operates.

In support of IT resilience, the Society has created specific roles within the first line to focus on managing risks within the IT Function and within the second line to support the assurance and governance of technology risks across the Society. These roles increase the capacity for managing risk effectively and for directing the use of technology in support of Society objectives.

Whilst there is a strong focus on the development of customer interfaces and services, the Society is also fully aware of external threats, in particular cyber-crime attacks designed to deny access to systems and compromise, or misuse, the data and assets held on Society systems. The Society has dedicated first and second line security teams, with specific responsibilities to protect Society and members' information. Certified experts also undertake independent exercises to test the Society's defences and to ensure that prevention, detection and response controls continually evolve, in line with the ever changing complexity of cybercrime.

In recognising the specialist nature of IT, information security, data governance and business resilience risks, the Society's RMF incorporates various senior management led working groups, which oversee the resolution of technical challenges arising out of Society operations. Each has a direct reporting responsibility to ORRC, with appropriate upstream reporting to BRC.

Financial crime risk

Financial crime continues to be a concern for all financial institutions with several high profile incidents during 2016. As a consequence, this remains high on the regulatory agenda, with the Financial Conduct Authority (FCA) including financial crime as one of its seven priorities within its 2016/17 Business Plan. To support the FCA in its further understanding of financial crime activity, the majority of financial institutions will be required to provide focused regulatory reporting from 2017.

The Society maintains a dedicated Financial Crime Team within the Risk Function. In recent years, the Society has made significant investment in people and systems to enhance its financial crime prevention capabilities. Oversight across the financial crime control environment is provided by the Compliance Function and a dedicated working group, which reports into ORRC. BRC and the Board also receive financial crime reporting, at an appropriate frequency.

Operational risk mitigation

In addition to the specific mitigants outlined above for the key operational risk drivers, the Society has implemented an integrated reporting approach to support the adoption of enterprise-wide risk management. This encourages first line ownership of risk management and reporting, with the second line performing more of a co-ordination, aggregation, challenge and oversight role. Independent reporting and analysis is undertaken when appropriate.

The Operational Risk Function engages with each area of the business to maintain departmental risk registers; this includes a dynamic assessment of the effectiveness of key controls as well as relevant mitigating actions. This is complemented by a 'Significant Incident Process'. The Society conducts risk control self-assessments twice yearly, which validate the risk and control environment.

During 2016, the Society introduced the ORRC, to enhance oversight of operational risk. This new committee receives operational risk management information, along with reporting on near misses or crystallised loss events, at each meeting. Further operational risk reporting is provided to BRC. ORRC is further supported by a number of working groups, each dedicated to oversight of a separate discipline of operational risk.

The Society also conducts a range of operational risk stress tests, which feed into the ICAAP and reverse stress testing processes.

Conduct risk

Conduct risk (a form of operational risk) is the risk that actual or potential customer detriment arises, or may arise, from the way the Society conducts its business. The Society has an extremely limited tolerance for conduct risk events, although it is recognised that operational risk failures may create isolated incidents, as a consequence of business activities.

Background and outlook

Effectively recognising, preventing and managing conduct risk is central to the successful delivery of the Society's vision, strategy and values. The Society is committed to proactively identifying emerging conduct risks and continually monitors how business operations impact members. This approach is constantly evolving, so that it remains fit for purpose and aligns to member and regulatory expectations.

During 2016, there were some important industry changes, which have delivered enhanced consumer protection. For example, MCD was introduced in March 2016, to harmonise the regulatory framework for mortgages across Europe. The SMR also came into force in March 2016, with the aim of increasing an individual's accountability for their work and the impact they can have on a financial institution. In addition, new rules have been introduced which will increase consumer transparency of complaint handling across the industry.

Looking ahead to 2017, preparations are underway within the industry to increase the speed of ISA transfers and the Society will work with other institutions to facilitate smoother transactions for members. The FCA will also seek to enhance customer communications across the industry, following its conclusions on the recent Cash Savings Market Study.

Conduct risk mitigation
In line with its stated appetite, the Society restricts its activities to areas where appropriate expertise is in place.

Customer-facing and operational departments provide first line management of conduct risk. All colleagues complete annual mandatory conduct risk training and there is a CRC approved Conduct Policy in place. As part of the governance framework, the Society has an independent second line Compliance Monitoring Team, whose purpose is to assess key business areas' compliance with regulatory requirements and identify the suitability of customer outcomes, the results of which are reported to the CRC.

Detailed conduct risk management information, including indicators on the Society's business model, governance and culture, product design and development, the delivery of its products and post-sale and servicing elements of business operations, is discussed at each CRC meeting. Conduct risk related management information is also reviewed by BRC and the Board.

Central to effective conduct risk management is the Product Governance Framework. This outlines internal processes for researching, developing and testing new products and services, ensuring that the Society offers products, which meet the needs of current and potential members.

Business and strategic risk

This represents the risk arising out of the delivery of the Society's Corporate Plan. This may occur through the selection of the wrong strategy, its improper implementation, lack of responsiveness to external business developments, or through changes in the business environment forcing deviation from plan.

Background and outlook
During 2016, risks relating to the Society's operating environment heightened. The outcome of the EU referendum has resulted in a period of increased macroeconomic uncertainty. While the Society is predominately a UK-centric business, future delivery of its strategy could be impacted by potential financial market disruption and a prolonged slowdown in economic performance, as a result of the EU exit negotiations.

Competition within the Society's core markets remains strong, due to the increased appetite of both established and new market participants. It is expected that competition will remain robust during 2017 and this will continue to erode margins.

During 2016, the Society continued to invest in its program of transformational activity, which will enhance the member proposition, as well as business resilience. While this has resulted in an increase to the Society's cost base, it retains efficient cost ratios, compared to its peers. The Society plans to make further investments in 2017, to support the delivery of its strategy.

Business risk mitigation
The Society addresses business and strategic risks within its Corporate Plan, which is reviewed and approved annually by the Board and is considered in the context of the Society's SRA. This includes stress testing of the Society's business across a range of alternative scenarios. The Board and BRC are also provided with management information regarding strategic risk, including a Strategic Heat Map, the CRO's Report and progress updates regarding transformational activity.

David Fisher
Chairman of the Board Risk Committee
21 February 2017

Directors' Report

Year ended
31 December 2016

The directors have pleasure in presenting their Annual Report, together with the Annual Accounts and Annual Business statement, for the year ended 31 December 2016.

Information on the Society's vision, strategy and business performance is provided in the Strategic Report on pages 8 to 23.

Profits and capital

The profit and capital position is set out in the Strategic Report on pages 8 to 23.

Principal risks and uncertainties

The principal risks and uncertainties faced by the Society (and its approach to managing them) are set out in the Risk Management Report on pages 28 to 39.

Corporate governance

Statements on corporate governance and directors' responsibilities are set out in the Corporate Governance Report on pages 42 to 54.

Colleagues

Information on key colleague policies and associated key performance indicators are included in the Strategic Report on pages 8 to 23.

Environmental policy

The Environmental Policy is summarised in the Corporate Responsibility Report on pages 24 to 27.

Charitable and political donations

In 2016 the Group made a donation of £90,000 (2015: £100,000) to the Leeds Building Society Charitable Foundation. Other Society donations to charities and good causes (including colleague fund matching) in the year amounted to £46,000 (2015: £23,000).

The Caring Saver Account and the Your Interest In Theirs scheme provided further donations of £19,000 (2015: £22,000) and £99,000 (2015: £82,000) respectively to specified charities.

Other charitable contributions from colleagues and members totalled £91,000 (2015: £99,000) taking total donations to charity and good causes to £345,000 (2015: £326,000). No political donations were made during the year (2015: £nil).

Creditor payment policy

The Society's policy is to agree terms and conditions with suppliers that outline the way in which business is to be transacted, including the terms of payment, and to pay in accordance with contractual and other legal obligations.

The creditor days stood at 15 days at 31 December 2016 (2015: 21 days).

Mortgage arrears

At 31 December 2016, there were 233 (2015: 304) mortgage accounts 12 months or more in arrears. The total mortgage arrears, in these cases, was £3.8m (2015: £4.2m) and the total principal balance outstanding was £37.3m (2015: £44.0m).

Pillar 3 disclosures

The disclosures required under Pillar 3 of CRD IV are published on the Society's website.

Directors' responsibilities in respect of the preparation of the Accounts

This statement is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report. It should be read in conjunction with the Statement of Auditor's Responsibilities on page 82.

For each financial year, the directors are required by the Building Societies Act 1986 (the Act) to prepare annual accounts that give a true and fair view of the income and expenditure of the Society, and the Group, and of the state of affairs of the Society, and the Group, as at the end of the financial year, and that provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it. The Act states that references to International Financial Reporting Standards (IFRS) accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing annual accounts, directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether the annual accounts have been prepared in accordance with IFRS; and
- prepare the annual accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

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

In addition to the annual accounts, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Society and its subsidiary undertakings.

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Society and its subsidiary undertakings:

- keep accounting records in accordance with the Building Societies Act 1986; and
- take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business.

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

The directors are responsible for the maintenance of the corporate and financial information included on the Society's website. Legislation in the United Kingdom, governing the preparation and dissemination of financial statements, may differ from legislation in other jurisdictions.

Going concern

The directors are required to prepare financial statements on a going concern basis unless it is inappropriate to presume that the Group and the Society will continue in business.

The Board undertakes regular rigorous assessments of whether the Group is a going concern, in light of current economic and market conditions and information about future risks and uncertainties. Principal risks are set out in the Risk Management Report on pages 31 to 39. The directors consider that:

- The Group maintains an appropriate level of liquidity that is sufficient to meet both the normal demands of the business and the requirements which might arise in stressed circumstances. The availability and quality of liquid assets are structured to ensure funds are available to repay any maturing wholesale funds and exceptional demand from retail investors. Investments are made in accordance with the Group's Funding and Liquidity Policy and Wholesale Credit Risk Policy. These Policies are regularly reviewed and updated.
- The Group's other assets consist primarily of mortgages secured on residential property. Regular assessment of the recoverability of all mortgage assets is undertaken and provision made, where appropriate, so that the Group is not exposed to losses on these assets, which would affect its decision to adopt the going concern basis.
- Reasonable profits have been generated in order to maintain capital ratios at a suitable level to meet regulatory requirements. Having reviewed future plans and forecasts, the directors consider the Group is able to generate sufficient profit to maintain capital in excess of regulatory requirements.

Therefore, the directors consider that the Society and Group have adequate resources to continue in operational existence for the foreseeable future and so continue to adopt the going concern basis in preparing the financial statements.

In addition, the directors have assessed the Society's and Group's prospects over a longer period than the 12 months required by the going concern requirements and this assessment is included in the Viability Statement on page 23 of the Strategic Report.

Directors

The names of the directors of the Society who served during the year, their roles and membership of Board committees are included in the Corporate Governance Report on pages 42 and 43. In line with best practice all the executive and non executive directors, with the exception of Susan Cooklin, offer themselves for re-election by the members at the Annual General Meeting. None of the directors holds any beneficial interest in shares in, or debentures of, any subsidiary undertaking of the Society.

Auditor

In accordance with EU audit reforms, a competitive external audit tender process has been undertaken. This review resulted in a recommendation to reappoint Deloitte LLP, which was approved by the Board in October 2016. Further information on this process may be found in the Audit Committee Report on pages 56 to 63. In accordance with Section 77 of the Building Societies Act 1986, a resolution for Deloitte LLP's reappointment as auditor will be proposed at the Annual General Meeting.

Post balance sheet events

The directors consider that no events have occurred since the year end to the date of this Annual Report that are likely to have a material effect on the financial position of the Group as disclosed in the Annual Accounts.

Katherine Tong
Director of Compliance and Secretary

21 February 2017

Corporate Governance Report

Chairman's statement

It is the responsibility of the Board, under my leadership, to maintain a high standard of corporate governance. Corporate governance is a key aspect of the framework through which the Board operates and underpins the Society's ability to deliver its strategy, grow the business and create long term value for members.

The Board's approach to corporate governance is based on the principles and provisions of the UK Corporate Governance Code (the Code) published by the Financial Reporting Council (FRC) in 2012, updated in July 2016. The Society has continued to comply with the provisions of the Code in so far as they are relevant to a building society. A copy of the code is available at www.frc.org.uk

Governance has also been a focus from our regulators, in particular the accountability of senior managers within the banking and building society sectors. A new regime (Strengthening Accountability in Banking) came into effect in March 2016, to increase clarity around the accountability of executive directors and some non executive directors. A significant amount of work was undertaken to ensure that the Society was well equipped to meet the new requirements, ahead of their introduction in March.

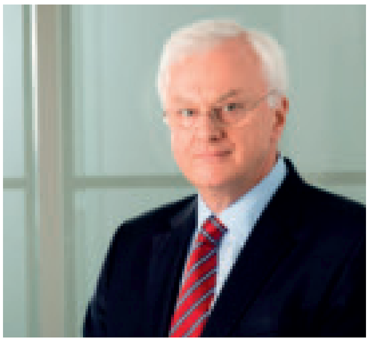
Richard Fearon joined our Board in February 2016, bringing with him a wealth of knowledge of the savings and mortgage markets. I would like to thank my Board colleagues for their ongoing support, wisdom and challenge.

This report sets out how the Board has operated throughout 2016 and applied the provisions of the Code.

Robin Ashton
Chairman

Leadership
Board of Directors

Robin Ashton
Chairman
(59)



I joined the Board as a non executive director in April 2011 and became Chairman in March 2013.

As Chairman, I attend many Board committees and I'm responsible for chairing and overseeing the performance of the Board of the Society. I'm a strong supporter of the building society sector and the mutual business model, which plays an important role in UK financial services. I'm a Chartered Accountant and spent my executive career in retail financial services. This has provided me with skills and experience, across a broad range of areas and, in particular, credit, treasury, audit and accounting. I'm also a non executive director of Shawbrook Group plc and its subsidiary Shawbrook Bank Ltd.

I'm married with three children and I enjoy reading and motorsports.

Peter Hill
Chief Executive Officer
(55)

I have over 37 years' experience in retail financial services, covering a wide range of disciplines.

I entered the mutual sector in 2001, joining the Society as General Manager (Sales) before moving into operations. I was appointed Operations Director in 2006 and Chief Executive Officer in 2011. As CEO, I'm responsible for developing and proposing the Society's strategy, objectives and plans, and the development of the Society's business model and culture. I'm Chairman of the Council of Mortgage Lenders, a director of the new Financial Services Trade Association (NewTA), an Associate of the Chartered Institute of Bankers and a fellow of the Royal Society of Arts. I'm married with two sons and a keen follower of Leeds Rhinos Rugby League Club.

Philippa Brown (50)

I joined the Board as a non executive director in January 2013, bringing a strong consumer, branding, digital and marketing perspective to the role.

I'm also a member of the Remuneration Committee. Putting our members' interests at the heart of the Society is important to me and integral to our business. I've been employed in marketing and advertising for over 25 years and I'm Chief Executive Officer of leading UK media agency Omnicom Media Group UK. Outside work, I enjoy swimming and have two children. I also support Breast Cancer Now and Future Dreams charities.

Susan Cooklin (56)

I joined the Board as a non executive director in February 2014 and I'm also a member of the Audit Committee.

I'm the Route Services Director at Network Rail Infrastructure Ltd, having previously been Group Chief Information Officer. Prior to this I was a senior executive at Barclays Bank within operations and technology. I bring to the Society broad expertise in enterprise risk and technology.
I spent my early career in the building society sector and I'm proud to be part of a mutual organisation where our members' interests are central to our business. Outside work, I enjoy spending time with my family and swimming.

Susan will be retiring from the Board at the 2017 AGM.

Richard Fearon (38)

I joined the Board as Chief Commercial Officer in February 2016.

I'm responsible for the Society's strategy and direction across product development, customer and digital, as well as direct and intermediary distribution. I chair the Society's Corporate Responsibility Steering Group and Conduct Risk Committee. After starting my career at Oliver Wyman & Company, I spent 10 years at Lloyds Banking Group in senior roles in the mortgages and savings businesses before joining the Society.
My experience has given me an excellent understanding of product development to meet customer needs, as well as strong strategic and commercial skills. I'm married with three young children and enjoy spending time with my family, and if there's ever a quiet moment, reading.

David Fisher (58)

I joined the Board in March 2012. I chair the Board Risk Committee.

My responsibilities include safeguarding the independence of the compliance and risk functions. I also chair the Pension Trustee Board and I'm a member of the Remuneration Committee. I started my financial services career with Halifax Building Society 27 years ago. Prior to joining the Society, I was Chief Executive of Sainsbury's Bank. I'm the Chairman of Amicus Finance plc and I also undertake a number of advisory roles. During my career, I have developed a wealth of knowledge in retail financial services and a strong understanding of risk management, pensions and human resources. I'm delighted to return to my mutual roots and be part of a Board that's totally committed to mutual status. Outside work, I'm married with two daughters and I'm a keen alpine walker and runner.

Andrew Greenwood (47)

I joined the Board as Chief Risk Officer in 2015 and I'm proud to be a director of the Society.

I started my career as a solicitor in private practice and have worked for the Society since 1998 in a variety of legal, compliance and risk-focused roles. I have developed extensive experience of working in a highly regulated environment. My skills and experience enable me to lead the Risk Division, which comprises a number of specialist teams. I'm responsible for the overall management of the risk control framework of the Society, which includes co-ordinating and managing principal risks and risk appetite. I report directly to the Board Risk Committee and attend all of the Society's management committees.
I live near York with my wife and two young children and enjoy watching sport and spending time with family and friends.

Gareth Hoskin (56)

It's a great privilege to serve the members of Leeds Building Society as I believe strongly in its mutuality and social purpose.

I joined the Board in November 2015.
I chair the Audit Committee where my responsibilities include safeguarding the independence of the Internal Audit Function and I'm the Society's Whistleblowing Champion. I also serve on the Board Risk Committee. Over my 30-year career, I've gained extensive UK and international financial services experience as a director of Legal & General plc and CEO of its International Division, and previously as a Chartered Accountant at Price Waterhouse.
I support Diabetes UK Ltd as a non executive director, Trustee and Audit Committee Chair and I'm also an Advisor to Green Park Partners Ltd. I'm married with two children and enjoy playing golf, travelling and spending time with my family.

John Hunt (62)

I joined the Board as a non executive director in April 2015.

I chair the Models and Rating System Committee and am also a member of the Board Risk Committee. I began my banking career with Yorkshire Bank in Leeds. Since then, I've held senior posts in a number of major UK and international banks and was a founder member of the Global Credit Data Consortium My areas of particular specialism fall within credit and treasury risk management. The past few years have been turbulent in the financial services world and I'm proud to be a Board member in a Society that's fully committed to mutuality, with its members' best interests at heart. I'm married with two sons.

Philip Jenks (66)

I joined the Board in March 2012. I'm a member of the Society's Board Risk and Models and Ratings System Committees.

I'm also Chairman at Charter Court Financial Services Group. I've worked as a consultant for organisations including the Government on housing related projects. With over 40 years' experience in the financial services and mortgage industries, I have developed a strong understanding in these and other specialist areas including credit and conduct risk management and technology. I fully appreciate the value of mutuality and I'm proud to be a director at a Society that's focused on getting things right for its members. I'm married with three children and enjoy walking, watching sport and going to the theatre.

Robin Litten (53)

I joined the Society in 2012 as Chief Financial Officer having spent the last 15 years in the mutual building society sector.

I have held senior roles at Barclays Bank, Skipton and Scarborough Building Societies. My role is to ensure that the Society remains financially secure and is able to fund continuing growth and investment for the benefit of our members. As a member of the Executive Committee, I lead the Society's Finance, Treasury and Strategy teams and I'm Chairman of the Assets and Liabilities Committee. Outside work, I enjoy spending time with my family, playing squash and cycling.

Les Platts (63)

I joined the Board in 2010 and I'm the Vice Chairman and Senior Independent Director.

I chair the Remuneration Committee and I'm responsible for overseeing the development of, and implementation of, the Society's remuneration policies and practices. I'm also a member of the Audit and Nominations Committees. The Society, with its proud history and firm commitment to mutuality, is a very strong part of Leeds' business community. As a Chartered Accountant, I was the Senior Partner for Deloitte in their Leeds office where I developed a deep understanding in the auditing and accounting arena. I have also developed a strong understanding in the fields of enterprise risk and human resources. Now I'm Chairman of an investment administration business and Honorary Treasurer of Lancashire County Cricket Club. Outside work, I'm married with two children and I support the NSPCC.

Karen Wint (51)

I have been Chief Operating Officer since late 2012.

I've worked in financial services for over 30 years with relevant experience to ensure that we have the right people, processes and technology in place to continue to deliver great service and value to our members. That includes continuing to change and update how we do things to meet new customer expectations in a rapidly changing world. I'm Chair of the Operational and Regulatory Risk Committee and a member of the Executive Committee. I'm a Chartered Banker and enjoy walking and spending time in the Yorkshire Dales.

Corporate Governance Report

Year ended
31 December 2016

Continued

The Board considers good corporate governance and a strong risk management framework to be essential to the long term success and viability of the Society. The Board is ultimately responsible for the business strategy and financial soundness of the Society and for establishing a governance framework and practices to facilitate its effectiveness in decision making and good governance. Management performance is assessed to ensure that adequate skills and resources exist to deliver strategy, including transformation projects which will help the Society to innovate and evolve for the benefit of its members.

The Board sets the tone from the top and provides oversight of management's role in establishing and maintaining its culture and values. This includes clearly setting out the key responsibilities of the Board and the senior leadership team. Distinct job descriptions exist for all Board related roles and details can be found later in this report.

A formal schedule specifies those matters reserved for approval by the Board and these include: the establishment of and changes to the Society's strategy; the Corporate Plan and budgets; proposals for the appointment, re-appointment or removal of external auditors; annual review of the effectiveness of the Society's systems of internal control; the Society's capital and liquidity requirements and annual approval of the Society's risk appetite.

The Board operates through meetings of the full Board, as often as is necessary for the proper conduct of business. This comprised 11 meetings in 2016, with two additional meetings dedicated to planning and strategy. A comprehensive and timely set of papers are provided for each meeting, which are designed to provide clear information to assist the Board with its deliberations and decision-making. Details of the areas considered by the Board can be found below.

Certain responsibilities are delegated to a number of Board committees, each one having clear and detailed terms of reference. The Board committees and their responsibilities are described in more detail on pages 46 to 48.

Powers are delegated from the Board to the Chief Executive Officer (CEO) and through him to the senior leadership team, via documented Delegated Authorities. These set out the responsibilities, decision-making and approval powers of managers at different levels of the Society and are reviewed and approved by the Board annually.

Board Activity

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

Strategy	• Monthly updates from the Chief Executive Officer on performance against corporate objectives, a risk overview, key business priorities and a summary of the economic outlook • Strategy and planning conferences • Performance against Corporate Plan and strategic objectives • Specific strategy reviews including retention and intermediary strategies • Business change and transformational project activity updates • Reviews of the competitive and external outlook • Reviews of the economic environment, including the implications of the UK's exit from the EU and the Monetary Policy Committee's interest rate decisions
Members	• Monthly updates from the Chief Commercial Officer on mortgage and savings business performance and customer complaints • Approval of the Annual General Meeting resolutions • Quarterly customer satisfaction and research reports • Update on TalkingPoint (a new member forum) • A Mutuality Review • Updates on customer centricity • Review of customer related management information

"The Board considers good corporate governance and a strong risk management framework to be essential to the long term success and viability of the Society."

Risk	• Monthly updates from the Chief Risk Officer on performance against corporate objectives, a risk overview and key risk focused priorities • Approval of Risk Appetite • Annual review of systems and controls across the three lines of defence • Annual Money Laundering Reporting Officer's Report on financial crime • Approval of capital issuances and annual update of the covered bonds and Euro Medium Term Note (EMTN) programmes • Approval of the ICAAP (Internal Capital Adequacy Assessment Process) • Approval of the ILAAP (Internal Liquidity Adequacy Assessment Process) • Approval of the Recovery and Resolution Plan • Minutes and updates from the Board Risk Committee, including the quarterly Chief Risk Officer's Report
Performance	• Monthly updates from the Chief Financial Officer on financial performance, capital, liquidity and financial risk • Monthly updates from the Chief Operating Officer on the change portfolio, IT resilience and customer service operations • Approval of the Society's interim and full year financial results • Reports and minutes from the Models and Ratings System Committee • Pricing and margin management methodology review • Approval of the Society's participation in the Term Funding Scheme
People	• Monthly updates from the Chief Operating Officer on people matters • Appointment and re-appointment of executive and non executive directors • Chairman's appraisal • Division of responsibilities between the CEO and the Chairman • Succession planning and talent management • Non executive pay review • Responsibility Maps for the Senior Managers Regime • Remuneration Policy • Approval of the move of the North East operations (circa 145 colleagues) to new premises • Reports and minutes from the Remuneration Committee • Updates on the attainment of the Investors in Diversity accreditation
Governance	• Board Effectiveness Review • Regulatory updates on new and emerging matters • Oversight of actions agreed with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) • Approval of the Delegated Authorities Manual • Corporate Responsibility Framework • Oversight of the development of the Society's culture • Annual review and approval of potential conflicts of interest • External auditor selection • Reports and minutes from the Audit Committee • Reports and minutes from the Nominations Committee • Private meetings between the Chairman and non executive directors, without the executives present

Board and executive committees

The Board delegates certain duties to a number of Board committees so that they can be discussed and considered in more detail. Board members are appointed to those Board committees most relevant to their skills and areas of expertise. The Chairman of each committee is responsible for ensuring that all committees receive accurate, timely and clear information to assist with their deliberations and decision making. Each committee has its own clearly defined terms of reference. Board committees have been established in line with the provisions of the Code.

There are three executive management committees to support the CEO in managing the business: the Executive Committee (ExCo), the Management Committee (ManCo) and the Transformation Committee (TranCo).
The executive management committees are also supported by a number of management working groups.

The Board committee and executive management governance structure is outlined below:

Board

The Board

The Board is accountable to the members of the Society and is primarily responsible for providing overall leadership of the Society and a solid framework in which to operate.

The Board is collectively responsible for:

- safeguarding members' interests;
- monitoring progress by Management in delivering the Society's strategy and business performance;
- ensuring robust risk management systems and robust financial and internal controls are in place;
- developing and delivering the Society's risk appetite;
- ensuring that the Society operates within its Rules (as amended from time to time), rules and guidance from the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) and all applicable laws;
- leading, developing and implementing the Society's culture.

Board committees

Board Risk Committee (BRC)

Reviews the Society's exposure to risk and oversees the Risk Management Framework to ensure that it is appropriate to mitigate current and prospective risks; oversees risk related reviews; develops strategic risk appetite and the Society's ICAAP, ILAAP and RRP for Board approval. The BRC is supported by four management committees: the Credit Committee, the Operational & Regulatory Risk Committee, the Conduct Risk Committee and the Assets & Liabilities Committee as set out on page 29 of the Risk Management Report.

Audit Committee (AC)

Monitors the integrity of external financial reporting; reviews the effectiveness of the systems of internal control and assesses the effectiveness, performance and independence of the Internal Audit Function and the external auditors.

Nominations Committee (NomCo)

Reviews the structure, size, diversity and composition of the Board; oversees succession planning and identifies candidates to fill Board vacancies; responsible for ensuring compliance with good corporate governance.

Remuneration Committee (RemCo)

Ensures that the remuneration policies, principles and practices support the long term interests of the Society and are appropriate to attract, reward and retain talented executive directors. In addition, to ensure that performance related elements of remuneration are transparent, stretching and rigorously applied, having regard to the risk appetite, member views and other stakeholders.

Models and Rating System Committee (MRSC)

Oversees the development and performance of the Society's rating system and reviews its performance against prudential regulation.

Executive Management Committees

The Executive Committee (ExCo)

The primary purpose of the ExCo is to enable the executive directors to manage the Society in a co-ordinated way, taking a broad view of key issues and priorities. The ExCo is required to monitor performance against corporate objectives and a balanced scorecard to facilitate early identification of divergence from plan and agree/monitor remedial action. The ExCo is responsible for formulation of strategy for approval by the Board and, in particular, has ownership of the People Strategy and the Customer Strategy. The ExCo is supported by the Management Committee (ManCo), the Pricing Working Group, the Transformation Committee, the Culture Working Group and the Stress Testing Working Group. The ExCo does not have a formal role in the Society's risk governance structure other than in the context of strategy and planning.

The Management Committee (ManCo)

The primary purpose of the ManCo is to enable the Senior Leadership Team to manage the Society in a co-ordinated way, providing a broad view on key issues and priorities. In support of the ExCo, the ManCo is required to monitor performance against corporate objectives and the balanced scorecard to facilitate early identification of divergence from plan and agree/monitor remedial actions. Again, in support of the ExCo, the ManCo provides input to the formulation of strategy, with a particular emphasis on the People Strategy and the Customer Strategy. Working alongside the TranCo and the Programme Management Working Group, ManCo assists in the co-ordination and implementation of strategic change programmes.

The Transformation Committee (TranCo)

The primary purpose of the TranCo is to provide oversight of the Society's change portfolio and ensure it is aligned to the overall strategic vision. TranCo is supported by the Portfolio Management Working Group which is responsible for governing the formulation, control and management of the overall change portfolio and providing oversight of small change activity/enhancements.

Corporate Governance Report

Continued

Board Risk Committee (BRC)

The Chairman of the BRC is David Fisher and the other members of the Committee during 2016 were Philip Jenks, Gareth Hoskin, John Hunt and Susan Cooklin.

In early 2016, the Society completed its transition to a new governance structure by putting into place four supporting management committees to support the BRC in the delivery of its extensive responsibilities. The management committees are: the Assets and Liabilities Committee, Credit Committee, Conduct Risk Committee and the Operational and Regulatory Risk Committee.

Further details on the new Risk Governance Framework and commentary on the types of risk faced by the Society, together with details of how these risks are managed, are set out in the Risk Management Report on pages 28 to 39 and in the Notes to the Accounts.

Audit Committee (AC)

The Chairman of the AC is Gareth Hoskin and the other members of the committee during 2016 were Susan Cooklin and Les Platts.

Further details on the work of this Committee can be found on pages 56 to 63.

Nominations Committee (NomCo)

The Chairman of the NomCo is Robin Ashton and the other member of the committee during 2016 was Les Platts.

In summary, the key responsibilities and deliverables of the committee in 2016 were:

- a review of the composition of the Board and Board committees;
- a review of the required capabilities and the job descriptions for the roles captured by the senior managers regime;
- oversight of the annual appraisal of directors;
- planning and preparation for the Board Effectiveness Review;
- a review of the Board Conflicts of Interest Register and approval of the policy;
- a review of the Competency Matrix and Board Succession Plan;
- annual Review of Compliance with the Corporate Governance Code;
- a review of Matters Reserved for the Board and the Division of Responsibilities between the Chairman and Chief Executive;
- annual review of the Diversity Policy;
- a review of Board Training and development.

Details on the work of this committee can be found throughout this report.

Remuneration Committee (RemCo)

The Chairman of the RemCo is Les Platts and the other members of the committee during 2016 were David Fisher and Philippa Brown.

Further information can be found in the Directors' Remuneration Report on pages 64 to 77.

Models and Ratings System Committee (MRSC)

The Chairman of the MRSC is John Hunt. The other non executive member of the committee during 2016 was Philip Jenks and other director members of the committee were Robin Litten and Andrew Greenwood.

The MRSC supports the Board in fulfilling its oversight responsibilities for the ratings system and general credit modelling. These responsibilities include overseeing the development of the ratings system and its performance, in addition to compliance with prudential regulatory requirements.

Terms of reference

The Schedule of Matters Reserved for the Board and the terms of reference for the committees are updated on an annual basis (or more frequently, if required) and are available to view on the Society's website: leedsbuildingsociety.co.uk/your-society/about-us/ or by writing to the Secretary at Leeds Building Society, 105 Albion Street, Leeds LS1 5AS.

Board and Board Committee membership attendance record

The table below shows the attendance of all directors at scheduled Board meetings and attendance of those who are members of the Board Committees at committee meetings held during the year.

Director	Board	Audit	Board Risk	Nominations	Remuneration	Models and Rating System
Robin Ashton	11/11			4/4		
Philippa Brown	9/11				4/4	
Susan Cooklin	11/11	6/7	2/2			
Richard Fearon*	9/10					
David Fisher	11/11		7/7		4/4	
Andrew Greenwood*	11/11					7/7
Peter Hill*	11/11					
Gareth Hoskin	11/11	7/7	7/7			
John Hunt	10/11		4/4			6/7
Philip Jenks	11/11		6/7			6/7
Robin Litten*	11/11					7/7
Les Platts	10/11	7/7		4/4	4/4	
Karen Wint *	11/11					

*executive directors/chief officers

Board roles

The roles of the Chairman and Chief Executive Officer are distinct and are held by different people. A review of the division of their responsibilities takes place annually by the NomCo, to ensure they remain separate and well defined.

The Chairman's principal role is to lead the Board. He is not involved in the day to day management of the Society. The CEO's primary role is to focus on the running of the Society and implementing strategy.

The role of the non executive directors is to bring independent judgement and perspective to Board debates and decisions and to constructively challenge the work and proposals of the senior leadership team, applying the highest standards of conduct, integrity and probity.

It is anticipated that after induction, non executive directors may be required to commit, on average, up to 36 days per annum in the discharge of their duties.

The main purpose of the non executive role is:

Strategy	To constructively challenge and help develop proposals on strategy, ensuring the fair treatment of customers and positive outcomes.
Member/ Customer	To ensure the fair treatment of members/customers.
Risk	To set the Society's risk appetite and to ensure that the integrity of financial information and controls are robust and fit for purpose.
Performance	To approve the Corporate Plan, monitor performance and challenge the executive team to deliver against plan objectives.
People	To have oversight of the culture, reward and talent management strategies while ensuring management performance achieves the required corporate goals.
Governance	To discharge allocated PRA/FCA Prescribed Responsibilities and/or FCA Business Activities via the Society's management forums, in line with the Society's Risk Management Framework.

Corporate Governance Report

Year ended 31 December 2016

Continued

Distinct job descriptions exist for all Board related roles and were enhanced to take into consideration the Strengthening Accountability in Banking Regime (which came into effect in March 2016).

The table below highlights the key accountabilities of these roles:

Role	Key accountabilities
Chairman	• The effective running of the Board and guardian of the Board's decision making process. • To support and advise the Chief Executive Officer in the development of strategy, as well as more broadly. • To ensure that the Board takes responsibility for the successful current and sustainable long term, performance of the Society. • To lead the development of the Society's culture by the governing body as a whole. • To ensure that the Board receives accurate, timely and clear information. • To take the lead in providing a properly constructed induction programme for new directors and in identifying and seeking to meet the development needs both of individual directors and of the Board as a whole. • To ensure the effectiveness of the Board, its committees, and individual directors is formally and rigorously evaluated, at least once a year. • To promote the highest standards of integrity, probity and corporate governance.
Chief Executive Officer	• To propose and develop the Society's strategy, objectives and Corporate Plan. • To ensure the Society operates an adequate system of control through the application of a three lines of defence model. • To ensure that prudential, conduct and operational risks are adequately controlled. • To deliver a balanced business performance across a wide range of scorecard measures to ensure the achievement of short term Corporate Plan objectives, whilst building long term sustainable performance. • To lead the executive team and, by implication, all colleagues within the Society. • To set the tone in respect of the Society's culture and to coalesce all colleagues around the Society's vision, strategy and values. • Responsible for all executive management matters affecting the Society. Whilst the Chief Internal Auditor reports to the Chairman of the Audit Committee, there is a subsidiary reporting line to the Chief Executive Officer. • To discharge the allocated PRA/FCA Prescribed Responsibilities and FCA Business Activities via the Society's management forums in line with the Society's Risk Management Framework.
Senior Independent Director/Vice Chairman	• To work closely with the Chairman, acting as a sounding board and providing support. • To act as an intermediary for other directors as and when necessary. • Be available to key stakeholders and other non executives to address any concerns or issues they feel have not been adequately dealt with through the usual channels of communication. • To meet at least annually with the non executives to lead the assessment of the Chairman's performance and to carry out succession planning for the Chairman's role. • To deputise for the Chairman.
Chair of Audit Committee	• To monitor the integrity of the financial statements of the Society and any formal announcements relating to financial performance, reviewing significant financial reporting judgements contained therein. • To review the adequacy and effectiveness of the Society's internal controls and risk management systems. • To monitor and review the independence, integrity, skills, resourcing and performance of the Internal Audit Function. • To make recommendations to the Board, for the appointment/re-appointment and remuneration of the external auditors and review and monitor their independence and objectivity. • To undertake the role of 'whistleblowing champion'.
Chair of: BRC, NomCo, RemCo, MRSC	• To ensure compliance with and delivery of good standards of governance, in accordance with the committee terms of reference, ensuring the committee provides effective independent oversight and challenge of executive decisions as appropriate by fostering open and inclusive discussions.

Secretary

In April 2016, Katherine Tong was appointed, by the Board, as the Society's Secretary. She replaces Andrew Greenwood who stood down in order to focus on his role as an executive director. Katherine is also the Director of Compliance and has worked for the Society for 16 years. Katherine has been employed in a number of business areas and has a wealth of experience in compliance and risk management. Katherine is supported in her role by the Secretariat Team.

Effectiveness

Board composition

As at the date of this report, the Board comprises 13 directors, of whom five are executive directors and eight are independent non executive directors. The size and composition of the Board is reviewed continually throughout the year and is considered at least annually by the Nominations Committee. This ensures that succession planning is adequately addressed, promoting the continual refresh of skills and experience on the Board.

The current composition of the Board complies with provision B.1.2 of the Code, which requires at least half of the Board, excluding the Chairman, to be made up of independent non executive directors. The Board considers that all non executive directors are independent in character and judgement. The Board's annual review of potential conflicts of interest (see page 53) did not identify any relationship or conflict which would impair a non executive director's ability to meet the criteria set out in the Code.

The Board considers that the current mix of directors' skills and expertise complement each other and provide an appropriate balance, which helps ensure members' interests are protected and the business has appropriate leadership and direction.

Where appropriate, all directors have access to the advice and services of the Secretary and, if required to fulfil their roles and responsibilities, to independent professional advice, at the Society's expense.

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

On 6 January 2017 the Society announced the resignation, with effect from 6 April 2017, of Susan Cooklin, a non executive director. Susan resigned following a promotion and increase in the commitment of her executive role at Network Rail. She will have served three years on the Board.

Succession planning

The NomCo regularly considers succession planning and the appointment of new directors and members of the senior leadership team, making recommendations to the Board, as appropriate.

The NomCo considers the size and composition of the Board and reviews the mix of skills (using a skills matrix) and experience of the existing directors to ensure that the Board continues to have the balance of skills, knowledge and expertise required to carry out its duties. The NomCo also reviews the length of service of each non executive director and the impact on Board Committee membership, when they are nearing the end of their term of appointment. The NomCo will then gauge which skills and expertise will be required when recruiting a new candidate.

Les Platts has been a non executive director since October 2010. Following review by the NomCo and taking into account his skills and experience, it was agreed to extend his directorship until 31 December 2018.

Appointments to the Board

A number of new appointments to the Board were highlighted within our Annual Report and Accounts for 2015, this included Richard Fearon who joined the Board in February 2016. There have been no other changes to the composition of the Board during the year.

As part of ongoing non executive director succession planning, the Board appointed Warren Partners to assist in the search for suitable candidates, including a replacement for Susan Cooklin. Warren Partners follow the executive search firms voluntary Code of Conduct, an industry standard code to redress gender balance and promote best practice. The search and appointment process will be comprehensive, involving open advertising, long and short listing, as well as a range of interviews, tools and techniques to assess candidate suitability.

In order to be successful, all directors must meet the tests of fitness and propriety prescribed by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) and must be approved by both regulators. In addition, they must be elected to the Board by the members.

The Board elects its Chairman and Vice Chairman, annually at the Board meeting immediately following the AGM.

In accordance with the Society's Rules, members are entitled to nominate candidates for election to the Board.

Copies of all non executive directors' letters of appointment are available on request from the Society's Secretary.

Corporate Governance Report

Year ended
31 December 2016

Continued

Board diversity

To reflect the importance we place on gender diversity, the Board has agreed a target of 33% for female Board members by 2021. Currently, three members of the Board are female representing 23% of the total Board membership, which is ahead of the FTSE 250 composite of 18%.

In terms of the wider senior leadership team (our top three levels of management) our female representation in this group is currently 31%.

The Society firmly believes in the importance of a diverse Board membership and gives consideration to all aspects of diversity. This is detailed within the Board Diversity Policy below.

Leeds Building Society firmly believes in the importance of a diverse Board membership in its broadest sense and promotes an inclusive culture across the organisation, in line with our values. We believe the diversity of skills, experience, backgrounds and other distinctions including gender and race strengthens the capability of the Board and, therefore, the effectiveness of its independence, judgement and decision making.

All Board appointments will be based on merit against objective criteria, the skills and experience of the Board as a whole and with regard to the benefits of diversity.

The Nominations Committee reviews and assesses Board composition on behalf of the Board on an annual basis and recommends the appointment of directors. The Committee also oversees the conduct of the annual review of Board effectiveness.

The Nominations Committee will agree annually the measureable objectives for Board diversity and recommend them to the Board for adoption. Currently, the objectives are to:

- Proactively aim for female representation of 33%, both on the Board and in the top three layers of our senior management team (excluding the Board) by 2021;
- Only engage executive search firms which have signed up to the voluntary Code of Conduct for gender diversity and best practice. External advertising is to be considered as part of the attraction methods utilised;
- Provide enhanced disclosure on the Board appointment process and the consideration of diversity as part of the board evaluation process.

The Nominations Committee will report annually in the corporate governance section of the Leeds Building Society Report and Accounts on the agreed objectives and the progress against these objectives and other initiatives taking place which promote gender and other forms of diversity.

The Society has signed up to the Women in Finance Charter demonstrating our commitment to diversity.

We also believe it is important to consider elements of diversity beyond gender and have committed to develop and agree a broad ranging Diversity Strategy, including the setting of milestones for the achievement of supporting activities in 2017.

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

Directors' induction, development and individual performance evaluation

On appointment, all new directors receive a detailed induction programme which is tailored to their individual requirements and based on their skills and expertise. The programme is also cognisant of the role they will play within the committee and governance structure

In order to maintain continuous professional development, all directors also have an individual personal development plan which is monitored, reviewed and refreshed during their annual evaluation.

Ongoing professional development is essential to enable directors to be sufficiently and appropriately informed about the Society, its values and culture, its business and objectives, the regulatory framework and the markets in which it operates. Having a strong command of issues relevant to prudential and conduct risk management systems are also essential and will inform Board or committee discussions and decisions.

The performance of individual non executive directors is evaluated annually by the Chairman. The Board evaluates the Chairman's own performance at a meeting when he is not present and feedback is provided to him by the Senior Independent Director.

Executive directors, including the Chief Executive Officer, are evaluated annually within the framework for all employees of the Society and by the Remuneration Committee in terms of remuneration and any bonus payments.

Board effectiveness

The Board undertakes an annual evaluation of its performance and effectiveness, which is facilitated by an external firm at least every three years. An externally facilitated review was last held in 2015. In June 2016, the Chairman and Senior Independent Director led the evaluation process internally. It concluded that the Board, including its members and committees, are operating effectively and no significant areas for remedial action were identified.

All Board committees also evaluate their own performance and effectiveness annually. This process serves to identify any areas where non executives require further training and development in order to discharge their duties effectively.

Conflicts of interest

All directors have a statutory duty to avoid any actual or potential conflicts of interest.

The Board has a Conflicts of Interest Policy which sets out the procedures for declaring and, if appropriate, authorising any real or potential conflicts of interest, should they arise. The Policy requires that any other positions which a director takes up should first be referred to the Board for consideration, in terms of any potential conflict of interest and time commitment.

The Secretary maintains a detailed register of any conflicts of interest and this is submitted annually to the Board for review. The Board has considered the current external appointments of all directors which may give rise to a situational conflict and has authorised potential conflicts, where appropriate. The Board considers that neither the Chairman nor any director had a material conflict of interest or any significant new commitments to declare, which would impact the effective discharge of their responsibilities, during the year ended 31 December 2016.

The NomCo considers that all directors comply with Article 91 of Capital Requirements Directive IV, which came into effect in July 2014 and have sufficient time to discharge their duties at the Society and do not hold more than the prescribed number of directorships.

Accountability

Risk management and internal control

The Board recognises the importance of sound systems of internal control in the achievement of its objectives and the safeguarding of member and Society assets. It is the responsibility of management to design, operate and monitor internal controls which adhere to the Board's policies on risk and control.

The Society operates a Risk Management Framework (RMF) which encourages a culture of sound risk management and internal control. The RMF facilitates robust risk assessment and requires the effectiveness of risk management and internal control systems to be monitored and reviewed.

The Board is responsible for reviewing the ongoing effectiveness of the systems of internal control and does so through regular reports and presentations to the Board as well as through the supporting Board committees; in particular the Audit Committee and the Board Risk Committee.

Further details of the Society's RMF can be found on pages 28 to 31. Details of the role and responsibilities of the Audit Committee can be found on pages 46 to 48.

As a Public Interest Entity under European guidance, the Society is required to follow the 2014 rules which came into effect in 2016. This means that during the year, the Society has been required to conduct a competitive tender exercise for the external auditor position. Further details of this process and its outcome can be found in the Audit Committee Report on pages 56 to 63.

The Board is satisfied with the effectiveness of the governance processes exercised through the RMF and that during 2016 the Society maintained an adequate system of internal control, covering all material controls including financial, operational and compliance controls.

Financial reporting

Following recommendation from the Audit Committee and after making appropriate enquiries and undertaking reviews of internal reports, as well as following completion of the external audit, the directors consider, taken as a whole, the Annual Report and Accounts to be fair, balanced and understandable and provide the necessary information for members to assess the Society's position, performance, business model and strategy.

Our statement on going concern, why it is considered appropriate to adopt and how this was arrived at, can be found in the Audit Committee Report on pages 56 to 63 and the assessment of and future prospects for the Society and the period to which it pertains can be found in the longer term viability statement, in the Strategic Report, on page 23.

Remuneration

The annual report on remuneration and details of the Society's Remuneration Policy can be found in the Directors' Remuneration Report on pages 64 to 77.

Relations with members and other investors

The Society is a member owned mutual organisation and the views of savers and borrowers are very important to us. Feedback on any aspect of the Society's business activities are encouraged in a number of ways:

Independent market research

Quarterly customer satisfaction surveys are conducted to understand and act upon customer feedback on the level of service they have received. These reports are submitted to the Board and used by management as a catalyst for service evaluation and improvement.

Nominate a Star

Through the Society's website, customers can nominate a colleague, who has gone above and beyond to make their experience with the Society special. Nominations are then considered by a management panel and prizes are awarded to successful nominees.

TalkingPoint

This online members' forum has quick polls, surveys and focus groups inviting members to share feedback on a wide range of subjects, including what they think of the Society itself and their opinions on new products and services. The forum has proved popular and helps the Society to better understand the needs of its customers.

Since launching in November 2015, TalkingPoint has provided the Society with invaluable member feedback. With more than 1,900 members currently active, the ability to conduct both qualitative and quantitative research has led to Society communications being redesigned to allow integral customer input into key future business developments.

One of the key areas TalkingPoint members have influenced is the communications sent by the Society. Feedback from 292 members fed into the process to reshape the eNewsletter which subsequently impacted the design and content, as well as the frequency of distribution.

Research into customer preferences, when it comes to interacting with their financial institution has also played a key role in directing the Society's digital developments moving forward.

The Annual General Meeting (AGM)

The AGM is a key event for our members to have their say on the way in which the Society is run. The next meeting will be held on Thursday 6 April 2017 at 11am at the Marriott Hotel, Leeds. All eligible members will be sent the Notice of the AGM, a proxy voting form and a Member Magazine which, includes the Summary Financial Statement, along with contact details.

Members are asked to vote on a number of resolutions including the Society's Annual Report and Accounts, the election or re-election of the external auditor, the Directors' Remuneration Report and the re-election of the directors.

Members can vote in person at the AGM, in one of the Society's branches, by post or online. Members are encouraged to personally attend and join the Society's directors who make themselves available to answer questions, both during and after the meeting. The results of the vote are published on the Society's website and via a regulatory news service.

Members are also asked to join TalkingPoint to provide feedback on their voting experience. This helps the Society to improve the customer experience and helps us to understand the method by which members prefer to vote and the information they require.

Further information on member engagement can be found in the Corporate Responsibility Report on pages 24 to 27.

Relations with other investors

The Society's Treasury team holds meetings with institutional investors after the half year and full year results have been announced. Regular meetings are also held on an ongoing basis. Regular dialogue is maintained with credit rating agencies.

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

Robin Ashton
Chairman

The Board's role is to provide leadership for the Society, within a framework of prudent and effective controls, which enables risk to be assessed and managed.

Audit Committee Report

Year ended
31 December 2016

Dear Member,

I am pleased to present our report on the work of your Audit Committee.

We have continued to see progress in the level and quality of assurance that the Committee receives in its role overseeing the control and risk environment.

Controls considered key to the Society were subject to a separate independent programme of quarterly testing by Internal Audit during the year, as a precursor to this work being embedded in management's own first line Risk and Control Self-Assessment (RCSA) from 2017 onwards. This will further augment the assurance gained by the Committee from this process.

Second line oversight has been fully engaged in this endeavour and has also provided substantial assurance to the Committee on other issues, in particular the ever increasing risk of cyber attack.

Internal Audit continue to provide a fully effective third line of defence and the Committee was pleased to receive the positive results of an external quality review of this Function, undertaken by KPMG.

Significant time and effort was devoted to undertaking a rigorous external audit tender, a process in which I took a direct interest. The Committee was pleased with the quality of those firms who tendered and is satisfied that a reappointment of Deloitte would secure the best firm for the role at this time.

The introduction of IFRS 9 is, and will continue to be, a considerable exercise and I am pleased to report that this project has made good progress during the year.

In 2017 the Committee will continue to seek progress in the above areas, all of which have the firm support of the Society's senior management.

G.J. Hoskin

Gareth Hoskin
Audit Committee Chairman
21 February 2017

Purpose and constitution

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

- monitor the integrity of the externally reported financial statements of the Society;
- review the effectiveness of internal controls and risk management systems;
- oversee the effectiveness and performance of the Society's Internal Audit Function;
- assess the independence, performance and objectivity of the Society's external auditor; and
- oversee the Society's whistleblowing arrangements.

The Committee is composed solely of independent non executive directors and is chaired by Gareth Hoskin. The other members are Susan Cooklin and Les Platts, Senior Independent Director.

During the year, the Committee held seven meetings. At the invitation of the Committee, meetings were attended by the Chief Executive Officer, Chief Financial Officer, Chief Risk Officer and the Chief Internal Auditor. The Audit Engagement Partner from the external auditor was also in attendance, as were representatives from the Finance Division and other relevant business areas.

The Committee held two private sessions with each of the external auditor and the Chief Internal Auditor, which were not attended by management.

Committee's main activities

Financial statements of the Society

As part of its work reviewing the financial statements of the Society, the Audit Committee received and discussed reports from management and the external auditor on both the interim and full year results of the Society.

In preparing these financial statements it is necessary for management to make certain assumptions, use estimates and form judgements, some of which are of material significance. The Committee, with appropriate input from the external auditor, examined and challenged those key areas affecting the financial statements and a summary of the Committee's work during the year is set out below.

Area of focus	Reporting issue	Role of the Audit Committee	Conclusion/action taken
Impairment provisions – residential and commercial mortgages	This is an area of inherent accounting estimate and judgement. The level of impairment provisions required in the residential mortgage book is based on statistical models, which incorporate historical default and loss experience information, and management judgement to determine expected economic conditions. As the commercial loan book has reduced in size, the use of purely statistical models has become less appropriate and, for impaired loans, assessments are made on a loan by loan basis, paying particular attention to collateral valuations.	Noted the impairment provisioning policy approved by the Credit Committee. Reviewed and challenged reports from management on the basis of the calculation of the impairment provisions and considered the outcome of the detailed discussions and challenges to management by the Credit Committee. The Chairman of the Audit Committee attended Credit Committee discussions on impairment. The Committee paid particular attention to the prudency and adequacy of post model adjustments made by management where current best estimates of losses diverge from empirical historic trends and the impact of forbearance. The valuation and recoverability of collateral was a key area of focus, as was the impact of Brexit.	Following consideration of this information, the Committee concurred with the Credit Committee's view that management's proposals for the level of impairment provisions, including post model adjustments, are reasonable.
Effective interest rate	Interest income is recognised in the Income Statement by reflecting a constant yield over the expected behavioural life of the mortgage loan. The rate of revenue recognition is derived from models which are maintained by management. An estimate of future behavioural lives is required to perform the constant yield calculation. These models are particularly sensitive to movements in the life of the mortgage loan including any prepayment of the loan.	Reviewed the methodology and assumptions made in the model, including behavioural lives, which were aligned to those used in the Society's pricing and planning models and balance sheet management. Considered the change made in respect of the estimated life of the residential mortgage portfolio to reflect the changes in the lives arising from current market conditions.	The Committee concluded that the methodology and assumptions used by management, including the shortening of the lives, are reasonable.
Hedge accounting	The Society holds derivative financial instruments in order to mitigate various business risks, including interest rate and foreign exchange risks. International Financial Reporting Standards require changes in the value of these derivatives to be recognised immediately in the Income Statement. However, if they adhere to strict accounting criteria some, or all, of the changes in the derivatives may be offset against the changes in the fair value of the underlying items being hedged.	Continued to oversee management's control activities in applying the rules of IAS 39. This included review and discussion of the external auditor's report on hedge effectiveness testing and internal reporting. Undertook specific Audit Committee training on fair values and hedge accounting, which included the Society's approach to hedge accounting, incorporating accounting principles, the Society's application of these and control processes in place.	The Committee has satisfied itself that amounts recognised by management in the financial statements are fairly stated and appropriate disclosures have been made.

Audit Committee Report

Year ended
31 December 2016

Continued

Area of focus	Reporting issue	Role of the Audit Committee	Conclusion/action taken
Fair values	The Society carries certain financial instruments at fair value throughout their lives in accordance with accounting standards. This includes derivatives, as well as some more complex products such as a collateral loan to a third party secured on equity release mortgages. The Society needs to determine the fair value of these instruments, for which open market prices may not be readily available, for recognition in the Annual Report.	Reviewed the derivative valuation process as part of the hedge accounting work as set out above. Reviewed the methodology for the fair valuation of the collateral loan and the derivative portfolio, including the relevant control processes. Considered the outcome of external work undertaken on the collateral loan value and the associated swaps, including the sensitivity analysis.	The Committee challenged the process for valuing derivatives and deemed it and the outputs to be appropriate. The Committee noted that there is a range of possible fair values for the collateral loan but that the fair values used in the preparation of the financial statements are reasonable. The Committee reviewed and was comfortable with the sensitivity analysis disclosed.
Technology infrastructure costs	During the year, the Society continued its strategic investment in technology functionality, including upgrading its broker service and building its digital customer capability. Judgement is required in ensuring that the key elements of this expenditure are accounted for as an expense for the year, or capitalised in accordance with the relevant accounting standards. In addition, where the project evolves over time, judgement is required to determine whether the amounts capitalised to date remain supportable in light of the future benefits to be realised.	Received management's paper setting out the costs incurred and their proposed treatment. Considered whether the allocations made between revenue and capital expenditure were appropriate. Considered management's assessment of the carrying value of the capitalised amounts, in light of project revisions and the benefits expected to be realised. Discussed the appropriateness of amounts capitalised with the external auditor.	The Committee agreed with the treatment of the costs incurred and the split between capital and revenue expenses. The Committee concluded that, in respect of the revised projects, the benefits were in excess of the total expected spend and therefore the carrying value was appropriate.

The Committee also considered other matters relevant to the preparation of the financial statements, with a particular focus in the following areas:

Retirement benefit obligation/ surplus	The Society has a defined benefit pension scheme, which was closed to new entrants in January 2000 and was closed to future service accrual on 31 December 2014. The amounts recognised in the financial statements are sensitive to a number of assumptions, including inflation, the rate of increase in salaries and pensions, the rate used to discount scheme liabilities, the expected return on scheme assets and mortality rates. During the year the single largest sensitivity has been to the rate used to discount the Scheme's liabilities.	Reviewed the assumptions set by management, based on a report from KPMG, the Scheme's actuary, on the assumptions used. Noted confirmation from management that these assumptions, together with the disclosures in the Annual Report, were consistent with IAS 19. Requested and considered a legal and accounting review of the Society's rights and obligations in light of the current and expected future requirements of IFRIC 14.	The Committee noted that the assumptions adopted by management were consistent with the actuary's report and confirmed by the external auditor. It satisfied itself with the position reported within the Annual Report and Accounts and the recognition on the balance sheet of the pension scheme obligation.

Area of focus	Reporting issue	Role of the Audit Committee	Conclusion/action taken
Provisions for liabilities and charges	The Society has set aside provisions for liabilities and charges including those for the FSCS levy and for the potential cost of customer redress, such as Mortgage Payment Protection Insurance (MPPI) and mortgage interest overpayments on one purchased mortgage portfolio. The level of these provisions is dependent on several of assumptions and estimates.	Reviewed and challenged reports from management, which set out the basis of the provisions. Considered the quantum of the proposed provisions in the context of actual claims experience, projections for future claims, associated costs and the proportion of claims upheld by the Financial Ombudsman.	The Committee concluded that the overall level of provisions, including the amount raised against compensation for overpayment of mortgage interest on one purchased mortgage portfolio, was appropriate.
Going concern	The Board is required to confirm whether the going concern assumption is appropriate for the Society to use as a basis for the preparation of its Annual Report and has delegated this assessment to the Audit Committee.	Reviewed and challenged the detailed report prepared by management which covered the Society's business performance, profitability, capital and liquidity forecasts, as well as the key operational risks faced by the Society, including technology risks. Considered whether the going concern assessment was consistent with other internal information, such as the Corporate Plan and the detailed stress testing, undertaken as part of the annual liquidity and capital adequacy assessments. Had regard to the outcome of the viability review undertaken by the Board Risk Committee.	After reviewing the report and the additional information, the Committee concluded that the adoption of the going concern assumption to prepare the 2016 Annual Report remained appropriate and was consistent with the outcome of the viability report.
Fair, balanced and understandable	The Society is required to ensure that its external reporting is fair, balanced and understandable and the Board has delegated this assessment to the Audit Committee.	Satisfied itself that there was a robust process of review and challenge throughout the process and at all levels to ensure balance and consistency. This included: • guidance issued to those involved in drafting or reviewing the Annual Report; • a thorough internal verification process of the factual content of the reports; and • a range of reviews of drafts of the Annual Report to ensure consistency of disclosures and an appropriate level of balance. Also considered consistency with other internal information, including a review of the Society's performance for the year.	After consideration of relevant information and discussion with the external auditor, the Committee was satisfied that, taken as a whole, the Annual Report and Accounts are fair, balanced and understandable.

Continued

Effectiveness of internal controls and risk management systems

The Board recognises the importance of systems of internal control in the achievement of its objectives and the safeguarding of member and Society assets. It is the responsibility of first line management to design, document, operate and monitor internal controls that adhere to the Board's policies and standards. The Society operates a Risk Management Framework (RMF) that encourages a culture of sound risk management and internal control, which is overseen by the Board Risk Committee and delivered through established governance mechanisms and a three lines of defence assurance model. Further details on the Society's RMF can be found on pages 28 to 31.

During the year the Audit Committee sought and received controls assurance from all three lines of defence and from the external auditor.

First line management

As part of the RCSA process, first line management undertakes a self-assessment twice a year and documents the implementation and effectiveness of key controls, including any material deficiencies when compared to key risks recorded in the risk register. Where deficiencies arise, management identifies and records remediation activities, which are tracked to completion. The 2016 RCSA exercises reflected a maturing approach to risk assurance, through the phased roll-out of an increasingly integrated approach to control testing and reporting under the Society's established three lines of defence model.

Second line – Risk

The Committee received assurance from the Risk Team over the operation of key controls which included the outcome of the RCSA. The overall conclusions of the reports received were that the risk profile and control environment was stable. Further investment in systems and processes continues to reduce the current reliance on many manual key controls.

The Committee has also remained appraised of developments in the Society's risk capabilities and infrastructure. In particular the Committee received updates on the Society's approach to technology and cyber risk including external training on technology and cyber risk governance.

Third line – Internal Audit

The Committee received regular reports from the Internal Audit Function containing key themes and control weaknesses arising from delivery of the agreed Internal Audit Plan, together with an update on the resolution of recommended actions to improve controls. This work was designed to provide an independent risk-based assessment of the internal control environment, but it also included work on particular areas of importance and interest to the Committee, including:

- regulatory reporting, including an audit of the framework and a detailed review of a sample of returns to the Society's regulators.
- financial and treasury operations, including completion of all recommendations made in the autumn 2015 audit.
- project governance, including specific pieces of work on treasury systems, as well as the IFRS 9 project.

Internal Audit tracked and followed up recommendations made in their reviews. In areas where higher priority recommendations were raised, the Committee received regular updates until matters were fully resolved. During the year Internal Audit also introduced consideration of business culture into each review. Overall, Internal Audit noted that their findings were received positively and that management was willing to take steps to address control weaknesses identified in a timely manner.

The Committee was pleased to note the programme of specific key controls review and testing undertaken by Internal Audit in 2016, which supplemented the self-assessment process by management and reported to the Risk Function. On a rotational basis, Internal Audit assesses the design and operation of the key controls described in each function's RCSA to provide improvement points and positive assurance as appropriate, and reported their findings quarterly to the Committee. During the course of 2017, this key controls testing will be migrated to the first line and will augment their RCSA work.

The Annual Report to the Committee of the Chief Internal Auditor summarised the 2016 audit findings and focused on the key themes, observations and root causes arising from Internal Audit's work. The report also mapped audit findings against the principal risks of the Society, identified by management and recorded in risk registers, which confirmed appropriate audit coverage. This Annual Report concluded that the Internal Audit Function had not identified any issues that they consider would materially impact the accuracy and completeness of the financial statements.

External Audit

In addition to its comments on the financial reporting assumptions, estimates and judgements, the external auditor also provided the Committee with reports on its assessment of the Society's internal control environment. This assessment is made solely for the purposes of reaching an external audit view on the Annual Report and Accounts but it does involve assessing the design and effectiveness of certain financial reporting, IT and operational controls. The Committee had regard to the results of this work in its assessment of the control environment. No high priority findings were identified from the 2015 year end audit or the 2016 interim or year end audits.

Effectiveness and performance of the Society's Internal Audit Function

The Board recognises the importance of Internal Audit in providing a reliable third line of defence and delegates to the Audit Committee the role of overseeing the effectiveness and performance of the Function. The Chief Internal Auditor reports directly to the Audit Committee Chairman. The Committee noted the continued, strong progress being made by Internal Audit. During the year it:

- received, assessed and approved the Internal Audit planning methodology and risk-based audit plan
- received and discussed regular updates on the progress of its work against this audit plan
- received, debated and approved the Internal Audit Charter and terms of Reference which detail the scope, purpose, authority and responsibilities of the Internal Audit Function
- received a comprehensive report on the skills and resources of Internal Audit, including the selective and appropriate use of PwC as co-source partners.
- oversaw the ongoing development of the skills, competencies and qualifications within the Internal Audit Function; and
- held two private meetings with the Chief Internal Auditor to discuss audit and planning priorities, methodologies and ongoing developments within the Internal Audit Function.

Following completion of a full independent External Quality Assurance (EQA) review of the Internal Audit Function undertaken by KPMG in 2015, the Committee received the final report. It was pleased to note that the EQA review identified significant improvement since its previous report in 2013 and concluded that the Function benchmarks favourably with its peer group, complying fully with the Institute of Internal Auditors' Standards across all areas.

The Audit Committee is pleased to note that the Society's Internal Audit Function is independent, effective and fully compliant with the Chartered Institute of Internal Auditors and with the Financial Services Code. The Committee concluded that the work completed by Internal Audit in 2016 has provided adequate coverage across the principal risks of the Society.

Independence, performance and objectivity of the external auditor

In undertaking its oversight of the relationship with the external auditor and their effectiveness in the external audit process, during 2016 the Audit Committee:

- received, challenged and approved the scope, materiality, coverage and timing of the external audit work, as set out in its audit planning document. This included evaluating the significant risks identified by the auditor against management's self-assessment and considering the effect of industry developments, including the risks associated with technology and cyber crime, on the audit approach.
- monitored the execution of the external auditor against the agreed plan and requested early reporting of work on critical controls and accounting areas.
- reviewed and approved the audit engagement letter and fees.
- reviewed the letters of representation drafted by management and recommended these to the Board for signing.
- satisfied itself as to the qualification, expertise, resources and ongoing independence of the external auditor, including the Audit Engagement Partner, David Heaton, who was appointed in 2015.
- considered progress against the points raised in the client services assessment in 2015 conducted by the external auditor and acknowledged the actions taken to improve the audit during 2016.
- reviewed and approved the policy on non-audit services, including the employment of former partners or staff of the external auditor, in light of the revisions to the Corporate Governance Code. The external auditor undertook a number of non-audit assignments during the year including regular annual review work in connection with Society's structured funding vehicles. These assignments were conducted in compliance with the approved policy and occur typically where it is either mandatory or more efficient for the external auditor to perform the work in light of the information previously reviewed during the audit engagement. In 2016, non-audit fees, including one-off items, represented 52% of the annual audit fee. The Committee is mindful of the EU audit reforms regarding non-audit services.

Audit Committee Report

Continued

- held two private meetings to discuss any issues and concerns arising from the auditor's work.

Based on the above work the Committee satisfied itself that the external auditor is effective and independent.

Other matters addressed by the Committee

External audit tender

Deloitte LLP was first appointed as external auditor to the Society in 2005 following a competitive tender process. In accordance with EU audit reforms, and as set out in the 2015 Annual Report, the Committee decided to re-tender the external audit engagement for the 2017 year end.

In July 2016, the Committee formed a subcommittee chaired by Gareth Hoskin to ensure that adequate time and attention could be allocated to the process. This was supported by a panel of colleagues from across the Society, including the Finance, Risk and Internal Audit functions.

Four external audit firms were invited to tender and provided with access to the relevant information and individuals to draft a written document setting out their external audit proposals. These were scored by each panel member against a set of pre-agreed criteria, which included scoring of the results from audit quality reviews undertaken by the Financial Reporting Council. The criteria were also shared with the firms to ensure transparency. Following a detailed discussion of the written documents and the scores received, the subcommittee shortlisted two firms.

The shortlisted firms were asked to deliver presentations expanding on some of the themes in their written documents and then to respond to specific questions from the panel. The subcommittee considered the individual views of each panel member, as well as the comments received from the firms' external referees.

The Audit Committee reviewed the subcommitee's assessment of the firms' offerings and, following further discussion, agreed with its recommendation. The Committee confirmed that it was content that the tender process had been an open, thorough and well run process, which ensured audit quality and auditor independence were maintained as part of a strong governance framework.

The Committee made its recommendation to the October Board meeting with a stated preference for the reappointment of Deloitte LLP. The Board agreed that the reappointment of Deloitte LLP would be proposed to members at the Annual General Meeting in April 2017.

Les Platts held a role as a partner of Deloitte LLP, from which he retired eight years ago and which he had declared at the outset of the process. In view of this, Les Platts was not present at subcommittee, Audit Committee or Board discussions when recommendation decisions were made.

Speak Up Policy

The Committee reviewed and approved the Society's Speak Up Policy and discussed the number and nature of reports submitted, none of which was deemed to be significant or concerning.

The Committee was also kept fully appraised of the regulations on whistleblowing which came into effect on 7 September 2016, following which a number of changes were submitted to and approved by the Committee which included:

- the appointment of an external company to provide a confidential, independent channel for anonymous concerns and feedback
- the appointment of a Whistleblowers' Champion, this being the Chairman of the Audit Committee;
- the extension of the Speak Up policy to include customers, suppliers and third parties and the types of concerns that can be reported; and
- refreshed training and a communication plan for colleagues.

IFRS 9

IFRS 9 is the forthcoming accounting standard that will determine the way in which the Society accounts for its financial instruments, including impairment losses, from 1 January 2018. The Audit Committee has overall responsibility for the Society's IFRS 9 project and work on this has accelerated in 2016. The Committee has received training on key aspects of the requirements, including accounting recognition, credit risk modelling and governance. It also considered regular progress updates against evolving industry practice information shared by management and the external auditor and reviewed and challenged accounting policy choices and initial quantitative analysis of the impact of IFRS 9 on certain items in the Statement of Financial Position. IFRS 9 will remain a key area of focus for the Committee in 2017, as the parallel run of models commences.

Pillar 3 Disclosures

The Committee approved the Pillar 3 Disclosure Policy and reviewed the 2016 disclosures, noting the work performed by the Prudential Risk and Internal Audit functions. Based on this the Committee recommended the Pillar 3 Document for approval by the Board.

Audit Committee effectiveness and training

During November, the Committee undertook a self-assessment of its effectiveness. The review was performed using anonymous questionnaires completed by all members and regular attendees at meetings including the external auditor. The review concluded that the Committee had operated effectively and in accordance with its Terms of Reference. It noted that the composition of the Committee was fit for purpose and included non executive directors with the appropriate skills and experience, including two chartered accountants.

The Terms of Reference were also reviewed and updated to align them to latest governance requirements and best practice, although these did not result in any fundamental changes to the Committee's activities. The revised Terms of Reference were approved at the November meeting.

All Committee members were required to undertake relevant training as part of their overall development during the year. The Committee members also receive training, as a whole, on relevant topics from both internal and external sources. In 2016, training for the Committee included updates on financial reporting, corporate governance, internal audit and information technology. Financial reporting training focused mainly on IFRS 9, but also included a session on fair values and hedge accounting. Technology training covered a range of themes such as cyber incident management, data privacy and data governance.

Directors' Remuneration Report

Year ended
31 December 2016

Annual Statement

Dear Member

I'm pleased to present the 2016 Directors' Remuneration Report, produced in compliance with the FCA dual-regulated firms Remuneration Code. It details our annual report on remuneration for the Society's executive directors and other Material Risk Takers (MRTs) for the year ended 31 December 2016.

The report is presented in two sections:

- The Remuneration Policy, which has been updated for 2017, in respect of the European Banking Authority (EBA) guidelines on Sound Remuneration Policies. The revised Policy will apply from the date of the Annual General Meeting (AGM) in 2017, subject to consideration of the outcome of the Ordinary Resolution.
- The Annual Report on Remuneration, which explains how we put our policy into practice in 2016 and outlines our approach for 2017.

Our members will have the opportunity to vote, on an advisory basis, on the Remuneration Policy and Directors' Remuneration Report at the AGM.

Remuneration policy

After a review of the measures of success for executive directors' variable remuneration, the Remuneration Committee has, from 2017, changed the performance measures for the annual bonus scheme to:

- ensure a better alignment to our short and long term strategy and objectives;
- align reward with our culture and values, with specific focus on customer and colleague metrics.

The performance measures, designed to support the long term interests and security of the Society, are equally balanced between financial, performance and personal objectives. The financial metric is related to our corporate objective relating to profit, providing security to our members. The performance element is based on a range of metrics, designed to support our strategy. For 2017, the priorities which will be remunerated are customer satisfaction, colleague engagement, our mortgage lending aspirations and cost management. Each year, the Remuneration Committee will agree these priorities, to ensure we are rewarding activities appropriate to our strategy and culture. Each executive director will also be set personal objectives, relevant to their individual responsibilities. In line with our commitment to the Women in Finance charter and our people agenda, each executive director will have a personal objective in 2017 related to the development and implementation of our Diversity strategy.

The bonus opportunity for our executive directors remains unchanged. Target performance will yield a payment of 47.5% of base salary, and the maximum bonus opportunity is 75%. The scheme for our Chief Risk Officer is based on solely personal objectives, with a maximum bonus opportunity of 50%. 40% of any award, for all executive directors, will be deferred over three years.

It is important we ensure our Remuneration Policy always remains in line with legal and regulatory requirements, so where we need to respond to such changes, the Remuneration Committee will use its discretion to amend the scheme accordingly. If this happens, we will describe what we have done in our next report and it will be formally incorporated into our Remuneration Policy when it is next put to our members for a vote.

2016 performance and awards

The Board continues to support an ambitious strategy for the Society, set to ensure we continue to have a thriving, sustainable business, which meets the needs of our members. For 2016, the Remuneration Committee set five priorities for executive directors, related to profit, creating value through growth, developing a customer strategy, colleague engagement and developing our risk maturity.

Earlier sections of the Annual Report and Accounts explain that we delivered a very strong financial performance, with net lending of £1.9bn (2015: £1.4bn), substantially ahead of our plan of £1.3bn. The Committee has noted that this was achieved within our agreed risk appetite, without detrimentally impacting other priorities and was primarily as a result of the executive team responding well to changing market opportunities throughout the year.

In 2016, we achieved another record for profit, at £116.6m (2015: £108.5m), again substantially ahead of our expectations of £96m. It is important for members to note that no significant conduct or prudential issues have arisen relating to profit incentivisation.

A focus for the executive directors during the year has been the development and implementation of our customer strategy, for which all the milestones have been achieved or exceeded, improving the experience for our customers. We realise we have still some distance to travel to meet our members' ever-changing expectations and it remains a key priority for us. In relation to our corporate objective for online capability for savings and mortgage processes, we have not achieved everything we planned for 2016 and, therefore, no bonus payment will be made relating to this element of our corporate objectives.

On a very positive note, our colleagues continue to do outstanding work, providing members with great service and expertise. We are proud to have retained our Best Companies accreditation and our colleague engagement has increased to 78%, ahead of our target.

The sustainability of the Society is paramount and we have continued to develop our risk management approaches, delivering the majority of our planned actions. We are continuing to finalise some of our credit risk measurement developments.

The Remuneration Committee has considered the performance of the Society and the executive directors in detail, balancing the strong financial, customer strategy and colleague engagement performance with the element of our risk maturity actions outstanding and the delivery of our technology solutions not being achieved. A breakdown of the outturn of the corporate and personal objectives is provided on page 74.

In this context, annual bonuses of between 39.63% and 64.67% have been awarded to the executive directors. This represents between 79% and 86% of the maximum award available.

The Remuneration Policy includes a risk assessment process, under which the Remuneration Committee considers a range of factors and input from the Board Risk Committee. These include whether the executive directors have operated within the agreed risk appetite, the exposure of the business to any significant regulatory or control failings and any financial exposure resulting from inappropriate management behaviour. The risk assessment process determined that the Remuneration Committee should assess whether an adjustment was required. Following full consideration, no adjustment was applied.

40% of the bonus award for the executive directors will be deferred and paid in equal instalments over the following three years.

In April 2016, following external benchmarking and as reported last year, the Remuneration Committee agreed salary increases of 14.3% for the Chief Executive Officer and 4.7% for the Chief Risk Officer. The salaries of other executive directors increased by 2.5%, as did the Chairman's fee. The basic salary increase for other colleagues ranged from 0% to 5%, with an average of 3.17%.

In addition to executive directors, a small number of other colleagues are considered to be Material Risk Takers. These include senior managers whose actions have a material impact on the risk profile of the Society. The average basic salary increase for this group in 2016 was 5.6%.

For 2017, the Remuneration Committee has given consideration to the scope, responsibilities and market conditions (using external benchmarking) of executive director roles. As such, the Chief Risk Officer's salary will increase by 14.66%, the Chief Operating Officer's salary will increase by 12.16% and the Chief Commercial Officer's salary will increase by 4%. The salaries of other executive directors will increase by 2%, in line will our colleague population.

Other matters considered by the Remuneration Committee

The main role of the Remuneration Committee is to set our Remuneration Policy including pay, bonuses and other benefits for executive directors and Material Risk Takers. Our aim is to maintain market competitive salaries and other benefits, in line with our strategy and the responsibility that is placed on our senior people in respect of the Society's long term future. This is to ensure that we are able to attract and retain the best people to deliver the Society's goals.

I chair the Remuneration Committee, which has two other non executive director members: David Fisher and Philippa Brown. The Chairman, Chief Executive Officer and other senior managers may be invited to attend meetings, but are not members. Our Director of People, Becky Hewitt, is the Committee Secretary.

There were four meetings in 2016, which dealt with the annual review of compliance with the Remuneration Code, consideration of a number of regulatory changes on remuneration, the setting and review of performance against objectives and oversight of the general colleague bonus scheme and pay award.

In addition, following the full review of the variable pay element of executive reward concluded in 2016, the Remuneration Committee considered the underlying measures of success for the annual schemes, as detailed above in the Remuneration Policy section of my report.

Summary

I hope that you will find this report informative and I look forward to seeing you at the AGM. The Remuneration Committee recommends that members vote in favour of the Directors' Remuneration Report and Remuneration Policy at the AGM.

Les Platts
Chairman of the Remuneration Committee

21 February 2017

Directors' Remuneration Report

Year ended
31 December 2016

Continued

Directors' Remuneration Policy

The Society's Remuneration Policy is designed to provide competitive remuneration packages which support the long term interests of the Society and which attract, reward and retain talented colleagues, to enable the delivery of business objectives to support the Society's strategy, whilst providing value for members.

Remuneration principles

In delivering this policy, the following principles are observed:

- Our Remuneration Policy is clearly linked to our business strategy, objectives, Values and the long term interests and security of the Society and its members.
- The Policy, procedures and practices are consistent with, and promote, sound and effective risk management. They balance fixed and variable remuneration to create an acceptable relationship between risk and reward, whilst not encouraging risk taking that exceeds the level tolerated by the Society.
- Basic salary and total remuneration is set at a competitive level to attract, retain and motivate people of the required calibre.
- Our pay policies meet regulatory requirements, including the FCA Dual-Regulated Firms Remuneration Code, PRA Rulebook and good corporate governance practice.
- The Remuneration Code includes the principle of proportionality. For 2016, the Society is a Tier 3 firm with assets averaging less than £15bn over the last three financial years. When the Society becomes a Tier 2 firm (i.e. with assets averaging over £15bn), we will ensure that the variable remuneration arrangements for relevant executive directors will comply with the requirements of the Remuneration Code, including the use of non-cash instruments, retention and deferral as appropriate.

Policy review

The Remuneration Policy is subject to an annual review of both its content and implementation and is approved by the Remuneration Committee. The Board Risk Committee also contributes to the policy review, to ensure it contains sufficient account of risk.

Vote

Members are asked to vote on the Remuneration Policy every three years, unless the Policy changes. The current Remuneration Policy took effect from the date of the 2014 AGM. As such, the policy set out below will apply from the date of the Annual General Meeting in 2017, subject to consideration of the outcome of the Ordinary Resolution.

Annual General Meeting 2016 Results

Resolution	% votes for	% votes against
Directors' Remuneration Report	90.29%	9.71%

Components of remuneration

The following table summarises the principal components of the executive directors' total remuneration. Changes made in respect of performance measures for 2017 are summarised in the Chairman's Statement on pages 64 and 65. Details which are commercially sensitive have not been provided, but performance against target is disclosed. The Annual Report on Remuneration from page 72 provides more detailed information on the implementation of the Policy.

Element of pay	Link to strategy	Operation	Performance measures	Minimum and maximum payable
Basic salary	Reflects level of accountability. Provides ability to attract and retain executives through market competitive rates of pay.	Once set, any future increases are linked to personal performance and market benchmarking. Base salaries are based on assessments of individual performance and by comparisons with roles carrying similar responsibilities, in organisations of a comparable size, complexity and diversity to the Society.	As for all colleagues, increases are based on personal performance.	Whilst there is no specified maximum, the base salaries of executive directors are reviewed as for any other colleague in accordance with the standard award matrix. The only exceptions are: (i) If benchmarking identifies remuneration is moving out of line with an appropriate peer group, from time to time the Committee may decide to operate outside the standard matrix. (ii) There is a material increase in scope or responsibility to the executive director's role.
Annual bonus scheme	Linked to the delivery of the annual business plan targets, including the achievement of strategic objectives and personal objectives, and links to the success factors in the ten year vision.	Challenging performance objectives are aligned with our Corporate Plan, recognising short, medium and long term goals. The performance of the executive directors is assessed against a scorecard of measures, to ensure significant reward cannot be achieved by the delivery of high performance in one area, to the detriment of another. Robust risk evaluation measures are independently assessed by the Chief Risk Officer and the Board Risk Committee.	The 75% maximum is split between: Financial – 25% Performance – 25% Personal – 25%. The financial measure is based on profit. Performance measures are set at the start of each year and include value enhancing growth, customer satisfaction and colleague engagement. Personal performance objectives, appropriate to the responsibilities of the director, are set at the start of each year and agreed by the Remuneration Committee. The 50% maximum for executive directors in a control function is based on a range of personal objectives.	Maximum of 75% of basic salary payable with 40% of the award deferred over a three year period. Executive directors in a control function have a maximum of 50% of basic salary payable, with 40% of the award deferred over a three year period. Minimum is 0% of basic salary.
Operation of malus and clawback[(i)]	Deferred element has been introduced in compliance with applicable regulations and ensures the annual performance creates value sustained over the longer term.	Independent assessment takes place prior to the payment of each deferred award, which provides the Remuneration Committee with the rationale to make a reduction in the level of award payable (down to zero), if appropriate. The assessment takes into account the following three key matters: • has management operated within the risk appetite of the business? • has the business been exposed to any significant regulatory or control failings? • has there been any financial exposure after the award has been made due to inappropriate management behaviour?	Not applicable.	Maximum of 100% of the deferred bonus awards are subject to malus and clawback. Clawback will be applied as required by regulation.

(i) The Remuneration Committee may apply discretion to reduce bonus awards in whole or part. The circumstances in which this might be applied include: issues with colleague behaviour or material error, where a business unit in which a colleague is engaged suffers a material downturn, a material failure of risk management, reasonable evidence of fraud or dishonesty or misstatement of audited results.

Malus – is a reduction factor which is applied to bonus payments which have not yet vested.
Clawback – is applied to seek recovery of bonus payments already paid.

Year ended
31 December 2016

Continued

Element of pay	Link to strategy	Operation	Performance measures	Minimum and maximum payable
Pension	Provides market competitive remuneration.	Based on membership of the Society's defined contribution section of the pension scheme. In appropriate circumstances, for example where contributions exceed the annual or lifetime allowance, there is an option to receive a monthly cash allowance in lieu of pension contributions.	Not applicable.	A range of relevant employer contributions, for example for age range = or > 53, up to 23% of basic salary. Cash allowance is in lieu of employer contributions, up to 23% of basic salary.
Benefits	Provides market competitive remuneration.	The principal benefits executive directors receive are: • life assurance • private medical insurance • long term health insurance • cash health plan. Other benefits may be provided based on individual circumstances, for example relocation.	Not applicable.	Life assurance (up to 4 x basic salary). Other benefits are set at an appropriate level in line with market practice.

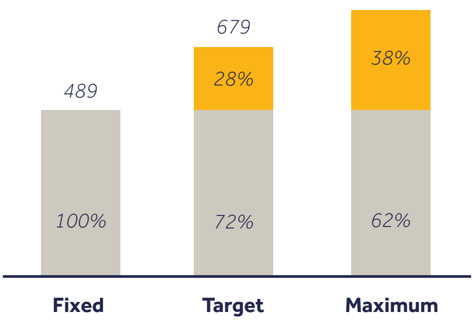
Policy for non executive directors

Element of pay	Link to strategy	Operation	Performance measures	Minimum and maximum payable
Fees	Reflects level of responsibilities and time commitment required for Board and board subcommittee meetings.	Fees are reviewed annually with recommendations made to the Board by executive directors. Non executive directors receive a basic fee and an additional fee for chairing a committee. Fee levels are benchmarked against other financial services organisations.	Not applicable.	The fees of non executive directors are reviewed by the executive directors as for any other colleague in accordance with the standard award matrix. The only exceptions are: (i) If benchmarking identifies remuneration is moving out of line with an appropriate peer group, from time to time the Board may decide to operate outside the standard matrix. (ii) There is a material change in responsibility to the non executive director's role.
Annual Bonus Scheme	Not eligible.			
Pension	Not eligible.			
Benefits		Reimbursement is made for travel expenses for attending meetings and, where tax liability arises, this will be covered by the Society.		

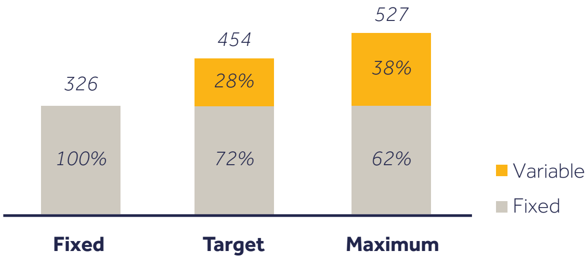
Awards under different scenarios

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

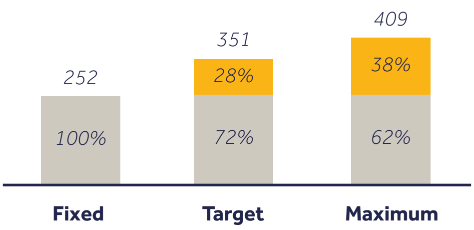
Chief Executive Officer £'000s



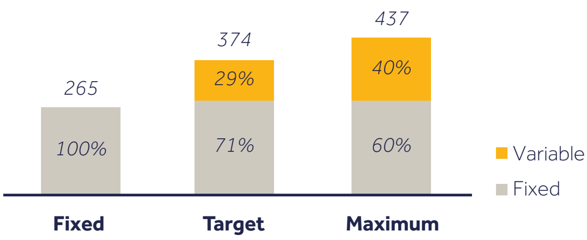
Chief Financial Officer £'000s



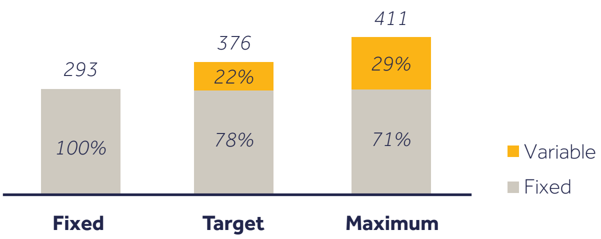
Chief Operating Officer £'000s



Chief Commercial Officer £'000s



Chief Risk Officer £'000s



In developing the scenarios, the following assumptions have been made:

Consists of basic salary and pension (£'000)
Basic salary is at 31 December 2016
Pension measured as 'pension' figure in the table on page 72.

	Executive director	Basic salary	Pension	Total fixed
Fixed	Chief Executive Officer	400	89	489
	Chief Financial Officer	268	58	326
	Chief Operating Officer	210	42	252
	Chief Risk Officer	236	57	293
	Chief Commercial Officer	231	34	265

Target — Based on what a director would receive if the target level of performance was achieved: annual variable element pays out at 63.3% of the maximum available (70% for the Chief Risk Officer).

Maximum — Based on what a director would receive if the maximum level of performance was achieved: annual variable element pays out at 100% of maximum available.

Year ended 31 December 2016

Continued

Approach to recruitment remuneration for executive directors

Component	Policy
General	The Committee's approach to recruitment remuneration is to pay no more than is necessary to attract appropriate candidates to the role. A new recruit may be appointed on lower than market rate salary with phased increases to bring to market level. Any new executive director's package will be consistent with our Remuneration Policy, as set out in this report. The Remuneration Policy is compliant with the provisions of the Remuneration Code. Where an executive director is appointed internally, all previous commitments relating to remuneration will be honoured, subject to meeting the relevant criteria.
Basic salary and benefits	The salary level will be set taking into account the responsibilities of the individual and by comparison with roles carrying similar responsibilities, in organisations of a comparable size, complexity and diversity to the Society. The executive director will be eligible to receive benefits as set out in the Remuneration Policy table.
Annual bonus	The executive director will be eligible to participate in the annual bonus scheme as set out in the Remuneration Policy table. The bonus award will be pro-rated to the number of complete months worked during that year.
Pension	The executive director will be able to participate in the defined contribution section of the pension scheme or to receive a cash allowance of up to a maximum of 23% of basic salary.
Replacement awards	When replacement awards cannot be avoided, the Committee will seek to structure any such awards so that, overall, they are no more generous in terms of quantum or vesting period than the awards due to be forfeited. In determining the quantum and structure of these commitments, the Committee will seek to replicate the fair value and, as far as practicable, the timing and performance requirements of remuneration foregone.
Recruitment remuneration	Any payments made to executive directors on joining the Society to compensate them for forfeited remuneration from their previous employer will be compliant with the provisions of the PRA Rulebook and the FCA Dual-Regulated Firms Remuneration Code.

Service contracts

Executive directors' terms and conditions of employment, including details of remuneration, are detailed in their individual service agreements, which include a notice period of 12 months. The standard contract is available to view at the registered office.

None of the executive directors currently holds any paid external directorships.

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

Policy on payment for loss of office

Component	Policy
General	When determining any loss of office payment for a departing individual, the Committee will seek to minimise costs to the Society whilst seeking to reflect the circumstances in place at the time. Accordingly, the Committee retains overiding judgement to make loss of office payments appropriate to the circumstances and applying the overriding principle that there should be no element of reward for failure.
Basic salary and benefits	In the event of termination by the Society, there will be no compensation for loss of office due to misconduct or poor performance. In other circumstances, executive directors may be entitled to receive compensation for loss of office. Such payments will be based on the monthly salary that the executive director would have received if still in employment with the Society.
Annual bonus	Where an executive director's employment is terminated during or after the end of a performance year but before the payment is made, the executive may be eligible for a pro-rated annual bonus for that performance year, subject to an assessment based on performance achieved over the period and subject to risk adjustment. No award will be made in the event of misconduct. Where an executive director leaves the Society after an award is made, deferred payments will remain payable, subject to the normal rules of the scheme, including risk adjustment. The Remuneration Committee has the right to exercise judgement to the level of any of the above awards.

Statement of consideration of conditions elsewhere in the Society
The Remuneration Committee considers the increase in general basic salary for the wider colleague population when determining the annual salary increases for the executive directors.

For 2016, the basic salary increase for the wider colleague group ranged from 0% – 5%, with an average of 3.17%. Pay increases for the executive directors were 3.03% and for the Chief Executive Officer was 14.3%. The pay increase for the Chief Executive Officer is a reflection of the increased responsibility due to the growth of the Society and a comparison with other comparable roles in similar organisations.

Statement of implementation of Remuneration Policy in the following year
The Remuneration Policy is implemented by management. A formal review of the implementation of the policy is conducted by the Remuneration Committee on an annual basis.

The approach to senior management remuneration will remain unchanged for 2017 and the Committee will continue to monitor the approach to executive pay, considering regulatory guidance, market conditions and external benchmarking. Awards to be made in 2017 under incentive plans will be in line with the Policy.

The executive directors' salaries from 1 January 2017 are as follows, compared with 2016:

	1 January 2017	1 January 2016
P A Hill	£ 400,000	£ 349,990
R S P Litten	£ 268,255	£ 261,712
K R Wint	£ 209,725	£ 204,610
A J Greenwood	£ 236,000	£ 225,500
R G Fearon (from February 2016)	£ 230,625	£ 225,000

The annual pay review takes place in April, for all colleagues in the Society, including executive directors. The increase in the salary of the Chief Risk Officer is based on the increased importance on risk management and a comparison with senior risk roles in comparable organisations. The increase in the salary of Chief Operating Officer is a reflection of the scope of the role and responsibility due to the growth of the Society and the increase in the salary of Chief Commercial Officer is due to his achievements in 2016. Following a market review and external benchmarking, salaries from this date will be as follows:

	1 April 2017
P A Hill	£408,000
R S P Litten	£273,620
K R Wint	£235,238
A J Greenwood	£270,606
R G Fearon	£239,850

Year ended
31 December 2016

Continued

Annual Report on Remuneration

Total remuneration summary

The total remuneration received by executive directors for 2016 is detailed below, compared with 2015. The total remuneration for executive directors equates to 2% of pre-tax profits.
This information has been audited and shows remuneration for the years ending 31 December 2015 and 31 December 2016, as required to be reported under the Building Societies (Accounts and Related Provisions) Regulations 1998.

The Chief Executive Officer is the Society's highest paid colleague and no colleague earns more than any executive director. As the Society is a mutual organisation, it has no share capital and, therefore, does not offer share based remuneration to executive directors or colleagues.

2016 audited

Executive directors	Salary	Annual bonus	Pension	Loss of office	Total remuneration
	£'000	£'000	£'000	£'000	£'000
P A Hill	387	252	89(i)	–	728
R S P Litten	267	168	58(i)	–	493
K R Wint	208	130	42(i)	–	380
A J Greenwood(ii)	233	94	57(i)	–	384
R G Fearon (iii)	198	124	34	–	356
Total remuneration(iv)	**1,293**	**768**	**280**	**–**	**2,341**

2015 audited

Executive directors	Salary	Annual bonus	Pension	Loss of office	Total remuneration
	£'000	£'000	£'000	£'000	£'000
P A Hill	348	226	75(i)	–	649
R S P Litten	260	160	52(i)	–	472
K L Rebecchi(v)	101	65	20(i)	224	410
K R Wint	203	129	41	–	373
A J Greenwood(ii)	224	94	55(i)	–	373
Total remuneration(iv)	**1,136**	**674**	**243**	**224**	**2,277**

Notes:
(i) These directors elected to receive part or all of the Society's pension contribution as a cash allowance.
(ii) This director was appointed on 8 January 2015.
(iii) This director was appointed on 19 February 2016.
(iv) No director received other taxable benefits of £1,000 or above.
(v) This director left the business on 30 June 2015. As reported in last year's Annual Report and Accounts, a loss of office payment was made, consisting of £136,407 paid in respect of the balance of contractual entitlement and £87,500 was paid which was reflective of an assessment of the director's statutory rights and in accordance with the Remuneration Policy.

Unpaid deferred elements of the annual bonus scheme

Executive directors	Performance year	Due 2017 £'000	Due 2018 £'000	Due 2019 £'000	Due 2020 £'000	Total £'000
P A Hill	2013	28	–	–	–	28
	2014	27	27	–	–	54
	2015	31	30	30	–	91
	2016	151	34	34	33	252
	Total	**237**	**91**	**64**	**33**	**425**
R S P Litten	2013	21	–	–	–	21
	2014	20	20	–	–	40
	2015	22	21	21	–	64
	2016	101	22	22	23	168
	Total	**164**	**63**	**43**	**23**	**293**
K L Rebecchi	2013	16	–	–	–	16
	2014	16	16	–	–	32
	2015	9	9	8	–	26
	2016	–	–	–	–	–
	Total	**41**	**25**	**8**	**–**	**74**
K R Wint	2013	16	–	–	–	16
	2014	16	16	–	–	32
	2015	17	17	17	–	51
	2016	78	17	17	18	130
	Total	**127**	**50**	**34**	**18**	**229**
A J Greenwood	2014	–	–	–	–	–
	2015	13	13	12	–	38
	2016	56	12	13	13	94
	Total	**69**	**25**	**25**	**13**	**132**
R G Fearon	2016	75	17	16	16	124
	Total	**75**	**17**	**16**	**16**	**124**
Total		**713**	**271**	**190**	**103**	**1,277**

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

Risk assessment

The risk assessment process is independently managed by the Risk Function. Following completion of the risk assessment process, the Chief Risk Officer (CRO) provides an annual report on areas the Remuneration Committee should consider, in respect of whether or not performance/risk adjustment is necessary to remuneration outcomes. The report is initially reviewed by the Board Risk Committee which then highlights for the Remuneration Committee any specific areas for further consideration. In addition, Risk considers the corporate priorities and personal objectives for executive directors' future year remuneration, to ensure they are aligned with our risk appetite.

The report from the CRO includes an assessment of the current year's performance, in the context of objectives for each prior year for which variable remuneration has been deferred.

The individual performance of Material Risk Takers and their teams is risk assessed by reference to a range of key dimensions, including audit findings, compliance with regulatory policies, compliance with the Society's risk appetite, and general control/governance matters.

The Board Risk Committee considered the 2016 report in full and determined the Remuneration Committee should assess whether an adjustment was required. Following full consideration, no adjustment was applied.

Year ended
31 December 2016

Continued

Performance outcomes against targets for incentive awards

The 2016 scheme has generated awards of between 39.63% and 64.67% of salary for executive directors, reflecting between 79% and 86% of the maximum award available.

The 2016 scheme provides for:

- Personal performance measures (max. 30% opportunity, with 10% of this for superior performance).
- Corporate measures (max. 30% opportunity, with 10% of this for superior performance).
- Peer group assessment (max. 15% opportunity). These are quantitative measures, which were selected as being those most closely aligned to our long term vision. These are objectively compared to published data from our peer group, against which the Society has performed at the upper end of expectations.

For executive directors in control functions the scheme provides for:

- Personal performance measures (max. 50% opportunity, with 15% of this for superior performance).

Annual incentive

For 2016, annual corporate and peer group incentive opportunities were based on the performance measures in the table below. The table also illustrates performance against each of the measures. Personal performance achievement for executive directors was in the range of 21.3% to 39.6%.

Corporate Performance Measure	Weightings (as % of salary)	Target	Actual	Pay out %
Profit (2 x Weighting)	12%	£96m	£116.6m (Superior)	12%
Value creation through growth	4.5%	£1.3bn	£1.9bn (Superior)	4.5%
Risk	4.5%	IT Resilience IRB rating system embedded in use test strategies	On target	3%
Creating a customer centric Society	4.5%	Approve and implement the Customer Centricity Strategy	Superior	2%
		Deliver Omni and MLT enabling risk based decisioning and online paperless savings account opening	Not achieved	0%
Engagement	4.5%	Retention of Best Companies 1* accreditation	Above target	4%
Peer	15%	Comparison to a range of measures compared to a defined peer group	Superior	15%

Notes:
(i) The corporate and peer group measures only apply to the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer and Chief Commercial Officer. The Chief Risk Officer is in a control function and, therefore, is remunerated on personal objectives only.

Remuneration for Material Risk Takers

Material Risk Takers are senior managers which include executive, non executive directors and directors whose actions have a material impact on the risk profile of the Society.

The basic salary of Material Risk Takers is determined to reflect the responsibilities of the role. Salaries are reviewed annually and increases are awarded based on personal performance, as for all colleagues. Material Risk Takers, other than non executive directors, are eligible for an annual bonus scheme. The bonus scheme for Material Risk Takers in control functions is based on the achievement of non-financial objectives. In 2016, there were 27 Material Risk Takers throughout the year.

Aggregate remuneration for Material Risk Takers is reported in the table below.

Remuneration for Material Risk Takers (MRTs)

	Number of beneficiaries		Fixed pay (i)		Current year variable pay (ii)		Total	
	2016	2015	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Senior management	27	28	4,262	3,639	1,254	1,248	5,516	4,887
Other MRTs	0(iii)	29	–	2,537	–	330	–	2,867
Total (iv)	27	57	4,262	6,176	1,254	1,578	5,516	7,754

Notes:

(i) Non executive directors' fees are included under fixed pay and they do not receive variable pay.

(ii) £677k of variable pay is deferred for one or three years (2015: £624k).

(iii) To align with SAIB and EBA regulations, the definition of MRTs was reviewed in 2015, with accountabilities aligned to our senior management in accordance with our risk management framework.

(iv) Material Risk Takers who left the Society during the calendar year are included in the table above.

Pensions and other benefits

P A Hill and R S P Litten are deferred members of the defined contribution section of the pension scheme and have opted for a cash allowance in lieu of the Society's pension contribution. A J Greenwood is a deferred member of the defined benefit section of the pension scheme. Up to 31 March 2016, A J Greenwood was an active member of the defined contribution section of the pension scheme. From 1 April 2016, A J Greenwood became a deferred member of the defined contribution section of the pension scheme and opted to receive cash allowance in lieu of the Society's pension contribution. K R Wint opted to receive pension benefits as part contributions to the defined contribution section of the pension scheme and part cash allowance in lieu of the Society's pension contribution. R G Fearon is an active member of the defined contribution section of the pension scheme. No executive director has the right or opportunity to receive enhanced benefits beyond those already disclosed, and the Committee has not exercised its discretion during the year to enhance benefits. There have been no other changes to benefits during 2016.

Long term incentive awards made in the financial year

There were no long term incentive awards made in the financial year.

Payments to former directors

A payment of £85,961 has been made in 2016 to K L Rebecchi, the former Distribution and Marketing Director who left the business on 30 June 2015. This payment is in respect of an incentive award which was subject to deferral and risk assessment. The Committee determined that no risk adjustment was appropriate.

Directors' Remuneration Report

Year ended
31 December 2016

Continued

Remuneration for non executive directors

The fees for non executive directors are made up of a basic fee, plus a committee chair fee, as appropriate. The Chairman and Vice Chairman do not receive additional fees for roles carried out other than that of Chairman and Vice Chairman respectively.

Non executive directors	Basic fees (£'000s)		Benefits[i] (£'000s)		Committee chair fees (£'000s)		Total (£'000s)	
	2016	2015	2016	2015	2016	2015	2016	2015
R J Ashton (Chairman)	141	137	8	7	–	–	149	144
L M Platts (Vice Chairman)	62	61	4	5	–	–	66	66
P A Brown	46	45	3	3	–	–	49	48
S Cooklin	46	45	3	2	–	–	49	47
D Fisher[ii]	46	45	–	–	15	10	61	55
G Hoskin – appointed 16 November 2015	46	6	4	2	10	1	60	9
J A Hunt – appointed 29 April 2015	46	30	4	4	10	7	60	41
P A Jenks	46	45	–	–	3	10	49	55
A Rajguru – retired 26 March 2015	–	10	–	1	–	–	–	11
I Robertson – retired 31 December 2015	–	45	–	–	–	10	–	55
Total	**479**	**469**	**26**	**24**	**38**	**38**	**543**	**531**

Notes:
(i) In addition to the payment of fees, non executive directors are reimbursed for travel expenses for attending meetings and, where a tax liability arises, this will be covered by the Society.
(ii) This non executive director took on additional responsibility in respect of the Board Risk Committee and is also the Chairman of the Pension Scheme Trustees.

In 2016, an increase of 2.5% was agreed for the Chairman to £141,350. The fee for the Vice Chairman was increased by 2.6% to £62,500 and the basic non executive director's fee was increased by 2.7% to £46,300. The committee chair fee was increased by 2.5%.

The annual pay review takes place in April, for all colleagues in the Society, including non executive directors. Following a market review and external benchmarking, fees from this date will be as follows:

Non executive directors	Basic fees (£'000s)	Committee chair fees (£'000s)	Total fees (£'000s)
	2017	2017	2017
R J Ashton (Chairman)	144	–	144
L M Platts (Vice Chairman)	64	–	64
P A Brown	47	–	47
S Cooklin	47	–	47
D Fisher	47	17	64
G Hoskin	47	17	64
J A Hunt	47	11	58
P A Jenks	47	–	47
Total	**490**	**45**	**535**

Directors' loans, transactions and related business activity

The aggregate amount outstanding at 31 December 2016 in respect of loans from the Society or a subsidiary undertaking to directors of the Society or persons associated with directors was £627,636, (2015: £352,650), being four mortgages (2015: three) to directors and persons connected to directors. These loans were at normal commercial rates. A register of loans and transactions with directors and their connected persons is maintained at the Head Office of the Society and may be inspected by members. There were no significant contracts between the Society or its subsidiaries and any director of the Society during the year.

Loss of office payments

There were no loss of office payments in the reporting year.

History of remuneration of Chief Executive Officer (CEO)

The table below shows the total remuneration of the Chief Executive Officer over the last five years, together with the performance pay awarded as a percentage of the maximum possible.

	Total remuneration £'000	Performance pay as % of maximum
2016	728	84.0
2015	649	86.0
2014[i]	586	79.3
2013	610	82.9
2012	581	86.0

(i) Total remuneration for 2014 includes an adjustment in respect of prior year allowances.

Percentage change in salary for CEO

The basic salary of the Chief Executive Officer increased by 14.3% during 2016. This compares to an average increase of 3.17% in fixed pay awarded to all colleagues.

Relative importance of spend on pay

The following table sets out the percentage change in profit, and overall spend on remuneration in the year ending 31 December 2016, compared to the previous year.

	2016 £m	2015 £m	Percentage change
Profit after tax	86.0	88.9	(3.3)%
Colleague remuneration costs	44.9	37.6	19.4%
Headcount	1,420	1,298	9.4%

External advisers to the Remuneration Committee

The Remuneration Committee seeks the advice of independent, external consultants, as required. The external advisers to the Remuneration Committee in 2016 were PricewaterhouseCoopers LLP, who in 2016 provided professional advice, guidance and training to the Committee. The appointment of advisers is carried out on a basis of careful evaluation of potential providers against agreed criteria. PricewaterhouseCoopers LLP does not have any other connection with the Society or conflict of interest in advising the Remuneration Committee.

Year ended
31 December 2016

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

Opinion on financial statements of Leeds Building Society

In our opinion the financial statements:

- give a true and fair view, in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2016 and of the Group's and the Society's income and expenditure for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise Group and Society Income Statements, Group and Society Statements of Comprehensive Income, Group and Society Statements of Financial Position, Group and Society Statements of Changes in Members' Interests, Group and Society Statements of Cash Flows and the related notes 1 to 38. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Going concern and the directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group

We have reviewed the directors' statement regarding the appropriateness of the going concern basis of accounting contained within note 1 to the financial statements and the directors' statement on the longer-term viability of the Group contained within the Strategic Report on page 23.

We have nothing material to add or draw attention to in relation to:

- The directors' confirmation within the Risk Management Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures on pages 31 to 39 that describe those risks and explain how they are being managed or mitigated.
- The directors' statement on page 41 about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements.
- The directors' explanation on page 23 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We agreed with the directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Independence

We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and we confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team. The inclusion of Capitalisation of IT software is the only modification to the risks stated in the prior period.

Risk	How the scope of our audit responded to the risk	Key observations
Impairment provisions The Group holds £54.2 million of impairment provisions at year end (2015: £64.1 million) against total loans and advances to customers of £13,532 million (2015: £11,608 million). The calculation of specific impairment provisions against residential customer loans is a judgemental process, requiring the estimation of customer default rates and forced sale discounts. The calculation of collective residential provisions includes judgements around the impact of macro-economic factors such as house price volatility, interest rate expectations and unemployment rates. Significant judgements are also made by Management in terms of determining if an impairment trigger has been reached in terms of loans within the commercial loan portfolio. In addition, valuations obtained to establish exposures can be highly subjective due to a lack of comparable properties or observable market data available to the internal and/or third party valuer. Loan loss provision balances are detailed within note 8. Management's associated accounting policies are detailed on page 91 with detail about judgements in applying accounting policies and critical accounting estimates on page 93. The Audit Committee's consideration of this risk is included on page 57.	We evaluated the design, and tested the implementation and operating effectiveness of internal controls over the provisioning process. This included reviewing minutes from key management review forums, and evaluating the level of challenge and determining if appropriate action was taken. This included Credit Committee meetings, which we also attended when the year-end loan provisions were assessed. We challenged the appropriateness of Management's assumptions in relation to residential impairment provisions by comparing these to historical experience, and benchmarking to external data. We recalculated the customer default rates and forced sale discounts applied, and independently created a collective impairment provision using source data extracted from the Society's mortgage administration system, to compare against Management's calculation. We assessed the completeness and validity of Management's identified impairment triggers in the commercial loan book, and tested a sample of unimpaired loans to determine whether these had experienced any of the trigger events requiring specific provision. In addition we evaluated the adequacy of property valuations used in determining commercial loan provisions, including consultation with our commercial real estate specialists. We have also assessed the appropriateness of the probabilities of default used in the collective provisioning considering the reduced number of loans to base the assumption on. For both residential and commercial provisions we assessed the appropriateness and valuation of post model adjustments made by Management which reflect the best estimate of losses incurred but which may not have been fully observed within the current arrears data. We tested the mechanical accuracy of the significant loan provisioning models, including engaging our IT specialists to test the underlying key controls, and to test data flows into the models to assess whether the data was complete and accurate.	Based on the evidence obtained, we found that loan loss provisions are reasonably stated, and that Management's judgements and assumptions are reasonable.

Independent Auditor's Report

Year ended
31 December 2016

Continued

Hedge accounting When hedge relationships are entered into it is possible they are not in compliance with IAS 39, this includes both the appropriate documentation being in place and that the items have been correctly designated into a hedge relationship. If subsequently a component of a hedging relationship is ineffective, it is removed from the hedge and any associated fair value of the hedged item is amortised over the remaining life to maturity of the instrument. This process involves some manual intervention and hence application of judgement. Management's associated accounting policies are detailed on pages 90 and 91 with detail about judgements in applying accounting policies and critical accounting estimates on page 94. The Audit Committee's consideration of this risk is included on page 57.	We evaluated the design, and tested the implementation and operating effectiveness of internal controls over the hedge accounting process. We tested the population of hedging instruments and hedged items on a sample basis, and our internal financial instruments specialists assessed and re-performed Management's retrospective hedge effectiveness testing. In addition, we obtained evidence of the prospective effectiveness testing which is required under IAS 39 to determine that hedge relationships continue to meet certain criteria. We reviewed Management's methodology for assessing items that have de-designated from the hedge relationship. We then substantively tested a sample of de-designated instruments by creating an expected amortisation profile and comparing that to Management's calculation. Our specialists also independently benchmarked derivative valuations to external data and recalculated the fair value of a sample of derivative instruments which were designated in hedge relationships. They challenged the appropriateness of key inputs into the valuations such as interest rates, volatility, exchange rates, counterparty credit ratings and valuation adjustments. We also performed procedures upon source data extracted from the Society's core treasury system to identify whether the population of derivative data was accurate and complete as well as reviewing confirmations received from counterparties and banks.	Based on the work performed we concluded that hedge accounting was appropriately applied and any amortisation relating to de-designated hedges complied with the requirements of IAS 39. Our independent valuation work indicated that Management's valuations of derivatives are appropriate and reasonable.
Revenue recognition The calculation of the Effective Interest Rate ("EIR") used to allocate interest income on loans and receivables requires significant judgement in the determination of the key assumptions, which are the behavioural life of mortgages and prepayment rates. These calculations are based upon historical data and estimates of future economic conditions. Discounts, cashbacks, arrangement and valuation fees, and costs directly attributable to establishing the mortgage are held on the balance sheet and amortised over the expected life of the associated mortgage portfolios. Management's associated accounting policies are detailed on page 92 with detail about judgements in applying accounting policies and critical accounting estimates on pages 93 and 94. The Audit Committee's consideration of this risk is included on page 57.	We evaluated the design and implementation of internal controls over the EIR calculation process. We have reviewed the approach to revenue recognition to determine whether it is consistent with the applicable accounting standards. We challenged Management's assumptions in relation to the calculation of the EIR by reference to historical data on behavioural lives, including using our internal Data Analytics specialists to perform a recalculation of the behavioural life model from independently extracted source data. We also considered the treatment of directly attributable fees and charges arising on mortgages, and independently verified the completeness and accuracy of the data used to perform the calculation. We have also reviewed new and existing products to assess whether revenue is recognised on a basis that is consistent with the Group's accounting policies and relevant accounting standards.	The results of our testing were satisfactory and the underlying methodology used for the calculation of EIR is materially accurate in the context of the accounting policies and the requirements of the relevant accounting standards. The behavioural life profiles applied by Management within the EIR calculation are considered appropriate.

Capitalisation of IT software		
During 2015 the Society began a project to upgrade some of its core IT infrastructure. During 2016 there has been continued expenditure on the project, and the treatment of the various cost elements is open to Management judgement. Specifically, Management's assessment of the continuing benefit of the investment to the Society, and the treatment of whether different cost types should be capitalised or expensed in the context of IAS 38 Intangible Assets. Management's associated accounting policies are detailed on page 92 with detail about judgements in applying accounting policies and critical accounting estimates on page 94. The Audit Committee's consideration of this risk is included on page 58.	We evaluated the design and implementation of internal controls over the cost capitalisation process. We have reviewed and challenged Management's assessment of the continuing economic value of the IT investment by reference to the underlying cost-benefit analysis performed by Management. On a sample basis we have confirmed whether new costs incurred during the year are appropriately capitalised, or expensed.	Based on the evidence obtained, we found that expenditure relating to IT software was appropriately capitalised or expensed during the year and that Management's judgements and assumptions relating to the carrying value of capitalised amounts are reasonable.

The description of risks above should be read in conjunction with the significant issues considered by the Audit Committee discussed on pages 57 to 58.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Our application of materiality

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

We determined materiality for the Group to be £5.8m (2015: £5.4m), which is 5% (2015: 5%) of profit before tax, and below 0.05% (2015: 0.05%) of total reserves and liabilities. The accumulation of profits is critical to maintaining and building capital for regulatory purposes and allowing the Group to invest in activities for its members. We have therefore selected profit before tax as the benchmark for determining materiality.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £115,000 (2015: £108,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

As in the prior year, our Group audit was scoped by obtaining an understanding of the Group and its environment, including group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we performed a full audit of the Society and all of its trading subsidiaries, executed at levels of materiality applicable to each individual entity which were lower than Group materiality and in the range of £0.03m to £5.7m (2015: £0.03m to £5.4m)

At the Group level we also tested the consolidation process.

Independent Auditor's Report

Continued

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

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

In our opinion the information given on page 140 for the financial year ended 31 December 2016 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

- proper accounting records have not been kept by the Society; or
- the Society financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

We have nothing to report in respect of these matters.

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

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 or the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

David Heaton
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and
Statutory Auditor

Leeds, United Kingdom

21 February 2017

Income Statements

For the year ended
31 December 2016

	Notes	**Group 2016 £M**	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
Interest receivable and similar income	3	**406.3**	402.7	**387.2**	392.1
Interest payable and similar charges	4	**(204.5)**	(195.2)	**(188.4)**	(182.8)
Net interest receivable		**201.8**	207.5	**198.8**	209.3
Fees and commissions receivable		**10.4**	12.3	**10.4**	12.1
Fees and commissions payable		**(0.8)**	(1.0)	**(0.1)**	–
Fair value gains less losses from financial instruments	5	**(1.3)**	(0.9)	**1.3**	(0.9)
Income from investments in subsidiaries		**–**	–	**–**	1.4
Other operating income		**1.9**	1.0	**1.0**	0.5
Total income		**212.0**	218.9	**211.4**	222.4
Administrative expenses	6	**(88.7)**	(77.0)	**(88.5)**	(76.3)
Depreciation and amortisation	14,15	**(3.2)**	(2.7)	**(3.1)**	(2.7)
Impairment gains/(losses) on loans and advances to customers	8	**0.9**	(18.5)	**0.9**	(18.5)
Provisions charge	24	**(3.9)**	(8.8)	**(3.9)**	(8.8)
Impairment losses on investments in subsidiary undertakings	13	**–**	–	**(0.2)**	(3.1)
Impairment losses on land and buildings	15	**(0.5)**	–	**(0.5)**	–
Investment property fair value movement	16	**–**	(3.4)	**–**	–
Operating profit and profit before tax		**116.6**	108.5	**116.1**	113.0
Tax expense	9	**(30.6)**	(19.6)	**(31.2)**	(20.5)
Profit for the financial year		**86.0**	88.9	**84.9**	92.5

All amounts relate to continuing operations.

The notes on pages 89 to 136 form part of these accounts.

Statements of Comprehensive Income

For the year ended
31 December 2016

	Notes	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
Profit for the financial year		**86.0**	88.9	**84.9**	92.5
Items that may subsequently be reclassified to profit and loss:					
Available for sale investment securities gain/(loss)		**7.8**	(3.5)	**7.8**	(3.5)
Tax relating to items that may subsequently be reclassified	30	**(1.8)**	0.6	**(1.8)**	0.6
Items that may not subsequently be reclassified to profit and loss:					
Actuarial (loss)/gain on retirement benefit surplus/obligation	28	**(9.5)**	2.1	**(9.5)**	2.1
Revaluation loss on properties revalued	15	**(1.8)**	–	**(1.8)**	–
Tax relating to items that may not be reclassified	30	**3.0**	(0.6)	**1.5**	(0.6)
Total comprehensive income for the year		**83.7**	87.5	**81.1**	91.1

Statements of Financial Position

As at 31 December 2016

	Notes	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
Assets					
Liquid assets					
Cash in hand and balances with the Bank of England	10	**938.9**	701.0	**938.9**	701.0
Loans and advances to credit institutions		**187.3**	126.4	**66.3**	43.4
Investment securities	12				
Available for sale		**753.7**	821.1	**1,422.6**	1,655.2
Loans and receivables		**24.1**	28.2	**24.1**	28.2
Derivative financial instruments	36	**263.1**	104.9	**174.3**	76.0
Loans and advances to customers	11				
Loans fully secured on residential property		**13,120.9**	11,146.0	**13,120.9**	11,146.0
Other loans		**356.8**	398.3	**356.8**	398.3
Investments in subsidiary undertakings	13	**–**	–	**14.5**	40.4
Intangible assets	14	**3.0**	3.4	**3.0**	3.4
Property, plant and equipment	15	**30.1**	32.1	**30.1**	32.1
Retirement benefit surplus	28	**–**	5.1	**–**	5.1
Deferred income tax asset	17	**2.6**	0.1	**1.8**	0.5
Other assets, prepayments and accrued income	18	**249.2**	140.0	**331.9**	199.3
Total assets		**15,929.7**	13,506.6	**16,485.2**	14,328.9
Liabilities					
Shares	19	**11,233.2**	9,932.9	**11,233.2**	9,932.9
Derivative financial instruments	36	**214.4**	135.7	**213.1**	136.0
Amounts owed to credit institutions	20	**572.1**	55.9	**572.1**	55.9
Amounts owed to other customers	21	**357.5**	418.3	**1,232.8**	1,703.4
Debt securities in issue	22	**2,471.2**	2,056.8	**2,158.0**	1,599.1
Current income tax liabilities		**14.1**	10.0	**14.0**	9.8
Deferred income tax liabilities	17	**2.7**	2.4	**2.0**	1.8
Other liabilities and accruals	23	**157.3**	72.6	**155.7**	68.3
Provision for liabilities and charges	24	**5.3**	6.4	**5.3**	6.4
Retirement benefit obligations	28	**2.6**	–	**2.6**	–
Subscribed capital	25	**25.0**	25.0	**25.0**	25.0
Total liabilities		**15,055.4**	12,716.0	**15,613.8**	13,538.6
Total equity attributable to members		**874.3**	790.6	**871.4**	790.3
Total liabilities and equity		**15,929.7**	13,506.6	**16,485.2**	14,328.9

The accounts on pages 89 to 136 were approved by the Board of Directors on 21 February 2017.
Signed on behalf of the Board of Directors by:

Robin Ashton
Chairman

Peter Hill
Chief Executive Officer

Robin Litten
Chief Financial Officer

Statements of Changes in Members' Interest

For the year ended
31 December 2016

Group 2016	**General Reserve £M**	**Available for Sale Reserve £M**	**Revaluation Reserve £M**	**Other Reserve £M**	**Total Equity attributable to members £M**
At 1 January 2016	**765.1**	**(1.2)**	**12.4**	**14.3**	**790.6**
Comprehensive income for the year	**79.0**	**6.0**	**(1.3)**	**–**	**83.7**
At 31 December 2016	**844.1**	**4.8**	**11.1**	**14.3**	**874.3**

Group 2015	General Reserve £M	Available for Sale Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Equity attributable to members £M
At 1 January 2015	674.7	3.9	12.4	14.3	705.3
Comprehensive income for the year	90.4	(2.9)	–	–	87.5
Corporation tax paid	–	(2.2)	–	–	(2.2)
At 31 December 2015	765.1	(1.2)	12.4	14.3	790.6

Society 2016	**General Reserve £M**	**Available for Sale Reserve £M**	**Revaluation Reserve £M**	**Other Reserve £M**	**Total Equity attributable to members £M**
At 1 January 2016	**765.0**	**(1.2)**	**12.4**	**14.1**	**790.3**
Comprehensive income for the year	**76.4**	**6.0**	**(1.3)**	**–**	**81.1**
At 31 December 2016	**841.4**	**4.8**	**11.1**	**14.1**	**871.4**

Society 2015	General Reserve £M	Available for Sale Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Equity attributable to members £M
At 1 January 2015	671.0	3.9	12.4	14.1	701.4
Comprehensive income for the year	94.0	(2.9)	–	–	91.1
Corporation tax paid	–	(2.2)	–	–	(2.2)
At 31 December 2015	765.0	(1.2)	12.4	14.1	790.3

Statements of Cash Flows

For the year ended
31 December 2016

	Notes	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
Profit before tax		**116.6**	108.5	**116.1**	113.0
Adjusted for changes in:					
Impairment provision		**(10.0)**	7.0	**(10.0)**	7.0
Provision for liabilities and charges		**(1.1)**	2.0	**(1.1)**	2.0
Depreciation and amortisation		**3.2**	2.7	**3.1**	2.7
Value of investment property		**–**	3.4	**–**	–
Impairment losses on land and buildings		**0.5**	–	**0.5**	–
Interest on subscribed capital		**–**	3.3	**–**	3.3
Cash generated from operations		109.2	126.9	108.6	128.0
Changes in operating assets and liabilities:					
Loans and advances to customers		**(1,923.5)**	(1,290.4)	**(1,923.5)**	(1,290.4)
Derivative financial instruments		**(79.5)**	(4.5)	**(21.3)**	(11.9)
Other operating assets		**(109.2)**	(11.3)	**(132.6)**	(15.7)
Shares		**1,300.3**	751.3	**1,300.4**	751.3
Amounts owed to credit institutions and other customers		**455.4**	(152.0)	**45.6**	797.8
Other operating liabilities		**85.3**	(8.3)	**86.2**	(6.6)
Taxation paid		**(27.1)**	(19.8)	**(26.9)**	(19.8)
Net cash flows from operating activities		**(189.1)**	(608.1)	**(563.5)**	332.7
Cash flows from investing activities					
Returns from investments and servicing of finance		**(1.8)**	0.5	**(0.8)**	(0.3)
Purchase of investment securities		**(695.7)**	(837.1)	**(695.7)**	(1,769.8)
Proceeds from sale and redemption of investment securities		**774.0**	989.2	**939.1**	1,124.1
Purchase of property, plant and equipment		**(2.8)**	(4.4)	**(2.8)**	(4.4)
Purchase of intangible assets		**(0.2)**	(3.9)	**(0.2)**	(3.9)
Change in investment in subsidiaries		**–**	–	**25.9**	81.0
Disposal of inventories		**–**	1.0	**–**	–
Net cash flows from investing activities		**73.5**	145.3	**265.5**	(573.3)
Cash flows from financing activities					
Issue and repayment of debt securities in issue		**414.4**	712.0	**558.8**	469.5
Repayment of subordinated debt		**–**	(0.9)	**–**	(0.9)
Net cash flows from financing activities		**414.4**	711.1	**558.8**	468.6
Net increase in cash and cash equivalents		**298.8**	248.3	**260.8**	228.0
Cash and cash equivalents at beginning of year		**827.4**	579.1	**744.4**	516.4
Cash and cash equivalents at the end of the year	26	**1,126.2**	827.4	**1,005.2**	744.4

Notes to the Accounts

For the year ended
31 December 2016

1. Accounting policies

Basis of preparation
These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union and in accordance with those parts of the Building Societies Act 1986 and the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) applicable to societies reporting under IFRS.

The accounts have been prepared on the going concern basis as outlined in the Directors' Report.

The particular accounting policies adopted are described below and have been consistently applied from the prior year.

The following IFRS pronouncements, relevant to the Group, were adopted with effect from 1 January 2016:

Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)
Annual Improvements to IFRSs: 2012-2014
Disclosure Initiative (Amendments to IAS 1)

The adoption of the above standards has not had a material impact on the financial statements of the Group.

At the date of authorisation of these financial statements, the following standards and interpretations (which have not been applied in these financial statements) were in issue but not yet effective:

Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)
IFRS 9 – Financial Instruments
IFRS 15 – Revenue from Contracts with Customers
IFRS 16 – Leases

The Directors do not expect these standards to have a material impact on the financial statements of the Group in future periods, except for IFRS 9 Financial Instruments. This standard changes the current incurred loss basis for credit provisions to an expected loss model which would have an impact on the valuation and income recognition methods relating to the Group's loans and advances to customers and derivative assets and liabilities. The standard also introduces new classification and measurement criteria for financial instruments.

The Group is continuing with its assessment of IFRS 9's impact. Implementation guidance from external sources including industry bodies, auditors and regulators continues to evolve and the Society remains engaged with the relevant bodies and participates in the discussion fora as appropriate. In 2015, the Society launched its IFRS 9 project, which reports progress through a steering group to the nominated oversight committees, and ultimately the Audit Committee.

During the year, an initial assessment of the classification and measurement of financial instruments was performed and presented to the Audit Committee. Financial assets were classified by assessing the business model in which they exist, as well as the structure of the underlying cash flows on an asset by asset basis. Instruments purchased for trading or containing complex payment structures, including derivatives, will generally be carried at fair value through the income statement and may give rise to volatility in the Group's results. Basic instruments will be carried at amortised cost or fair value through Other Comprehensive Income depending on the business model in which they are held. Financial liabilities are carried at either fair value through the income statement or amortised cost depending on the product features. Basic products are typically carried at amortised cost and more complex instruments, including derivatives, are carried at fair value.

The expected credit loss model for the core residential mortgage portfolios is under development. The scope of the model has been agreed and definitions of the key components, such as probability of default and exposure at default, have been drafted and are being tested and reviewed in accordance with the agreed governance structures. The model build stage has commenced based on the draft interpretations and will continue into 2017. Work on the other asset portfolios, including commercial loans and liquid assets, has begun but the size and nature of these assets mean that the models are less complex and therefore the majority of the development will be undertaken in 2017. The number and source of forward looking macroeconomic scenarios have been agreed by the Stress Testing Oversight Forum but these have not yet been incorporated into the models. A period of parallel running is expected to ensure that outputs are fit for purpose ahead of full implementation.

The hedge accounting part of IFRS 9 is not expected to have a significant impact on the Society, which expects to continue to use IAS 39 in accordance with the IFRS 9 carve out.

Work on the disclosure requirements of IFRS 9, including sourcing and mapping data, is underway.

These financial statements are presented in sterling and, except where otherwise indicated, have been rounded to the nearest one hundred thousand pounds.

Accounting convention
The Group prepares its accounts under the historical cost convention, except for the revaluation of available for sale financial assets, financial assets and liabilities held at fair value through profit or loss, all derivative contracts, and certain freehold and long leasehold properties.

Basis of consolidation
The Group accounts consolidate the accounts of Leeds Building Society, its subsidiaries and those entities over which it is deemed to have control, as listed in note 13. Uniform accounting policies are applied throughout the Group. Intercompany transactions are eliminated upon consolidation.

1. Accounting policies (continued)

Investment in subsidiaries
Investments in subsidiaries are recorded in the Society's Statement of Financial Position at cost, less any provision for impairment.

Financial instruments
(a) Classification
Purchases and sales of financial assets are accounted for at settlement date.

In accordance with IAS 39, Financial Instruments: Recognition and Measurement, the financial instruments of the Group have been classified into the following categories:

(i) Loans and receivables
The Group's loans and advances to customers and credit institutions are classified as 'loans and receivables', except for a collateral loan which represents a pool of mortgage assets purchased from a third party for which certain, but not all, risks were transferred to the Group. These are held at fair value through profit or loss.

Loans and receivables are assets initially recorded at fair value plus any attributable costs and then subsequently measured at amortised cost using the effective interest rate method. In accordance with the effective interest rate method, initial costs and fees such as cashbacks, mortgage premia paid on the acquisition of mortgage books, mortgage arrangement fees, valuation fees and procuration fees and mortgage discounts are amortised over the expected life of the mortgage, where they are directly attributable to the mortgage asset.

(ii) At fair value through profit or loss
These instruments comprise assets and liabilities which have been specifically designated as such at inception and all derivative financial instruments, including embedded derivatives. Any change in the fair value of the instrument is recognised immediately in the Income Statement. Interest income and expense are recognised on an effective interest rate basis.

A collateral loan to a third party was designated into this category at the date of inception and is held at fair value through profit or loss. This presentation provides more relevant information as it removes a measurement inconsistency that would otherwise arise from measuring assets or liabilities on a different basis. The Group uses this approach for financial assets that are economically hedged but where it is not practical to apply hedge accounting.

(iii) Available for sale
Available for sale assets are non-derivative financial assets that are not classified into either of the categories above and are initially recorded at fair value plus any attributable costs. Subsequent changes in the fair value of available for sale assets are recognised in equity, except for impairment losses. The Group uses this category for purchased investment securities for which an active market exists.

The premia and discounts arising from the purchase of available for sale assets are amortised over the period to the maturity date of the security on an effective yield basis.

The fair values of quoted investments in active markets are based on current bid prices.

(iv) Financial liabilities
All financial liabilities are initially recorded at fair value less directly attributable transaction costs and subsequently measured at amortised cost using the effective interest method, except for those financial liabilities measured at fair value through profit or loss, for example derivative liabilities.

The premia and discounts, together with commissions and other costs incurred in the raising of wholesale funds and subordinated liabilities, are amortised over the period to maturity using the effective interest rate method.

(b) Sale and repurchase agreements
Investments and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained on the Statement of Financial Position when substantially all of the risks and rewards of ownership remain within the Group, and the counterparty liability is included separately on the Statement of Financial Position as appropriate. Where applicable, the difference between sale and repurchase price is accrued over the life of the agreement using the effective interest rate method.

(c) Derecognition of financial assets and liabilities
Financial assets are only derecognised when the contractual rights to receive cash flows from them have expired or when the Group has transferred substantially all risks and rewards of ownership. The Group has not derecognised the mortgage loans which have been used to secure its issue of debt securities as substantially all the risks and rewards are retained by the Group and the Group retains control of the assets. Financial liabilities are only derecognised when the obligation is discharged, cancelled or has expired. Failed sale assets and liabilities are recognised by the Society and its subsidiaries to reflect intra-group transfer of risks and rewards which are eliminated on consolidation.

(d) Derivative financial instruments and hedge accounting
Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently remeasured monthly at their fair value. The need for credit valuation adjustments is considered in the determination of the fair value of derivatives.
All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

1. Accounting policies (continued)

All derivatives are entered into by the Group for the purpose of providing an economic hedge; however certain criteria must be met before the instruments can be allocated to accounting hedge relationships. The Group makes use of accounting fair value hedges to reduce volatility in the Income Statement. If derivatives are not designated as hedges then changes in fair values are recognised immediately in the Income Statement.

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans and investment products. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the relationship is de-designated and the adjustment to the carrying amount of the hedged item is amortised to the Income Statement over the period to maturity. The Group did not enter into any cash flow hedge relationships during the year.

Impairment of financial assets

Impairment losses are recognised in the Income Statement at the point at which they are incurred. An impairment provision is maintained between the point at which the loss is incurred and the point at which it is realised, unless there is objective evidence that the loss should be reversed.

Impairment of loans and advance to customers

The Group assesses its loans and advances to customers for objective evidence of impairment at each Statement of Financial Position date. An impairment loss is recognised if, and only if, there is a loss event (or events) that has occurred after initial recognition and before the Statement of Financial Position date, which has a reliably measurable impact on the estimated future cash flows.

If evidence of impairment is identified, a provision is made to reduce the value of the impaired asset to the amount that is expected to be recovered based upon objective evidence of estimated future cash flows. In assessing the recoverable amount, factors taken into consideration include the time and cost incurred to possess and sell, and the value of the security based on latest available information.

Impairment is categorised as either individual impairment (where individual assets have been assessed for loss) or collective impairment (where losses are assessed as being present in a portfolio of loans, but cannot be attributed to individual accounts).

Individual assessments are performed for all mortgage loans in default or possession and where there is objective evidence that not all cash flows will be received. Based upon these assessments an individual impairment provision is made against these assets as appropriate.

In addition, a collective impairment provision is made against those loans and advances to customers where objective evidence, including forbearance measures, indicates that it is likely that, for some assets, a loss event has occurred and losses may ultimately be realised. The assets are allocated into categories based on similar characteristics and the impairment value is calculated by applying factors to each loan. These factors take into account the Group's experience of default and delinquency rates, loss emergence periods, regional property price movements, and adjustments to allow for forced sale values.

Forbearance strategies exercised by the Group include mortgage term extensions, transfer of mortgages (in full or in part) to an interest only product and capitalisation of arrears once the customer has demonstrated six months of consecutive contractual payments. These strategies are only adopted where they will not give rise to customer detriment. Note 35 provides further information on the forbearance strategy.

If a loss is ultimately realised, it is written off against the provision previously made. Any subsequent recoveries are recognised directly in the Income Statement as they arise.

Impairment of intangible assets

Purchased software and development costs are reviewed for impairment at each reporting date or when there is an indication of impairment. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. The recoverable amount is the higher of fair value less costs of disposal and value in use. Any impairment in the value of these assets is written down through the Income Statement as it arises.

Impairment of investment securities

The Group assesses its investment securities for objective evidence of impairment at each Statement of Financial Position date. This assessment includes consideration of any financial difficulties of the issuer, the nature of any supporting assets (if appropriate), any credit ratings changes and the adherence to covenants, including making scheduled payments.

An impairment loss is recognised if, and only if, there is a loss event (or events) that has occurred after initial recognition and before the Statement of Financial Position date, which has a reliably measurable impact on the estimated future cash flows.

Where the Group determines that there is objective evidence of impairment, or that trigger events exist at the Statement of Financial Position date, then, in the case of available for sale instruments, the amount of the cumulative loss that had been recognised directly in reserves that relates to the impairment is removed from reserves and recognised in the Income Statement. If in a subsequent period, the fair value of a debt instrument classified as available for sale increases, and the increase can be related to an event occurring after the impairment loss was recognised through the Income Statement, the impairment loss is reversed, with the amount of the reversal recognised through the Income Statement. For assets classified as loans and receivables the loss, and any adjustment to or reversal of this amount, is recognised immediately in the Income Statement.

1. Accounting policies (continued)

Interest income and expense

Interest income and expense on all financial instruments are recognised in interest receivable or payable in the Income Statement.

Interest income and expense on financial assets and liabilities held at amortised cost are measured using the effective interest rate method. The effective interest rate method is a method of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument.

Specifically, for mortgage assets, the effect of this policy is to spread the impact of discounts, cashbacks, arrangement and valuation fees, and costs directly attributable and incremental to setting up the loan, over the expected life of the mortgage. Expected lives are reassessed at each Statement of Financial Position date and any changes are reflected in the effective interest rate models, resulting in an immediate gain or loss in the Income Statement.

Fees and commission receivable

Fees and commissions are generally recognised on an accruals basis in line with the delivery of the service.

Fees integral to the loan yield are included within interest income and included in the effective interest rate calculation as set out above.

Commission received by the Group from third parties may be required to be repaid at a later date if certain policies are cancelled. A provision is included in the accounts to cover the estimate of the amount of clawbacks that will become payable in the future, based on products that have been sold and commissions received prior to the year end.

Intangible assets

An intangible asset is an identifiable non-monetary asset without physical substance. An intangible asset is recognised to the extent it is probable that expected future economic benefits will flow from it and the costs can be measured reliably.

The Group has purchased software licences and certain IT development services, which qualify for recognition as intangible assets. Amortisation of such assets is charged to the Income Statement on a straight line basis over the useful life of the asset once it is brought into use. The useful life of such assets is deemed to be five years.

Intangible assets are reviewed annually for indications of impairment. Impairment occurs when the economic benefits arising from the asset are lower than its carrying amount. Impairment losses are recognised immediately as an expense.

Property, plant and equipment

Freehold and long leasehold properties are revalued every three years by an independent firm of valuers. The fair value of the properties is determined from market based evidence.

No provision is made for depreciation of freehold and long leasehold properties as in the opinion of the Board, their residual value will not be materially different to book value.

All other items of property, plant and equipment are initially recognised at cost and then depreciated. Depreciation is calculated on a straight line method to write down the cost of such assets to their residual values over the estimated useful lives as follows:

Short leasehold properties	Unexpired lease term
Improvements to properties	8 to 10 years
Office and computer equipment	3 to 5 years
Motor vehicles	3 to 5 years (reducing balance basis)

Property, plant and equipment are reviewed annually for indication of impairment. Impairment losses are recognised immediately as an expense.

Investment properties

The Group disposed of its only investment property in 2015. The investment property was held for long term rental yields and capital appreciation. The property was stated at fair value at the Statement of Financial Position date. Changes in fair value were included in the Income Statement in the period in which they arose. Depreciation was not charged on the investment property.

Pension benefits

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due.

For defined benefit retirement benefit schemes, the cost of providing benefits is determined using the Projected Unit Method, with actuarial valuations updated at each year end. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the Income Statement and presented in the Statement of Comprehensive Income.

The retirement benefit asset or obligation recognised in the Statement of Financial Position represents the fair value of Scheme assets less the present value of the defined benefit obligation. Where the fair value of the assets exceeds the present value of the liabilities, the surplus that may be recorded on the Statement of Financial Position is capped at the asset ceiling. This is the total of the future economic benefits that will flow to the Group as a result of the surplus.

Leases

Rentals under operating leases are charged to administrative expenses on a straight line basis over the life of the lease.

Notes to the Accounts

For the year ended 31 December 2016 **Continued**

1. Accounting policies (continued)

Tax
Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantially enacted by the Statement of Financial Position date. Tax on the profits for the period comprises current tax and deferred tax. Tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in reserves, in which case it is recognised in reserves. Current tax is the expected tax payable on the taxable income for the year, using tax rates applicable at the Statement of Financial Position date and any adjustment to tax payable in respect of previous years.

Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available, against which deductible temporary differences can be utilised. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Foreign currency
Assets and liabilities denominated in foreign currencies are translated into sterling at the appropriate rates of exchange prevailing at the year end and exchange differences are included in the Income Statement. All foreign currency income and expense is translated into sterling at the rate of exchange on the day of receipt or payment.

Segmental reporting
The chief operating decision maker has been identified as the Chief Executive Officer, who reviews the Group's internal reporting and is responsible for all significant decisions.

Financial information provided in note 38 is consistent with that presented to the Chief Executive Officer.

2. Critical accounting estimates and judgements

Some asset and liability amounts reported in the accounts are based on management estimates, judgements and assumptions. The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities in the next financial year. It also makes judgements in applying its accounting policies which affect the amounts in the financial statements. Therefore there is a risk of changes to the carrying amounts for these assets and liabilities during the next financial year and beyond. The Group reviews all critical estimates and judgements on a regular basis to ensure that these remain appropriate.

Impairment losses on loans and advances and investment securities
The Group reviews its loan portfolios and investment securities to assess impairment on at least a quarterly basis to determine whether an impairment loss should be recorded in the Income Statement. In undertaking this review, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before such a decrease in an individual loan can be identified. This evidence may include observable data indicating that there has been an adverse change in the payment status or borrower's local economic conditions, including forbearance measures (such as a transfer to interest only products and term extensions that correlate with defaults on assets in the Group).

Management uses critical estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment to assess the probability and size of potential losses. Management also assesses the expected loss on loans and advances as a result of the expected movement in property prices and the discount on the sale of possession properties. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to minimise any differences between loss estimates and actual loss experience. The key sensitivity associated with this is house price movements. If expected house prices reduced by 5%, the total residential impairment provision required would increase by £0.8m (2015: £0.5m increase). If commercial property prices reduced by 5%, the total commercial impairment provision required would increase by £1.3m (2015: £1.7m increase).

Retirement benefit obligation/surplus
The Income Statement cost and Statement of Financial Position obligation or surplus of the defined benefit pension scheme are assessed in accordance with the advice of a qualified actuary. Assumptions are made for inflation, the rate used to discount scheme liabilities, the expected return on scheme assets and mortality rates. Changes to any of the assumptions could have an impact on the Statement of Financial Position liability and to the costs in the Income Statement. The impact of a 0.25% decrease in the interest rate used to discount the future value of the benefit obligation would be to increase the present value of the obligation by £5.9m (2015: £4.7m decrease in surplus). The impact of a 0.25% increase in the inflation rate used to calculate the defined benefit obligation would be to increase the present value of the obligation by £4.2m (2015: £3.7m decrease in surplus).

Effective interest rate
IAS 39 requires that financial instruments carried at amortised cost be accounted for on an effective interest rate (EIR) basis. Revenue on financial instruments classified as loans and receivables or financial liabilities at amortised cost, is recognised on an EIR basis. This calculation takes into account interest received or paid, and fees and commissions paid or received that are integral to the yield as well as incremental transaction costs. The EIR is the rate that discounts the expected future cash flows over the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial instrument at initial recognition.

In respect of residential mortgages, all discounts, premia, incremental fees and costs associated with the origination of a mortgage are deferred and amortised over the estimated mortgage life. Mortgage life is based upon historic observable data, amended for management's estimation of future economic conditions. The impact of a one month decrease in the anticipated life of mortgage assets would result in an increase of £0.5m (2015: £0.4m decrease) in the Group's interest income.

Fair values
Fair values are determined in accordance with the valuation hierarchy set out in note 37. Each financial instrument is valued using the most reliable valuation source available. Where no level one active observable market price exists, valuation techniques including net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist and other valuation models are used. Market observable inputs used in valuation techniques include future interest rates, foreign exchange rates and equity index prices. Other inputs into valuations include assumptions on mortgage prepayment and mortality rates. The Group allocates each instrument type to the relevant level of the hierarchy based on a judgement of the reliability of each key valuation source.

Technology infrastructure costs
The Group applies judgement to assess whether amounts spent on technology infrastructure meet the criteria for capitalisation as an intangible asset, notably whether they are able to be measured reliably and whether they are expected to give rise to future economic benefit. The costs of each significant project are evaluated against the criteria based on an assessment of future benefits performed by the relevant business area and reviewed in accordance with the agreed governance process. Costs are reviewed as the project progresses to ensure that the categorisation remains appropriate and that, where an intangible asset arises, any future benefits are still expected to arise.

3. Interest receivable and similar income

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
On loans fully secured on residential property	**433.7**	423.2	**433.7**	423.2
On other loans	**17.6**	18.5	**17.6**	18.5
On debt securities				
Interest and other income	**10.8**	10.0	**17.2**	17.4
On other liquid assets				
Interest and other income	**4.3**	3.8	**4.3**	3.8
Net expense on financial instruments	**(60.1)**	(52.8)	**(85.6)**	(70.8)
Total interest receivable	**406.3**	402.7	**387.2**	392.1

Included within interest receivable and similar income is interest recognised on impaired financial assets of £4.1m (2015: £5.2m). Of the total Group and Society interest receivable, a net expense of £48.2m (2015: £42.6m) and £54.3m (2015: £47.4m) respectively relate to instruments held at fair value through profit and loss. The remainder relates to instruments not held at fair value through profit and loss.

4. Interest payable and similar charges

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
On shares held by individuals	**171.8**	163.7	**171.8**	163.7
On subscribed capital	**3.3**	3.3	**3.3**	3.3
On deposits and other borrowings	**59.4**	56.0	**43.2**	43.5
Net income on financial instruments	**(30.0)**	(27.8)	**(29.9)**	(27.7)
Total interest payable	**204.5**	195.2	**188.4**	182.8

Of the total Group and Society interest payable, net receipts of £30.0m (2015: £27.8m) and £29.9m (2015: £27.7m) respectively relate to instruments held at fair value through profit and loss. The remainder relates to instruments not held at fair value through profit and loss.

For the year ended 31 December 2016 **Continued**

5. Fair value gains less losses from derivative financial instruments

	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
Change in fair value of financial assets designated at fair value through profit and loss	**17.6**	(18.8)	**17.6**	(18.8)
Change in fair value of financial liabilities designated at fair value through profit and loss	**(22.0)**	18.2	**(20.4)**	19.4
Change in fair value of derivatives in designated fair value hedge accounting relationships	**(11.9)**	9.4	**(15.5)**	19.9
Adjustment to hedged items in designated fair value hedge accounting relationships	**7.6**	(9.2)	**12.7**	(18.5)
Change in fair value of derivatives in designated cashflow hedge accounting relationships	**–**	0.7	**–**	0.7
Change in fair value of cross currency swap net of retranslation on matched euro liabilities	**7.4**	(1.2)	**6.9**	(3.6)
Total fair value gains and losses from derivative financial instruments	**(1.3)**	(0.9)	**1.3**	(0.9)

The fair value accounting volatility loss of £1.3m (2015: £0.9m loss) represents the net fair value movement on derivative instruments that are matching risk exposures on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted, or is not achievable on certain items. The net position for the Group on the cross currency swaps is composed of a fair value gain on cross currency swaps of £91.0m (2015: £15.4m loss) and an exchange loss of £86.1m (2015: £14.2m gain) on retranslation of the matched euro liabilities. For the Society there was a gain of £36.4m (2015: £15.3m loss) and a loss of £33.2m (2015: £11.6m gain) respectively. The cross currency swaps were entered into to reduce the exchange risk from funding in foreign currency; however, they are not in accounting hedge relationships.

6. Administrative expenses

	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
Staff costs:				
Wages and salaries	**44.9**	37.6	**44.8**	37.3
Social security costs	**4.4**	3.5	**4.4**	3.5
Other pension costs	**4.6**	3.7	**4.6**	3.6
Remuneration of auditor (see below)	**0.4**	0.4	**0.4**	0.4
Other administrative expenses	**34.4**	31.8	**34.3**	31.5
Total administrative expenses	**88.7**	77.0	**88.5**	76.3

There are 27 directors, senior management and members of staff, whose actions have a material impact on the risk profile of the Group, with fixed remuneration of £4.3m and variable remuneration of £1.3m (2015: 57 individuals £6.2m and £1.6m). The new Senior Managers Regime came into force in 2016, which reduced the number of colleagues included in these categories.

The analysis of auditor's remuneration is as follows:

	Group & Society 2016 £000	Group & Society 2015 £000
Fee payable to the Society's auditor for the audit of the Society's annual accounts	**247.4**	186.2
Fees payable to the Society's auditor for the audit of the Society's subsidiaries	**47.8**	25.0
Total audit fees	**295.2**	211.2
Tax services	**17.5**	–
Further assurance services	**134.8**	96.3
Other services	**–**	21.8
Total non-audit fees	**152.3**	118.1
Fees payable to the Society's auditor and its associates in respect of associated pension schemes	**6.5**	7.0

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

Notes to the Accounts

For the year ended 31 December 2016 **Continued**

7. Staff numbers

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

	Group & Society	
	2016 Number	2015 Number
Central administration	**1,001**	882
Branches	**363**	341
Total number of persons employed	**1,364**	1,223

8. Impairment losses on loans and advances to customers

2016

Group & Society

	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2016				
Collective impairment	10.8	10.7	–	21.5
Individual impairment	15.1	25.0	2.5	42.6
Opening impairment	25.9	35.7	2.5	64.1
Income and expenditure account				
Charge/(release) for the year				
Collective impairment	1.1	(5.1)	–	(4.0)
Individual impairment	4.7	(0.7)	–	4.0
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.9)	–	–	(0.9)
Total income and expenditure	4.9	(5.8)	–	(0.9)
Amount written off during the year:				
Individual impairment	(4.8)	(4.2)	–	(9.0)
At 31 December 2016				
Collective impairment	11.9	5.6	–	17.5
Individual impairment	14.1	20.1	2.5	36.7
Closing impairment	26.0	25.7	2.5	54.2

For the year ended 31 December 2016 **Continued**

8. Impairment losses on loans and advances to customers continued

2015

Group & Society

	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2015				
Collective impairment	9.8	6.5	–	16.3
Individual impairment	19.8	18.5	2.5	40.8
Opening impairment	29.6	25.0	2.5	57.1
Income and expenditure account				
Charge for the year:				
Collective impairment	1.0	4.2	–	5.2
Individual impairment	5.8	8.1	–	13.9
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.6)	–	–	(0.6)
Total income and expenditure	6.2	12.3	–	18.5
Amount written off during the year:				
Individual impairment	(9.9)	(1.6)	–	(11.5)
At 31 December 2015				
Collective impairment	10.8	10.7	–	21.5
Individual impairment	15.1	25.0	2.5	42.6
Closing impairment	25.9	35.7	2.5	64.1

For the year ended 31 December 2016 **Continued**

9. Tax expense

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
Analysis of charge in the year				
Current tax				
UK corporation tax on profits for the year	**31.2**	20.8	**31.2**	21.7
Adjustments in respect of previous years	**0.3**	(1.2)	**0.3**	(1.2)
Total current tax	**31.5**	19.6	**31.5**	20.5
Deferred tax				
Origination and reversal of timing differences	**(0.6)**	–	**–**	–
Adjustments in respect of previous years	**(0.3)**	–	**(0.3)**	–
Total deferred tax	**(0.9)**	–	**(0.3)**	–
Tax on profit on ordinary activities	**30.6**	19.6	**31.2**	20.5
Factors affecting current tax charge for the year:				
Profit on ordinary activities before tax	**116.6**	108.5	**116.1**	113.0
Profit on ordinary activities multiplied by standard rate of corporate tax in the UK of 20% (2015: 20.25 %)	**23.3**	22.0	23.2	22.8
Effects of:				
Expenses not deductible for tax purposes	**0.3**	0.7	**0.3**	0.7
Adjustment in respect of prior years	**–**	(1.2)	**–**	(1.2)
Rate change	**(0.3)**	(0.1)	**(0.2)**	(0.1)
Banking surcharge	**7.4**	–	**7.4**	–
Income not taxable	**(0.1)**	(0.5)	**0.5**	(0.5)
Disposal of investment property	**–**	(1.3)	**–**	(1.2)
	30.6	19.6	**31.2**	20.5

The standard rate of corporation tax applicable to the Group for the year ended 31 December 2016 was 20% (2015: 20.25%). In the July 2015 Budget, it was announced that the main rate of corporation tax will reduce to 19% with effect from 1 April 2017 and to 18% with effect from 1 April 2020. These changes were substantively enacted on 26 October 2015 as part of the Finance No.2 Bill 2015. The rate to be applicable from 1 April 2020 was revised from 18% to 17% as part of the March 2016 Budget.

The deferred tax balances have been calculated at the standard rate of 17%, as it is expected that these balances will mostly reverse after 1 April 2020.

In addition, the surcharge of 8% on the profits of banking companies (including building societies) above the £25m threshold took effect from 1 January 2016. The expected impact of the surcharge has also been applied to the deferred tax balances.

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

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
Cash in hand	**2.0**	2.8	**2.0**	2.8
Balances with the Bank of England	**936.9**	698.2	**936.9**	698.2
Included in cash and cash equivalents (see note 26)	**938.9**	701.0	**938.9**	701.0

Balances with the Bank of England do not include mandatory reserve deposits of £20.8m (2015: £18.0m) which are not available for use in the Group's day to day operations. Such deposits are included within Loans and Advances to Credit Institutions in the Statements of Financial Position.

11. Loans and advances to customers

	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
(a) Loans and receivables				
Loans fully secured on residential property	**13,081.9**	11,149.1	**13,081.9**	11,149.1
Other loans				
Loans fully secured on land	**125.3**	194.0	**125.3**	194.0
Other loans	**2.5**	2.5	**2.5**	2.5
Fair value adjustment for hedged risk	**70.1**	26.7	**70.1**	26.7
Total loans and receivables	**13,279.8**	11,372.3	**13,279.8**	11,372.3
(b) At fair value through profit and loss				
Loans fully secured on residential property	**0.2**	1.3	**0.2**	1.3
Other loans	**251.9**	234.8	**251.9**	234.8
Total loans at fair value through profit and loss	**252.1**	236.1	**252.1**	236.1
Less:				
Impairment loss (see note 8)	**(54.2)**	(64.1)	**(54.2)**	(64.1)
Total loans and advances to customers				
Loans fully secured on residential property	**13,120.9**	11,146.0	**13,120.9**	11,146.0
Other loans	**356.8**	398.3	**356.8**	398.3
Total loans and advances to customers	**13,477.7**	11,544.3	**13,477.7**	11,544.3

The Group has a number of residential mortgage portfolios purchased from third parties. The Group took on certain, but not all, risks arising from these loans, and as a consequence these residential mortgages have been recognised as a collateral loan to a third party within other loans at fair value through profit or loss. The net profit on loans and advances, which are designated as fair value through profit or loss, was £16.0m (2015: £3.9m loss) for both the Group and Society.

Loans and advances to customers, for both the Group and Society, include £2,708.1m (2015: £2,764.3m) of loans, which have been transferred from the Society to its associated secured funding vehicles.

The following transfers have been made:

2016	**Covered Bonds LLP £M**	**Albion No. 2 Plc £M**	**Albion No. 3 Plc £M**	**Guildford No. 1 Plc £M**	**Total £M**
Loans and advances transferred from the Society to securitisation vehicles	**1,842.4**	**95.7**	**220.2**	**549.8**	**2,708.1**
Loan notes issued by securitisation vehicles	**1,217.8**	**107.6**	**256.2**	**569.9**	**2,151.5**

2015	Covered Bonds LLP £M	Albion No. 2 Plc £M	Albion No. 3 Plc £M	Guildford No. 1 Plc £M	Total £M
Loans and advances transferred from the Society to securitisation vehicles	1,543.2	130.0	353.4	737.7	2,764.3
Loan notes issued by securitisation vehicles	819.3	142.2	370.4	752.4	2,084.3

The covered bonds and residential mortgage backed securities issued have been used to secure long term funding from other counterparties. The loans are retained in the Society's Statement of Financial Position as the Society continues to control the loans and substantially retains the risks and rewards relating to them.

12. Investment securities

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
Debt securities				
Listed	**777.8**	714.2	**1,254.1**	1,355.7
Unlisted	**–**	135.1	**192.6**	327.7
Total investment securities	**777.8**	849.3	**1,446.7**	1,683.4

Investment securities held by the Group increased by £6.8m in 2016 (2015: decreased by £3.7m) due to changes in fair value. In addition to those securities held by the Group, the Society has purchased investment securities issued by other Group entities. Total investment securities held by the Society increased by £6.8m in 2016 (2015: decreased by £2.8m) due to changes in fair value. These movements were recorded in equity. No provisions have been made against investment securities during the year, nor were there any provisions held as at 31 December 2016 (2015: nil).

	Available for sale £M	**Loans and receivables £M**	**Total £M**
2016 Group			
At 1 January 2016	**821.1**	**28.2**	**849.3**
Additions	**695.7**	**–**	**695.7**
Disposals (sale and redemption)	**(769.6)**	**(4.4)**	**(774.0)**
Change in fair value	**6.5**	**0.3**	**6.8**
At 31 December 2016	**753.7**	**24.1**	**777.8**

	Available for sale £M	Loans and receivables £M	Total £M
2015 Group			
At 1 January 2015	975.6	29.5	1,005.1
Additions	837.1	–	837.1
Disposals (sale and redemption)	(987.7)	(1.5)	(989.2)
Change in fair value	(3.9)	0.2	(3.7)
At 31 December 2015	821.1	28.2	849.3

12. Investment securities continued

	Available for sale £M	Loans and receivables £M	Total £M
2016			
Society			
At 1 January 2016	**1,655.2**	**28.2**	**1,683.4**
Additions	**695.7**	**–**	**695.7**
Disposals (sale and redemption)	**(934.8)**	**(4.4)**	**(939.2)**
Change in fair value	**6.5**	**0.3**	**6.8**
At 31 December 2016	**1,422.6**	**24.1**	**1,446.7**

	Available for sale £M	Loans and receivables £M	Total £M
2015			
Society			
At 1 January 2015	1,011.2	29.5	1,040.7
Additions	1,769.8	–	1,769.8
Disposals (sale and redemption)	(1,122.6)	(1.5)	(1,124.1)
Change in fair value	(3.2)	0.2	(3.0)
At 31 December 2015	1,655.2	28.2	1,683.4

As permitted by the amendment to IAS 39 issued by the International Accounting Standards Board in October 2008, the Society has reclassified (from 1 July 2008) certain mortgage backed securities and floating rate note assets from the available for sale category to the loans and receivables category. The assets were reclassified as the Society considered that, due to adverse conditions in financial markets, the market for the sale and purchase of mortgage backed securities and floating rate notes had become inactive. This was evidenced by significant fluctuations in the quoted market value of these instruments and that these instruments were no longer being actively traded. The market value of the assets reclassified on 1 July 2008 was £828m, which included £15.8m fair value losses recognised during the period directly in reserves. The carrying value of the remaining assets at 31 December 2016 was £24.1m (2015: £28.2m), and this compares to a market value of £22.6m (2015: £26.6m).

The fair value gain that would have been recorded directly in reserves if the assets had not been reclassified was £0.2m (2015: £0.4m loss). The net loss, after deferred tax, of £1.5m (2015: loss of £0.7m) previously recognised in the available for sale reserve is released to profit or loss as part of the effective interest rate based on the maturity profile of the underlying instruments. The weighted average interest rate on the mortgage backed securities and floating rate note assets was 1.5% (2015: 1.6%). At 31 December 2016, nil (2015: nil) of investment securities were pledged as collateral under sale and repurchase agreements.

13. Investments in subsidiary undertakings

	Society 2016 £M	Society 2015 £M
a) Shares held in subsidiary undertakings		
Cost		
At 1 January 2016	–	–
At 31 December 2016	**–**	–
b) Loans to subsidiary undertakings		
Cost		
At 1 January 2016	**40.4**	121.4
Additions	**–**	–
Repayments	**(25.7)**	(77.9)
Impairment of loan to Headrow Commercial Property Services Ltd	**(0.2)**	(3.1)
At 31 December 2016	**14.5**	40.4
Total investments in subsidiary undertakings	**14.5**	40.4

For the year ended
31 December 2016

Continued

13. Investments in subsidiary undertakings continued

(c) Interest in subsidiary undertakings

The Society holds the following interests in subsidiary undertakings, all of which are registered in England.

Name	Major activities	Class of shares held	Interest of Society	Address
Leeds Financial Services Ltd	Non-trading	Ordinary £1 shares	100%	105 Albion Street, Leeds LS1 4AS
Leeds Mortgage Funding Ltd	Provision of mortgage finance	Ordinary £1 shares	100%	105 Albion Street, Leeds LS1 4AS
Headrow Commercial Property Services Ltd	Non-trading	Ordinary £1 shares	100%	105 Albion Street, Leeds LS1 4AS
Leeds Building Society Covered Bonds LLP	Provision of mortgage assets and guarantor of covered bonds	*	*	105 Albion Street, Leeds LS1 4AS
Leeds Covered Bonds Designated Member (No. 1) Limited	First designated member of Leeds Building Society Covered Bonds LLP	*	*	35 Great St. Helen's, London EC3A 6AP
Leeds Covered Bonds Designated Member (No. 2) Limited	Second designated member of Leeds Building Society Covered Bonds LLP	*	*	35 Great St. Helen's, London EC3A 6AP
Leeds Covered Bonds Holdings Company Limited	Holding company to both Leeds Covered Bonds Designated Member (No. 1) & (No. 2) Limited	*	*	35 Great St. Helen's, London EC3A 6AP
Albion No. 2 plc	Provision of residential mortgage-backed-securities	*	*	35 Great St. Helen's, London EC3A 6AP
Albion No. 2 Holdings Limited	Holding company to Albion No. 2 plc	*	*	35 Great St. Helen's, London EC3A 6AP
Albion No. 3 plc	Provision of residential mortgage-backed-securities	*	*	35 Great St. Helen's, London EC3A 6AP
Albion No. 3 Holdings Limited	Holding company to Albion No. 3 plc	*	*	35 Great St. Helen's, London EC3A 6AP
Guildford No. 1 plc	Provision of residential mortgage-backed-securities	*	*	Third Floor, 1 King's Arms Yard, London EC2R 7AF
Guildford No. 1 Holdings Limited	Holding company to Guildford No. 1 Holdings Limited	*	*	Third Floor, 1 King's Arms Yard, London EC2R 7AF

* The Society's interest is equal to being a 100% owned subsidiary as these entities pass the test of control under IFRS 10. Consequently they have been consolidated in the Group accounts in accordance with IFRS 10 Consolidated Financial Statements. Although the Society does not legally own these entities, it is deemed to control the subsidiaries, as it has power over the activities undertaken by the subsidiaries through the group management and operational structures in place, and it has exposure to variable returns through the purchase of loan notes, deferred consideration and intragroup loans.

In 2016 the Society impaired £0.2m (2015: £3.1m) of its intragroup debt with Headrow Commercial Property Services Ltd, which is currently undergoing a solvent liquidation.

The Society received no dividends from any of its subsidiaries in 2016. In 2015 the Society received dividends of £0.1m from Leeds Overseas (Isle of Man) Ltd, £0.4m from Leeds Financial Services Ltd and £1.0m from Leeds Mortgage Funding Ltd.

14. Intangible assets

2016 Group & Society	**Purchased software £M**	**Development costs £M**	**Total £M**
Cost			
At 1 January 2016	**2.2**	**1.7**	**3.9**
Additions	**–**	**0.2**	**0.2**
At 31 December 2016	**2.2**	**1.9**	**4.1**
Amortisation			
At 1 January 2016	**0.4**	**0.1**	**0.5**
Charged in year	**0.4**	**0.2**	**0.6**
At 31 December 2016	**0.8**	**0.3**	**1.1**
Net book value			
At 31 December 2016	**1.4**	**1.6**	**3.0**

2015 Group & Society	Purchased software £M	Development costs £M	Total £M
Cost			
At 1 January 2015	–	–	–
Additions	2.2	1.7	3.9
At 31 December 2015	2.2	1.7	3.9
Amortisation			
At 1 January 2015	–	–	–
Charged in year	0.4	0.1	0.5
At 31 December 2015	0.4	0.1	0.5
Net book value			
At 31 December 2015	1.8	1.6	3.4

During 2016 the Group continued its programme of works that met the definition of an intangible asset. This included software licences and certain IT development costs. Amortisation of such assets is charged to the Income Statement on a straight line basis over the useful life of the asset once it is brought into use. The useful life of such assets is deemed to be five years.

Intangible assets are reviewed annually for indications of impairment. Where an indication of impairment exists, the discounted cash flow method is used to assess the recoverability of the asset. No impairment (2015: £nil) has been recognised.

For the year ended 31 December 2016 **Continued**

15. Property, plant and equipment

	Freehold premises £M	Long leasehold premises £M	Short leasehold premises £M	Office & computer equipment £M	Motor vehicles £M	Total £M
2016						
Group						
Cost or valuation						
At 1 January 2016	**22.2**	**0.3**	**1.4**	**36.8**	**0.1**	**60.8**
Additions	**–**	**–**	**–**	**2.8**	**–**	**2.8**
Disposals/reclassifications	**–**	**–**	**–**	**(0.6)**	**(0.1)**	**(0.7)**
Decrease in value taken to Other Comprehensive Income	**(1.8)**	**–**	**–**	**–**	**–**	**(1.8)**
At 31 December 2016	**20.4**	**0.3**	**1.4**	**39.0**	**–**	**61.1**
Depreciation and impairment						
At 1 January 2016	**1.1**	**–**	**1.3**	**26.2**	**0.1**	**28.7**
Disposals/reclassifications	**(0.5)**	**–**	**–**	**(0.2)**	**(0.1)**	**(0.8)**
Depreciation charged in year	**–**	**–**	**–**	**2.6**	**–**	**2.6**
Impairment charged in year	**0.5**	**–**	**–**	**–**	**–**	**0.5**
At 31 December 2016	**1.1**	**–**	**1.3**	**28.6**	**–**	**31.0**
Net book value						
At 31 December 2016	**19.3**	**0.3**	**0.1**	**10.4**	**–**	**30.1**

	Freehold premises £M	Long leasehold premises £M	Short leasehold premises £M	Office & computer equipment £M	Motor vehicles £M	Total £M
2015						
Group & Society						
Cost or valuation						
At 1 January 2015	22.2	0.3	1.4	32.4	0.1	56.4
Additions	–	–	–	4.4	–	4.4
At 31 December 2015	22.2	0.3	1.4	36.8	0.1	60.8
Depreciation and impairment						
At 1 January 2015	1.1	–	1.3	24.0	0.1	26.5
Depreciation charged in year	–	–	–	2.2	–	2.2
At 31 December 2015	1.1	–	1.3	26.2	0.1	28.7
Net book value						
At 31 December 2015	21.1	0.3	0.1	10.6	–	32.1

The Society's depreciation charge for the year was £2.5m. The net book value of property, plant and equipment is the same as Group.

Included in depreciation and impairment charged in the year is £0.5m relating to impairment losses on land and buildings. In accordance with the Group's accounting policies, an updated valuation was undertaken as at 31 December 2016 by Knight Frank for all freehold and long leased properties. The properties will next be revalued as at 31 December 2019.

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
The amount of freehold and long leasehold premises (included above at valuation) determined according to the historical cost convention is as follows:				
Freehold premises	**9.7**	9.7	**9.7**	9.7
Long leasehold premises	**0.1**	0.1	**0.1**	0.1
Net book value	**9.8**	9.8	**9.8**	9.8
Land and building occupied by the Group and Society for its own activities				
Net book value	**18.7**	16.4	**18.7**	16.4

No equipment, fixtures and vehicles were held under finance leases (2015: £nil).

16. Investment properties

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
At 1 January 2016	**–**	4.4	**–**	–
Net fair value movement	**–**	(3.4)	**–**	–
Intragroup transfer	**–**	–	**–**	1.0
Transfer to inventories	**–**	(1.0)	**–**	(1.0)
At 31 December 2016	**–**	–	**–**	–

The investment property disposed of in 2015 was a commercial possession property held by Headrow Commercial Property Services Ltd. This was transferred to the Society on 16 October 2015 for £1.0m, which represented the market value on an arm's length basis. The Society prepared the property for sale and therefore, shortly after transfer, appropriated it from investment properties to inventory. The property was subsequently sold to a third party for £1.0m on 26 November 2015.

17. Deferred income tax

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
Deferred tax				
At 1 January 2016	**(1.0)**	(1.2)	**(1.2)**	–
Adjustment to amounts brought forward	**(1.3)**	–	**(0.1)**	–
Amount recognised directly in equity	**1.2**	0.8	**(0.3)**	(0.8)
Income and expenditure movement during the year	**1.0**	(0.6)	**1.4**	(0.4)
At 31 December 2016	**(0.1)**	(1.0)	**(0.2)**	(1.2)

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
Deferred income tax liabilities				
Gain on revaluation	**0.6**	0.5	**0.6**	0.5
Pensions and other post retirement benefits	**–**	1.3	**–**	1.3
Other temporary differences	**2.1**	0.6	**1.4**	–
Total deferred income tax liabilities	**2.7**	2.4	**2.0**	1.8

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
Deferred income tax assets				
Pensions and other post retirement benefits	**2.4**	–	**2.4**	–
Other provisions	**0.2**	0.1	**(0.6)**	0.5
Total deferred income tax assets	**2.6**	0.1	**1.8**	0.5

For the year ended 31 December 2016

Continued

18. Other assets, prepayments and accrued income

	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
Collateral	**238.2**	128.7	**238.2**	128.7
Prepayments	**3.4**	3.6	**3.4**	3.4
Other assets	**7.6**	7.7	**90.3**	67.2
Total other assets, prepayments and accrued income	**249.2**	140.0	**331.9**	199.3

Other assets include £238.2m (2015: £128.7m) owed by credit institutions on cash collateralisation of derivatives.

19. Shares

	Group & Society 2016 £M	Group & Society 2015 £M
Held by individuals	**11,194.2**	9,912.1
Other shares	**7.9**	10.2
Fair value adjustments for hedged risk	**31.1**	10.6
Total shares	**11,233.2**	9,932.9

20. Amounts owed to credit institutions

	Group & Society 2016 £M	Group & Society 2015 £M
Total amounts owed to credit institutions	**572.1**	55.9

21. Amounts owed to other customers

	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
Amounts owed to subsidiary undertakings	**–**	–	**875.3**	1,285.1
Other deposits	**357.5**	418.3	**357.5**	418.3
Total amounts owed to other customers	**357.5**	418.3	**1,232.8**	1,703.4

22. Debt securities in issue

	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
Certificates of deposit	**15.5**	14.0	**15.5**	14.0
Senior unsecured debt	**896.5**	763.2	**896.5**	763.2
Covered bonds	**1,276.3**	846.7	**1,246.0**	821.9
Residential mortgage backed securities	**282.9**	432.9	**–**	–
Total debt securities in issue	**2,471.2**	2,056.8	**2,158.0**	1,599.1

The interest rates on debt securities in issue include both fixed and variable rates. The underlying security for the covered bonds and residential mortgage backed securities (RMBS) are certain loans and advances to customers (see note 11 for further detail).

For the year ended 31 December 2016 **Continued**

23. Other liabilities and accruals

	Group 2016 £M	Group 2015 £M	Society 2016 £M	Society 2015 £M
Income tax	**1.3**	10.4	**1.3**	10.4
Accruals	**16.2**	18.8	**16.5**	18.9
Other payables	**139.8**	43.4	**137.9**	39.0
Total other liabilities and accruals	**157.3**	72.6	**155.7**	68.3

Included within other payables is a liability for financial guarantee contracts of £3.6m (2015: £3.6m).

Other payables includes £90.0m (2015: £18.6m) owed to credit institutions on cash collateralisation of swaps.

24. Provisions for liabilities and charges

2016	**FSCS Levy £M**	**Customer redress and other related provisions £M**	**Commission clawback £M**	**Total £M**
Group & Society				
At 1 January 2016	**2.8**	**3.3**	**0.3**	**6.4**
Amounts paid during the year	**(2.6)**	**(2.4)**	**–**	**(5.0)**
Provision charge in the year	**2.3**	**1.6**	**–**	**3.9**
At 31 December 2016	**2.5**	**2.5**	**0.3**	**5.3**

2015	FSCS Levy £M	Customer redress and other related provisions £M	Commission clawback £M	Total £M
Group & Society				
At 1 January 2015	3.1	1.0	0.3	4.4
Amounts paid during the year	(5.8)	(1.0)	–	(6.8)
Provision charge in the year	5.5	3.3	–	8.8
At 31 December 2015	2.8	3.3	0.3	6.4

Financial Services Compensation Scheme ('FSCS') Levy

The levy represents the estimated amount of interest payable under the FSCS for the 2016/17 scheme year, which runs from April 2016 to March 2017, and is calculated with reference to the protected deposits held at 31 December 2015. Based on IFRIC 21 Levies this amount was recognised in full at the trigger date, 1 April 2016. Refer to note 27 for the Group's contingent liability in relation to the FSCS as at the Statement of Financial Position date.

Customer redress and other related provisions

This provision is made in respect of claims for redress by customers, including potential claims on payment protection insurance sold by the Group and other fees and premia charged. The provision also includes the cost of a proactive remediation exercise undertaken by the Group. This is in respect of an error on a small number of mortgages to which the incorrect interest rate was applied.

Commission clawback

This provision has been for the potential clawback of commission on assurance policies sold.

Notes to the Accounts

For the year ended 31 December 2016

Continued

25. Subscribed capital

	Group & Society	
	2016 £M	2015 £M
13 3/8% permanent interest bearing shares	**25.0**	25.0

The subscribed capital, which is denominated in sterling, was issued for an indeterminate period and is only repayable in the event of the winding up of the Society.

26. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

	Group 2016 £M	Group 2015 £M	**Society 2016 £M**	Society 2015 £M
Cash in hand and balances with the Bank of England (note 10)	**938.9**	701.0	**938.9**	701.0
Loans and advances to credit institutions	**187.3**	126.4	**66.3**	43.4
Total cash and cash equivalents	**1,126.2**	827.4	**1,005.2**	744.4

27. Guarantees and other financial commitments

(a) Financial Services Compensation Scheme

The Group has a contingent liability in respect of contributions to the Financial Services Compensation Scheme provided by the Financial Services and Markets Act 2000. The FSCS provides compensation to depositors in the event that a financial institution is unable to repay amounts due and is funded by contributions from the financial services industry. Following the failure of a number of financial institutions, the FSCS raised borrowings from the UK Government to cover compensation in relation to protected deposits. These borrowings are anticipated to be largely repaid from the realisation of the assets of the failed institutions. During 2016 there was no FSCS specific capital element levied separately as sufficient levies had been paid in previous years to fund the shortfalls arising. It is possible that capital levies may be required in the event of institutional failures in the future. Interest on the loan made by HM Treasury in respect of failed financial institutions will continue to be accrued based on the known interest cost and the Society's market share as communicated by the FSCS.

(b) Subsidiary undertakings

The Society is obliged under the Building Societies Act 1986 to discharge the liabilities of its subsidiary undertakings to the extent they were incurred before 11 June 1996 and in so far as those bodies are unable to discharge the liabilities out of their own assets.

(c) Capital commitments

The Group has commitments of £9.9m (2015: £12.3m) payable under executory contracts over a period of ten years which relate to the ongoing investment programme. This amount is inclusive of value added tax.

(d) Lease commitments

At 31 December the total undiscounted commitments under non-cancellable operating leases were as set out below:

Group & Society	**2016 £M**	2015 £M
Land and buildings operating leases		
Commitment expiring:		
Within one year	**1.7**	1.6
Between one and five years inclusive	**3.3**	4.2
After five years	**2.7**	3.4
Total land and buildings operating leases	**7.7**	9.2
Other operating leases		
Commitment expiring:		
Within one year	**5.9**	5.0
Between one and five years inclusive	**23.8**	19.9
More than five years	**17.8**	19.9
Total other operating leases	**47.5**	44.8

For the year ended 31 December 2016 **Continued**

28. Retirement benefit obligations/surplus

The Group operates both defined benefit and defined contribution schemes. In addition, the Group has, for one individual (2015: one individual) in the UK, an employer funded retirement benefits scheme. The schemes have been accounted for under IAS19, which covers employee benefits.

The defined benefit section of the Scheme provides benefits based on final salary for certain employees. The assets of the Scheme are held in a separate trustee-administered fund. Contributions to the defined benefit section are assessed in accordance with the advice of an independent qualified actuary using the projected unit method. The defined benefit section was closed to new entrants from 1 January 2000, and closed to future benefit accrual from 31 December 2014. As at 31 December 2016 there were 354 deferred defined benefit members (2015: 418).

Actuarial gains and losses are recognised immediately in full through the Statements of Comprehensive Income. The major assumptions used by the Actuary were (in nominal terms):

Group & Society	**2016**	2015	2014	2013	2012
Rate of increase in salaries*	**–**	–	4.80%	5.15%	4.65%
Rate of increase for pensions in payment**	**3.05%**	3.00%	2.95%	3.20%	2.80%
Rate of increase for deferred pensions**	**3.05%**	3.15%	3.05%	3.40%	2.90%
Discount rate	**2.55%**	3.80%	3.60%	4.45%	4.50%
Inflation assumption RPI	**3.20%**	3.15%	3.05%	3.40%	2.90%
Inflation assumption CPI	**2.20%**	2.15%	2.05%	2.40%	2.20%

* As the Scheme was closed to future benefit accrual from 31 December 2014 salary-based measures have ceased to apply.

** in excess of any Guaranteed Minimum Pension (GMP) element.

The expected return on the assets has been derived as the weighted average of the expected returns from the main asset class (equities and bonds). The expected return for the asset class reflects a combination of historical performance analysis, the forward-looking view of the financial markets (as suggested by yields available), and the views of the investment organisations.

The most significant non-financial assumption is the assumed rate of longevity, which is based on the SAPS tables known as S2PXA (2015: S2PXA), projected in line with members' years of birth. Future improvements in mortality allowed for are in line with the CMI 2015 projection with a 1% long term trend. The table below shows the life expectancy assumptions used in the accounting assessments. Pensioner life expectancies are for a member currently aged 63 retiring now. Non-pensioner life expectancies are for a member retiring at age 63 currently aged 43.

	2016		2015		2014	
	Pensioner years	**Non-Pensioner years**	Pensioner years	Non-Pensioner years	Pensioner years	Non-Pensioner years
Male	**23.7**	**25.1**	23.7	25.0	23.9	25.2
Female	**25.8**	**27.3**	25.7	27.2	26.2	27.7

For the year ended 31 December 2016

Continued

28. Retirement benefit obligations/surplus continued

Group & Society	**2016**	2015	2014	2013	2012
Category of assets					
Equities	**31.3%**	56.5%	55.7%	57.7%	53.0%
Property	**–**	1.1%	1.4%	2.5%	4.8%
Government bonds	**–**	31.1%	21.7%	19.5%	19.9%
Corporate bonds	**–**	10.7%	20.5%	19.8%	21.8%
Absolute return bonds	**13.5%**	–	–	–	–
Diversified growth funds	**34.4%**	–	–	–	–
Liability driven investment	**20.5%**	–	–	–	–
Cash/other	**0.3%**	0.6%	0.7%	0.5%	0.5%

During 2016 the Pension Scheme Trustees undertook a review of the Scheme's investment strategy to reduce future volatility. Following the review, the Trustees amended the Scheme's investments in order to diversify the return generating assets as well as improving the efficiency of the risk reducing assets. These changes were implemented in 2016.

Reconciliation of funded statement	**2016 £M**	2015 £M	2014 £M	2013 £M	2012 £M
Present value of pension scheme's liabilities	**(114.2)**	(97.7)	(103.7)	(97.5)	(87.7)
Assets at fair value	**111.6**	102.8	105.0	94.2	85.3
(Deficit)/surplus	**(2.6)**	5.1	1.3	(3.3)	(2.4)

The amounts recognised in the Income Statements are as follows:

Group & Society	**2016 £M**	2015 £M
Net interest cost and expected return	**(0.3)**	(0.1)
Administration expenses	**0.5**	0.3
Total cost – defined benefit scheme	**0.2**	0.2

For the year ended 31 December 2016

Continued

28. Retirement benefit obligations/surplus continued

Experience recognised in the Statements of Comprehensive Income (SOCI)

Group & Society	2016 £M	2015 £M	2014 £M	2013 £M	2012 £M
Experienced (loss)/gain on pension scheme liabilities	**(26.0)**	4.2	(13.6)	(7.9)	(5.3)
Percentage of scheme liabilities (%)	**22.8%**	4.3%	13.1%	8.1%	6.0%
Experienced gain/(loss) on assets	**16.5**	(2.1)	6.2	5.6	3.7
Percentage of scheme assets (%)	**14.8%**	2.0%	5.9%	5.9%	4.3%
Total (loss)/gain recognised in SOCI during the year	**(9.5)**	2.1	(7.4)	(2.3)	(1.6)

Changes in the present value of the defined benefit obligations are as follows:

Group & Society	2016 £M	2015 £M
At 1 January 2016	**97.7**	103.7
Interest cost	**3.4**	3.6
Actuarial losses/(gains)	**26.0**	(4.2)
Benefits paid	**(12.9)**	(5.4)
At 31 December 2016	**114.2**	97.7

Changes in the fair value of plan assets are as follows:

Group & Society	2016 £M	2015 £M
At 1 January 2016	**102.8**	105.0
Interest income	**3.7**	3.7
Actuarial gains/(losses)	**16.5**	(2.1)
Contribution by employer	**2.0**	1.9
Administration expenses	**(0.5)**	(0.3)
Benefits paid	**(12.9)**	(5.4)
At 31 December 2016	**111.6**	102.8

The cumulative amount of actuarial gains and losses recognised in the Statements of Other Comprehensive Income since the date of transition to IFRSs is a net loss of £12.4m (2015: £2.9m).

For the year ended 31 December 2016 **Continued**

28. Retirement benefit obligations/surplus continued

Sensitivity to change in key assumptions

The table below gives a broad indication of the impact on the pension deficit to changes in assumptions and experience.

All figures are before allowing for deferred tax.

	Approximate impact on current deficit £M	Approximate impact on projected pension cost £M
Reduce discount rate by 0.25%	+5.9	+0.2
Increase inflation assumption by 0.25%	+4.2	+0.2
Change long term trend of increases in mortality improvement from 1% per annum to 1.25% per annum	+2.0	+0.1

Estimated contributions for 2016 financial year

Group & Society	2016 £M
Estimated employer normal contributions in Financial Year 2017	2.0

29. Related party transactions

Group

Key management personnel comprises the executive directors and non executive directors, who are responsible for ensuring that the Society and its subsidiary undertakings meet their strategic and operational objectives. The Group enters into transactions in the ordinary course of business with directors of the Group and persons connected with the directors of the Group, on normal commercial terms.

Society

Details of the Society's shares in Group undertakings and subsidiaries are given in note 13. A number of transactions are entered into with these related parties in the normal course of business. These include loans, deposits, and the payment and recharge of administrative expenses. The volumes of related party transactions, outstanding balances at the year end, and the related income and expenses for the year are as follows:

	Society subsidiaries		Directors and connected persons	
	2016 £M	2015 £M	2016 £M	2015 £M
Loans payable to the Society				
Loans outstanding at 1 January 2016	40.4	121.4	0.4	0.4
Net movement during the year	(25.9)	(81.0)	0.2	–
Loans outstanding at 31 December 2016	14.5	40.4	0.6	0.4
Deposits payable by the Society				
Deposits outstanding at 1 January 2016	1,285.1	335.4	1.3	0.6
Net movement during the year	(409.8)	949.7	(0.1)	0.7
Deposits outstanding at 31 December 2016	875.3	1,285.1	1.2	1.3

Directors' emoluments	2016 £M	2015 £M
Total remuneration	2.8	2.6

Directors' emoluments include those emoluments received by directors from the Society and its associated bodies. Further information on directors' emoluments is included in the Directors' Remuneration Report on pages 64 to 77. No directors are active members of the defined benefit section of the Leeds Building Society Pension Scheme (2015: none). Three directors were members of the defined contribution section of the Leeds Building Society Pension Scheme during 2016 (2015: two).

For the year ended 31 December 2016 **Continued**

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

2016	Group Before tax amount £M	Group Tax benefit/ (expense) £M	Group Net of tax amount £M	Society Before tax amount £M	Society Tax benefit/ (expense) £M	Society Net of tax amount £M
Available for sale investment securities	7.8	(1.8)	6.0	7.8	(1.8)	6.0
Revaluation loss on properties revalued	(1.8)	0.5	(1.3)	(1.8)	0.5	(1.3)
Actuarial losses on retirement benefit obligations	(9.5)	2.5	(7.0)	(9.5)	2.5	(7.0)
Adjustment to tax in relation to prior periods	–	–	–	–	(1.5)	(1.5)
Other comprehensive income	(3.5)	1.2	(2.3)	(3.5)	(0.3)	(3.8)

2015	Group Before tax amount £M	Group Tax benefit/ (expense) £M	Group Net of tax amount £M	Society Before tax amount £M	Society Tax benefit/ (expense) £M	Society Net of tax amount £M
Available for sale investment securities	(3.5)	0.6	(2.9)	(3.5)	0.6	(2.9)
Actuarial losses on retirement benefit obligations	2.1	(0.6)	1.5	2.1	(0.6)	1.5
Other comprehensive income	(1.4)	–	(1.4)	(1.4)	–	(1.4)

31. Liquidity risk

Liquidity risk represents the risk that the Group is unable to meet its financial obligations as they fall due, or can only do so at excessive cost. The Group's business model is to fund long term mortgages through short term retail customer deposits. In practice, although mortgages may have long legal contractual maturities and customer deposits may have short notice periods, customer behaviour tends to shorten mortgage lives and extend retail deposits. This reduces the inherent mismatch of the Group's liquidity position, but does not eliminate the risk and therefore the Group is required to take additional steps to manage and monitor the liquidity gap.

The Group's liquidity policy is to maintain sufficient liquid resources to meet statutory, regulatory and operational requirements. These requirements are designed to allow the Group to cover cash flow imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Group, and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of high quality purchased liquid assets, through committed wholesale funding facilities (including securitisation arrangements) and through management control of the growth of the business.

It is the Group's policy to ensure that sufficient liquid assets are available to meet the Group's statutory, regulatory and operational obligations. The development and implementation of liquidity policy is the responsibility of the Assets & Liabilities Committee (ALCO). The day-to-day management of liquidity is the responsibility of the Treasury Function with oversight from the independent Risk Function.

A series of liquidity stress tests are performed each month to confirm that the level of liquid resources remains appropriate. ALCO is responsible for setting limits over the level and maturity profile of wholesale funding and for monitoring the composition of the Group Statement of Financial Position.

Liquidity policy is approved by ALCO and agreed with the Board. Limits on potential cash flow mismatches over defined time horizons are the principal method of liquidity control. The size of the Group's holdings of readily realisable liquid assets is primarily driven by such potential outflows and access to contingent funding from the Bank of England.

Pledged assets (encumbrance)
The Group has issued a number of debt instruments which are secured against its assets, specifically the retail mortgage portfolio. These provide long term funding from institutions counterparties, either through cash realised from the sale of securities, or through sale and repurchase agreements.

The Society established Leeds Building Society Covered Bond LLP in 2009 and at 31 December 2016 had £1,245.4m covered bonds in issue (2015: £819.3m), including €500m issued in 2016. In addition, the Group had a further £282.6m (2015: £512.6m) of debt securities in issue through the Albion No. 2 and Albion No. 3 securitisation programmes.

For the year ended 31 December 2016 **Continued**

31. Liquidity risk continued

The table below illustrates the external secured funding balances after redemptions in the mortgage pool:

	2016		2015	
	Assets pledged £M	**Secured funding £M**	Assets pledged £M	Secured funding £M
Secured against loans and advances to customers – Albion No.2 plc	**95.7**	**71.7**	130.0	106.4
Secured against loans and advances to customers – Albion No.3 plc	**220.2**	**210.8**	353.4	325.0
Secured against loans and advances to customers – Covered Bonds LLP	**1,842.4**	**1,245.4**	1,543.2	819.3
Total pledged assets	**2,158.3**	**1,527.9**	2,026.6	1,250.7

Pledged assets include those available to Leeds Building Society Covered Bonds LLP, Albion No.2 plc and Albion No.3 plc to provide collateral to support external funding transactions. However, disclosed above is the funding obtained through issuance to external counterparties. It does not include self-issued bonds. As a result, the relationship shown above between the assets pledged and level of funding, does not represent the 'haircut' applied to collateral values in determining the available level of funding. All of the assets pledged are retained in the Society's Statement of Financial Position as it substantially retains control of the loans and the risks and rewards associated with them. The Guildford loan notes issued were sold to the Society for liquidity purposes and therefore are consolidated out of the Group's financial results.

The covered bond programme operates under a Mortgage Sale Agreement in which there is an equitable assignment of the loans from the Society to the LLP. Legal title remains with the Society and full transfer of title is not affected until the occurrence of certain 'perfection' events, such as a failure to pay or breach of obligation on behalf of the Society, or the insolvency of the Society or the LLP.

The securitisation programme operates under a Mortgage Sale Agreement, where there is an equitable assignment of the loans from the seller to the issuers (Albion No.2 plc, Albion No.3 plc and Guildford No.1 plc). Legal title remains with the Society and full transfer of title is not affected until the occurrence of certain 'perfection' events such as it being directed by a regulatory authority, the courts or the Society.

Contractual maturity

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables below have been drawn up based on the undiscounted contractual maturities of the financial liabilities including interest that will be accrued to those instruments except where the Group is entitled and intends to repay the liabilities before their maturity. The subscribed capital has a fixed rate of interest of 13³/₈% payable twice a year for an indeterminate period.

31 December 2016	Repayable on demand £M	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Group						
Shares	**5,578.7**	**533.7**	**1,924.4**	**3,141.1**	**55.1**	**11,233.0**
Amounts owed to credit institutions	**–**	**572.1**	**–**	**–**	**–**	**572.1**
Amounts owed to other customers	**–**	**265.7**	**89.8**	**21.5**	**–**	**377.0**
Debt securities in issue	**–**	**10.0**	**77.3**	**1,956.8**	**427.1**	**2,471.2**
Subscribed capital	**–**	**–**	**–**	**–**	**25.0**	**25.0**
Total liabilities	**5,578.7**	**1,381.5**	**2,091.5**	**5,119.4**	**507.2**	**14,678.3**

For the year ended 31 December 2016 **Continued**

31. Liquidity risk continued

31 December 2015	Repayable on demand £M	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Group						
Shares	6,045.9	324.7	957.8	2,732.1	72.4	10,132.9
Amounts owed to credit institutions	–	56.0	–	–	–	56.0
Amounts owed to other customers	–	287.5	114.4	17.9	–	419.8
Debt securities in issue	–	5.0	9.1	1,399.7	850.4	2,264.2
Subscribed capital	–	–	–	–	25.0	25.0
Total liabilities	6,045.9	673.2	1,081.3	4,149.7	947.8	12,897.9

Contractual maturity

The following table details the Group's expected maturity for its derivative financial instruments. The table has been drawn up based on the undiscounted net cash inflows/(outflows) on the derivative instruments that settle on a net basis and the undiscounted gross inflows and (outflows) on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the conditions existing at the reporting date. For example, interest rates have been projected as illustrated by the yield curves existing at the reporting date, and where the amount varies with changes in an index, the amount disclosed may be based on the level of the index at the reporting date.

31 December 2016	**Less than 3 months £M**	**3 to 6 months £M**	**6 to 12 months £M**	**1 to 5 years £M**	**Over 5 years £M**
Swap contracts	**15.2**	**15.6**	**25.7**	**93.0**	**79.3**
31 December 2015					
Swap contracts	11.2	11.9	18.3	56.8	39.6

Maturity profile of financial instruments

The table below analyses the Group's financial assets and liabilities into relevant maturity groupings, based on the remaining period between the date of the Statement of Financial Position and the contractual maturity date.

Group 31 December 2016	**Repayable on demand £M**	**Less than 3 months £M**	**3 to 12 months £M**	**1 to 5 years £M**	**Over 5 years £M**	**Total £M**
Financial assets						
Cash in hand and balances with the Bank of England	**938.9**	**–**	**–**	**–**	**–**	**938.9**
Loans and advances to credit institutions	**–**	**187.3**	**–**	**–**	**–**	**187.3**
Derivative financial instruments	**–**	**1.6**	**11.7**	**137.4**	**112.4**	**263.1**
Loans and advances to customers						
Loans fully secured on residential property	**14.0**	**6.3**	**41.7**	**423.0**	**12,635.9**	**13,120.9**
Other loans	**18.8**	**42.9**	**56.6**	**30.1**	**208.4**	**356.8**
Investment securities	**–**	**59.5**	**72.2**	**493.9**	**152.2**	**777.8**
Total financial assets	**971.7**	**297.6**	**182.2**	**1,084.4**	**13,108.9**	**15,644.8**
Financial liabilities						
Shares	**116.3**	**5,208.8**	**2,430.9**	**3,422.4**	**54.8**	**11,233.2**
Derivative financial instruments	**–**	**0.6**	**8.8**	**99.2**	**105.8**	**214.4**
Amounts owed to credit institutions, other customers and debt securities in issue	**79.0**	**212.3**	**155.4**	**2,510.5**	**443.6**	**3,400.8**
Subscribed capital	**–**	**–**	**–**	**–**	**25.0**	**25.0**
Total financial liabilities	**195.3**	**5,421.7**	**2,595.1**	**6,032.1**	**629.2**	**14,873.4**

Notes to the Accounts

For the year ended 31 December 2016 **Continued**

31. Liquidity risk continued

Group 31 December 2015	Repayable on demand £M	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Financial assets						
Cash in hand and balances with the Bank of England	701.0	–	–	–	–	701.0
Loans and advances to credit institutions	–	126.4	–	–	–	126.4
Derivative financial instruments	–	6.1	9.2	59.0	30.6	104.9
Loans and advances to customers:						
Loans fully secured on residential property	13.2	5.6	34.5	355.8	10,736.9	11,146.0
Other loans	34.3	11.1	18.0	86.5	248.4	398.3
Investment securities	–	52.1	210.4	512.0	74.8	849.3
Total financial assets	748.5	201.3	272.1	1,013.3	11,090.7	13,325.9
Financial liabilities						
Shares	6,002.8	323.6	945.9	2,591.6	69.0	9,932.9
Derivative financial instruments	–	0.6	7.0	39.0	89.1	135.7
Amounts owed to credit institutions, other customers and debt securities in issue	129.3	188.1	136.7	1,304.8	772.1	2,531.0
Subscribed capital	–	–	–	–	25.0	25.0
Total financial liabilities	6,132.1	512.3	1,089.6	3,935.4	955.2	12,624.6

Society 31 December 2016	**Repayable on demand £M**	**Less than 3 months £M**	**3 to 12 months £M**	**1 to 5 years £M**	**Over 5 years £M**	**Total £M**
Financial assets						
Cash in hand and balances with the Bank of England	**938.9**	**–**	**–**	**–**	**–**	**938.9**
Loans and advances to credit institutions	**–**	**66.3**	**–**	**–**	**–**	**66.3**
Derivative financial instruments	**–**	**1.6**	**11.7**	**75.2**	**85.8**	**174.3**
Loans and advances to customers:						
Loans fully secured on residential property	**14.0**	**6.3**	**41.7**	**423.0**	**12,635.9**	**13,120.9**
Other loans	**18.8**	**42.9**	**56.6**	**30.1**	**208.4**	**356.8**
Investment securities	**–**	**59.5**	**108.1**	**539.3**	**739.8**	**1,446.7**
Total financial assets	**971.7**	**176.6**	**218.1**	**1,067.6**	**13,669.9**	**16,103.9**
Financial liabilities						
Shares	**116.3**	**5,208.8**	**2,430.9**	**3,422.4**	**54.8**	**11,233.2**
Derivative financial instruments	**–**	**0.6**	**8.8**	**96.7**	**107.0**	**213.1**
Amounts owed to credit institutions, other customers and debt securities in issue	**115.6**	**210.3**	**94.7**	**3,098.7**	**443.6**	**3,962.9**
Subscribed capital	**–**	**–**	**–**	**–**	**25.0**	**25.0**
Total financial liabilities	**231.9**	**5,419.7**	**2,534.4**	**6,617.8**	**630.4**	**15,434.2**

For the year ended 31 December 2016 **Continued**

31. Liquidity risk continued

Society 31 December 2015	Repayable on demand £M	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Financial assets						
Cash in hand and balances with the Bank of England	701.0	–	–	–	–	701.0
Loans and advances to credit institutions	–	43.4	–	–	–	43.4
Derivative financial instruments	–	6.1	9.2	30.1	30.6	76.0
Loans and advances to customers						
Loans fully secured on residential property	13.2	5.6	34.5	355.8	10,736.9	11,146.0
Other loans	34.3	11.1	18.0	86.5	248.4	398.3
Investment securities	–	52.1	210.4	593.6	827.3	1,683.4
Total financial assets	748.5	118.3	272.1	1,066.0	11,843.2	14,048.1
Financial liabilities						
Shares	6,002.8	323.6	945.9	2,591.6	69.0	9,932.9
Derivative financial instruments	–	0.6	7.0	35.6	92.8	136.0
Amounts owed to credit institutions, other customers and debt securities in issue	129.3	388.0	136.7	2,365.2	339.2	3,358.4
Subscribed capital	–	–	–	–	25.0	25.0
Total financial liabilities	6,132.1	712.2	1,089.6	4,992.4	526.0	13,452.3

Notes to the Accounts

For the year ended
31 December 2016

Continued

32. Interest rate risk

Market risk is the risk that the value of, or income emanating from, the Group's assets and liabilities changes adversely as a consequence of movements in market variables.

The primary market risk faced by the Group is interest rate risk. The net interest income and asset position of the Group is exposed to movements in interest rates. This exposure is managed on a continuous basis, within limits set by the Board, using a combination of offsetting assets and liabilities and derivatives. The Group uses interest rate stress testing and gap analysis to monitor and manage its interest rate position.

The Group does not run a trading book and therefore does not have the type of higher risk exposure run by many banking institutions. Given the Group's policy of hedging fixed rate assets and liabilities back to floating rate, outright interest rate risk arises mainly from the Board's decision to invest the Group's reserves according to a specified fixed rate maturity profile.

The following table provides a summary of the interest rate re-pricing profile of the Group's assets and liabilities as at 31 December 2016. Assets and liabilities have been allocated to time bands by reference to the earlier of the next interest rate reset date and the contractual maturity date.

The table takes account of derivative financial instruments whose effect is to alter the interest basis of Group assets and liabilities. The non-interest bearing balances have been included in a separate column.

31 December 2016	Less than 3 months £M	3 to 6 months £M	6 to 12 months £M	1 to 5 years £M	More than 5 years £M	No specific reprice date £M	Non-interest bearing £M	Total £M
Assets								
Liquid assets	1,397.5	–	67.5	394.3	26.6	–	18.1	1,904.0
Loans fully secured on residential property and other loans	4,521.4	478.3	1,449.0	6,687.9	238.6	–	102.5	13,477.7
Total interest bearing assets	5,918.9	478.3	1,516.5	7,082.2	265.2	–	120.6	15,381.7
Total non-interest bearing assets	–	–	–	–	–	–	548.0	548.0
Total assets	5,918.9	478.3	1,516.5	7,082.2	265.2	–	668.6	15,929.7

	Less than 3 months £M	3 to 6 months £M	6 to 12 months £M	1 to 5 years £M	More than 5 years £M	No specific reprice date £M	Non-interest bearing £M	Total £M
Liabilities								
Shares	5,208.8	1,166.8	1,264.1	3,422.4	54.8	–	116.3	11,233.2
Amounts owed to credit institutions, other customers and debt securities in issue	1,439.1	78.0	16.5	1,353.3	426.1	–	87.8	3,400.8
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Total interest bearing liabilities	6,647.9	1,244.8	1,280.6	4,775.7	480.9	25.0	204.1	14,659.0
Total non-interest bearing liabilities	–	–	–	–	–	–	1,270.7	1,270.7
Total liabilities	6,647.9	1,244.8	1,280.6	4,775.7	480.9	25.0	1,474.8	15,929.7
Effect of derivative items	2,346.4	643.7	(327.8)	(2,700.2)	37.9	–	–	–
Interest rate sensitivity gap	1,617.4	(122.8)	(91.9)	(393.7)	(177.8)	(25.0)	(806.2)	–

32. Interest rate risk continued

31 December 2015	Not more than 3 months £M	More than 3 but less than 6 months £M	More than 6 months but less than 1 year £M	More than 1 but less than 5 years £M	More than 5 years £M	No specific reprice date £M	Non-interest bearing £M	Total £M
Assets								
Liquid assets	987.9	95.0	113.0	449.1	1.5	–	30.2	1,676.7
Loans fully secured on residential property and other loans	4,394.3	717.0	1,429.7	4,693.2	164.4	–	145.7	11,544.3
Total interest bearing assets	5,382.2	812.0	1,542.7	5,142.3	165.9	–	175.9	13,221.0
Total non-interest bearing assets	–	–	–	–	–	–	285.6	285.6
Total assets	5,382.2	812.0	1,542.7	5,142.3	165.9	–	461.5	13,506.6

	Not more than 3 months £M	More than 3 but less than 6 months £M	More than 6 months but less than 1 year £M	More than 1 but less than 5 years £M	More than 5 years £M	No specific reprice date £M	Non-interest bearing £M	Total £M
Liabilities								
Shares	5,237.9	516.3	764.7	3,258.4	68.9	–	86.7	9,932.9
Amounts owed to credit institutions, other customers and debt securities in issue	1,121.3	74.8	39.5	501.8	736.2	–	57.4	2,531.0
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Total interest bearing liabilities	6,359.2	591.1	804.2	3,760.2	805.1	25.0	144.1	12,488.9
Total non-interest bearing liabilities	–	–	–	–	–	–	1,017.7	1,017.7
Total liabilities	6,359.2	591.1	804.2	3,760.2	805.1	25.0	1,161.8	13,506.6
Effect of derivative items	1,902.3	(226.6)	(701.3)	(1,401.6)	427.2	–	–	–
Interest rate sensitivity gap	925.3	(5.7)	37.2	(19.5)	(212.0)	(25.0)	(700.3)	–

Liquid assets comprise cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.

The Group uses derivatives to manage interest rate risk and reduce the Group's overall interest rate gap position. The profile of the interest flows arising from these derivatives is set out above.

The Society's interest rate repricing profile is not materially different to the Group position.

The Group monitors the impact of a range of possible interest rate changes on its assets and liabilities closely and sensitivities are reported to ALCO on a monthly basis. The following table details the Group's and Society's sensitivity to a 200 basis point change in interest rates at the year end (with all other variables held constant). A positive number indicates an increase in profit or other equity.

	Group and Society +200bps 2016 £M	Group and Society +200bps 2015 £M	**Group and Society -200bps 2016 £M**	Group and Society -200bps 2015 £M
Impact	**(1.2)**	(5.2)	**0.6**	0.9

Interest rate risk is managed on a Group basis. The Society will differ to the overall Group position as the sensitivity would generate offsetting movements in the subsidiaries.

The above interest rate risk represents the market value movement, calculated using a discounted cashflow basis, on all of the Group's financial assets and liabilities, resulting from an immediate 200 basis points parallel shift in interest rates. All exposures include investments of the Group's reserves. Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics – such as LIBOR and Bank of England base rate) and prepayment risk (the risk of loss arising from early repayments of fixed rate mortgages and loans) are also monitored closely and regularly reported to ALCO.

For the year ended 31 December 2016 **Continued**

33. Currency risk

Foreign currency risk arises as a result of the Group's activities in raising funds and making investments in foreign currencies. This is done to ensure cost effective funding is obtained across a wider pool of providers. The Group's policy is not to run any speculative foreign exchange positions. The majority of the Group's assets and liabilities are denominated in sterling; however it also holds Euro mortgages and receives funding via retail deposits and its debt issuance in foreign currencies, which give rise to exchange rate fluctuations. Cross currency interest rate swaps and basis swaps are utilised to reduce both the interest rate and exchange rate risk exposures that arise from operating in foreign currencies.

The carrying amount of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date is as follows:

	Assets		Liabilities	
	2016 £M	2015 £M	**2016 £M**	2015 £M
Euro	**3,060.6**	1,716.2	**3,056.9**	1,711.6

At the year end the Group has hedges in place to manage its foreign currency exposures, via the use of currency swaps which reduce the impact of foreign exchange fluctuations. Therefore any movement in foreign currency through profit or loss and other equity will be minimised.

34. Wholesale credit risk

The Group holds various investments in order to satisfy operational demand and to meet current and future liquidity regulatory requirements. Credit risk arises because of the risk of factors such as deterioration in the individual investee's financial health and uncertainty within the wholesale market generally. Wholesale lending credit risk is managed through setting strict upper and lower limits to each type of investment that are dependent on criteria such as: time to maturity, credit rating and originating country. These limits are set by ALCO and monitored by the Treasury Function on a continuous basis.

Comprehensive management information on movement and performance within the wholesale portfolios ensures that credit risk is effectively controlled, and any adverse trends are identified before they impact on performance.

At 31 December 2016 none of the Group's treasury portfolio exposure was either past due or impaired (2015: none). There are no assets that would otherwise be past due or impaired whose terms have been renegotiated. 99.8% (2015: 99.8%) of the Group's treasury investments are rated single A or better. The Group has implemented a policy that initial investments in treasury assets must be grade A3 or above.

Counterparty credit ratings are used to inform the Group's assessment of wholesale credit risk. The table below provides ratings details for the Group's treasury investment portfolio as at 31 December 2016:

	Group & Society	
	2016 %	2015 %
Aaa	**21.0**	32.4
Aa1-Aa3	**54.2**	13.3
A1-A3	**8.9**	11.8
Sovereign exposure to the UK	**15.7**	42.3
Other	**0.2**	0.2
Total percentage	**100.0**	100.0

For the year ended 31 December 2016 **Continued**

34. Wholesale credit risk continued

All wholesale exposures are to financial institutions in major industrial countries. The largest exposure to a single institution other than the UK Government was £84.2m (2015: £45.2m).

In addition, the Group's exposure to counterparty concentrations is also kept under watch. Limits exist to mitigate the risk of overexposure to geographical areas, and these are continuously reviewed and updated. At 31 December 2016, the Group had exposures to the following geographical regions:

Group	2016 £M	2016 %	2015 £M	2015 %
UK	**1,658.9**	**87.2**	1,402.4	83.7
Europe split into individual countries as follows:				
France	**–**	**–**	19.9	1.2
Germany	**33.2**	**1.7**	25.8	1.5
Ireland	**0.6**	**–**	0.4	–
Switzerland	**–**	**–**	25.0	1.5
Netherlands	**34.9**	**1.8**	28.2	1.7
Sweden	**–**	**–**	10.0	0.6
European Supranational	**65.8**	**3.5**	65.5	3.9
North America	**17.7**	**0.9**	1.8	0.1
Global Supranational	**64.6**	**3.4**	52.4	3.1
Far East	**28.3**	**1.5**	45.3	2.7
Total wholesale exposures	**1,904.0**	**100.0**	1,676.7	100.0

The Society's geographical exposure is equal to the Group's except it holds £2,246.2m (2015: £2,153.5m) in the UK.

The nature of the instrument determines the level of collateral held. Loans and debt securities are generally unsecured with the exception of asset-backed securities which are secured by a collection of financial assets. The Group prefers to document its derivative activity via the International Swaps and Derivatives Association (ISDA) Master Agreement. In conjunction with this the Group has executed with some counterparties a Credit Support Annex (CSA). Under a CSA, cash is posted as collateral between the counterparties of the deal to mitigate some of the counterparty credit risk inherent in outstanding derivative positions, as well as credit risk exposure arising on sale and repurchase transactions and guaranteed equity bonds.

Transactions are usually settled on a gross basis, and therefore there is no netting in the Financial Statements. Legally the Group does have right of set-off for those transactions. Accordingly the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will offset positive mark to market values on derivatives, subject to an absolute of zero.

Wholesale credit risk is recorded in the below extracts from the Statements of Financial Position:

	Group		Society	
	2016 £M	2015 £M	2016 £M	2015 £M
Cash in hand and balances with the Bank of England	**938.9**	701.0	**938.9**	701.0
Loans and advances to credit institutions	**187.3**	126.4	**66.3**	43.4
Investment securities	**777.8**	849.3	**1,446.7**	1,683.4
Wholesale exposures	**1,904.0**	1,676.7	**2,451.9**	2,427.8
Derivative financial instruments	**263.1**	104.9	**174.3**	76.0
Total wholesale credit risk	**2,167.1**	1,781.6	**2,626.2**	2,503.8
Debt securities, which are shown after fair value and impairment adjustments, can be further analysed as:				
UK Government securities	**298.6**	359.8	**298.6**	359.8
Certificates of deposit	**–**	135.1	**–**	135.1
Supranational bonds	**244.6**	219.1	**244.6**	219.1
Covered bonds	**96.9**	60.7	**96.9**	60.7
Permanent interest bearing shares	**1.7**	1.7	**1.7**	1.7
Residential mortgage backed securities	**136.0**	72.9	**804.9**	907.0
Total investment securities	**777.8**	849.3	**1,446.7**	1,683.4

35. Credit risk on loans and advances to customers

Credit risk management

An experienced Credit Risk Function operates within the Group and is driven by both the recognised need to manage the potential and actual risk and the need to continually develop new processes to ensure sound decisions are made in the future. In this way, any variations in risk from market, economic or competitive changes are identified and the appropriate controls are developed and put in place.

Comprehensive management information on movement and performance within the various retail and wholesale portfolios ensure that credit risk is effectively controlled, and any adverse trends are identified before they impact on performance. Group performance is also measured against the industry (where appropriate) to identify where debt default levels are out of line with the industry average. This management information is distributed widely across the Group and monitored within tight boundaries by the Board and its committees.

The Group has managed all types of credit risk in a consistent manner as in previous years.

The Group's exposure to retail credit risk can be broken down as below:

	Group & Society	
	2016 £M	2015 £M
Retail mortgages	**13,081.9**	11,150.6
Commercial lending	**125.3**	194.0
Other loans	**184.9**	183.5
Total gross exposure (contractual amounts)	**13,392.1**	11,528.1
Impairment, fair value, EIR and hedging adjustments	**85.6**	16.2
Total net exposure	**13,477.7**	11,544.3

Retail mortgages

The Group is firmly committed to the management of credit risk at all stages of the lending cycle. The Group monitors closely customer affordability and income multiples at the application stage. It employs appropriate underwriting and fraud detection techniques to minimise losses once loans have been approved, and it also takes a proactive approach to the control of bad and doubtful debt which is managed by a specialist team dedicated solely to the collections and recovery process.

The Group monitors individual borrowers but also sets and applies limits to manage concentration risk. The limits are managed through the mortgage application process and monitored throughout the life of the products to ensure that the new lending complements the risk profile of loans already within the Group's portfolio. This mitigates the risk that the Group is overexposed to borrowers with similar characteristics, for example properties in similar locations where local housing market fluctuations may arise.

The Group's geographical concentration of residential mortgage loans is as follows:

	Group & Society	
	2016 %	2015 %
Scotland	**6.8**	6.5
North East	**4.0**	4.2
Yorkshire and Humberside	**10.5**	11.2
North West	**8.2**	8.1
Midlands	**14.7**	14.5
East of England	**4.8**	4.8
South West	**8.3**	8.1
Greater London	**16.1**	15.8
South East	**18.8**	18.2
Wales	**3.1**	3.2
Northern Ireland	**2.7**	3.1
Republic of Ireland	**1.2**	1.3
Spain	**0.6**	0.7
Other	**0.2**	0.3
Total percentage	**100.0**	100.0

The Group's retail lending exposures are predominantly in the UK, with some exposure in Ireland and Spain. The risk characteristics of the Irish residential portfolio are different from the rest of the Group's residential portfolio because of higher average arrears rates and higher falls in property prices since origination on the Irish portfolio. The Spanish residential portfolio, however, continues to perform in line with the UK because the majority of the borrowers are UK residents.

For the year ended 31 December 2016 **Continued**

35. Credit risk on loans and advances to customers continued

Loan to value distribution of retail mortgage balance

One of the key indicators of the credit risk associated with a mortgage book is the relationship between the amount of the loan made and the value of the underlying security, which is known as the loan to value percentage. In general the lower the loan to value percentage the greater the equity within the property, and the lower the losses expected to be realised in the event of default and subsequent repossession.

The Group sets strict loan to value criteria for new loans, which must be supported by an external expert valuation of the security. The loan to value profile of the Group's book is monitored closely against the limits set by the Credit Committee.

The indexed loan to value analysis on the Group's residential loan portfolio is as follows:

	Group & Society Residential	
	2016 %	2015 %
<70%	**73.7**	73.7
70% – 80%	**16.0**	16.4
80% – 90%	**7.5**	6.9
>90%	**2.8**	3.0
Total percentage	**100.0**	100.0

The overall weighted average loan-to-value of the residential portfolio is 56% (2015: 58%). The overall indexed loan to value on the collateral loan is 32% (2015: 32%). The collateral held against this loan is a lifetime mortgage portfolio secured on property with a value of £584m (2015: £576m). The average loan to value of new lending in 2016 was 65.2% (2015: 67.7%)

Fair value of collateral held for residential mortgages

The collateral held against residential mortgages consists of residential houses. The use of such collateral is in line with terms that are usual and customary in standard lending activities.

Upon initial recognition of loans and advances, the fair value of collateral is based on the purchase price of the property. In subsequent periods, the fair value is updated to reflect current market price based on the quarterly Halifax regional house price index.

The table below shows the collateral held capped at 100% of the individual loan amount:

	Group & Society Residential	
	2016 £M	2015 £M
Neither past due nor impaired	**12,671.2**	10,661.5
Past due but not impaired	**237.0**	289.9
Past due and impaired	**110.4**	128.0
Possessions	**8.4**	11.1
Total collateral	**13,027.0**	11,090.5

The table below provides further information on the Group's loans and advances to customers by payment due status as at 31 December 2016. The balances exclude the fair value adjustment for hedged risk and impairment losses. The table includes £40.3m (2015: £44.1m) of loans and advances secured on residential property in Ireland that are past due and £0.4m (2015: £0.9m) in possession. Of the loans and advances secured on residential property in Spain, £11.8m (2015: £10.8m) are past due and £0.8m (2015: £0.9m) are in possession.

	Group & Society Residential		Group & Society Other (i)	
	2016 £M	**2016 %**	**2016 £M**	**2016 %**
Not impaired:				
– Neither past due nor impaired	**12,718.7**	**97.3**	**182.4**	**98.6**
– Past due up to 3 months but not impaired	**240.4**	**1.8**	**–**	**–**
Impaired:				
– Not past due but impaired	**–**	**–**	**2.5**	**1.4**
– Past due 3 to 6 months	**50.9**	**0.4**	**–**	**–**
– Past due 6 to 12 months	**31.8**	**0.2**	**–**	**–**
– Past due over 12 months	**30.6**	**0.2**	**–**	**–**
– Possessions	**9.5**	**0.1**	**–**	**–**
Total loans and advances to customers	**13,081.9**	**100.0**	**184.9**	**100.0**

For the year ended 31 December 2016 **Continued**

35. Credit risk on loans and advances to customers continued

	Group & Society Residential		Group & Society Other [i]	
	2015 £M	2015 %	2015 £M	2015 %
Not impaired:				
– Neither past due nor impaired	10,707.6	96.0	181.0	98.6
– Past due up to 3 months but not impaired	297.1	2.7	–	–
Impaired:				
– Not past due but impaired	–	–	2.5	1.4
– Past due 3 to 6 months	58.7	0.5	–	–
– Past due 6 to 12 months	41.1	0.4	–	–
– Past due over 12 months	32.7	0.3	–	–
– Possessions	13.4	0.1	–	–
Total loans and advances to customers	11,150.6	100.0	183.5	100.0

[i] Other loans include a collateral loan secured on lifetime mortgages £182.4m (2015: £181.0m) and other loans of £2.5m (2015: £2.5m).

Loans in the analysis above which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears or for which a loss event has occurred.

Forbearance strategies

The Group continues to invest in developing and enhancing its arrears management strategies to minimise credit risk losses, whilst ensuring that customers are treated fairly. Such forbearance strategies include the use of arrangements to assist borrowers in arrears who are now able to meet agreed repayment strategies, including or excluding arrears balances. Forbearance strategies aim to avoid repossession when it is in the interest of the borrower.

2016	**Payment arrangement £M**	**Concessions £M**	**Capitalisations £M**	**Transfer to interest only £M**	**Term extensions £M**	**Other £M**	**Total forbearance £M**
Neither past due nor impaired	**18.2**	**3.9**	**2.6**	**19.4**	**58.8**	**3.9**	**106.8**
Past due up to 3 months	**45.2**	**6.5**	**0.5**	**0.6**	**1.0**	**0.4**	**54.2**
Past due more than 3 months	**33.2**	**2.9**	**–**	**–**	**–**	**0.1**	**36.2**
Possessions	**1.1**	**0.1**	**–**	**0.1**	**–**	**–**	**1.3**
Total loans with forbearance arrangements	**97.7**	**13.4**	**3.1**	**20.1**	**59.8**	**4.4**	**198.5**

2015	Payment arrangement £M	Concessions £M	Capitalisations £M	Transfer to interest only £M	Term extensions £M	Other £M	Total forbearance £M
Neither past due nor impaired	22.1	3.4	7.5	16.2	72.9	5.2	127.3
Past due up to 3 months	74.8	10.3	2.9	0.9	2.6	0.8	92.3
Past due more than 3 months	52.5	5.3	0.4	–	–	0.1	58.3
Possessions	0.7	–	–	–	–	–	0.7
Total loans with forbearance arrangements	150.1	19.0	10.8	17.1	75.5	6.1	278.6

The table above provides further information on loans existing at the 2016 reporting date by types of account renegotiations applied to borrowers over the last 12 months. This includes all renegotiations regardless of whether or not our customer has experienced financial difficulty in repaying their loan with the Group. For clarity, this table includes all balances which have had their terms renegotiated in the last 12 months, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

For the year ended 31 December 2016 **Continued**

35. Credit risk on loans and advances to customers continued

Commercial mortgages

Credit risk associated with lending to businesses is affected by similar factors to those affecting retail mortgages, although on average loans are generally larger than to individual customers. The Group ceased new commercial lending in 2008. All commercial lending is based in the UK.

The Group monitors the profile of the commercial portfolio in much the same way as for retail mortgages, with regular review of concentration limits. As the credit risk associated with commercial loans is more closely linked to the performance of a specific industry, in addition to the loan to value, concentration risk by industry is also assessed:

Industry type	Group & Society Commercial 2016 %	Group & Society Commercial 2015 %
Leisure and hotel	**2.4**	1.5
Retail	**22.0**	31.3
Offices	**53.1**	38.6
Commercial investment and industrial units	**20.3**	20.4
Others, including mixed use	**2.2**	8.2
Total percentage	**100.0**	100.0

Loan to value

The indexed loan to value analysis on the Group's commercial loan portfolio is as follows:

	Group & Society Commercial 2016 %	Group & Society Commercial 2015 %
<70%	**30.4**	47.1
70% – 80%	**29.9**	5.8
80% – 90%	**4.5**	21.7
>90%	**35.2**	25.4
Total percentage	**100.0**	100.0

The overall indexed loan to value of the commercial portfolio is 76% (2015: 68%).

The table below provides further information on the Group's commercial loans and advances by payment due status as at 31 December 2016. The balances exclude the fair value adjustment for hedged risk and impairment losses.

	Group & Society Commercial		Group & Society Commercial	
	2016 £M	**2016 %**	2015 £M	2015 %
Not impaired:				
– Neither past due nor impaired	**75.0**	**59.9**	137.8	70.9
Impaired:				
– Not past due but impaired	**43.0**	**34.3**	42.8	22.1
– Past due up to 3 months	**0.1**	**0.1**	0.1	0.1
– Past due 3 to 6 months	**–**	**–**	–	–
– Past due 6 to 12 months	**–**	**–**	–	–
– Past due over 12 months	**–**	**–**	–	–
– Possessions	**7.2**	**5.7**	13.3	6.9
	125.3	**100.0**	194.0	100.0

Loans in the analysis above which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears, or for which a loss event has occurred. No loans (2015: none) that would be past due or impaired have had their terms renegotiated during 2016.

35. Credit risk on loans and advances to customers continued

The collateral held against commercial loans consists of commercial property. The use of such collateral is in line with terms that are usual and customary to commercial lending activities. The fair value is based on open market value or indices of similar assets. The loans and the associated collateral are monitored individually by a specialist team. The level of collateral at 31 December 2016 reflects the reduction in the portfolio during the year.

Fair value of collateral held	Group & Society Commercial	
	2016 £M	2015 £M
Neither past due nor impaired	**72.0**	71.1
Impaired	**35.2**	99.5
Possession	**4.4**	9.7
Total collateral	**111.6**	180.3

The table above shows the collateral held capped at 100% of the individual loan amount.

The Group continues to invest in developing and enhancing its arrears management strategies to minimise credit risk whilst ensuring that its corporate customers are treated fairly. Such forbearance strategies include the renegotiation of covenants and/or loan term to assist borrowers in arrears who are now able to meet agreed repayment strategies, including or excluding arrears balances.

36. Derivative financial instruments

Derivative financial instruments are contracts or arrangements whose value is derived from one or more underlying price, rate or index inherent in the contract or arrangement, such as interest rates, exchange rates or stock market indices. These types of instruments tend to have a smaller or no initial net investment relative to financial assets/liabilities offering the same risk/return as cash flows and are generally settled at a future date. Derivatives are only used by the Group in accordance with Section 9A of the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates or other factors of a prescribed description which affect the business. Accordingly, such instruments are not used in trading activity or for speculative purposes. The Group utilises its derivative instruments for hedging purposes.

Types of derivatives

The main derivatives used by the Group are interest rate swaps, interest rate options, and cross currency swaps. The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks. These risks may alternatively be managed using on Statement of Financial Position instruments or natural hedges that exist in the Group Statements of Financial Position.

Activity	Risk	Type of Derivative
Fixed rate savings products	Sensitivity to changes in interest rates	Receive fixed interest (fair value hedge)
Fixed rate mortgage lending	Sensitivity to changes in interest rates	Pay fixed interest rate (fair value hedge)
Fixed rate funding rate	Sensitivity to changes in interest rates	Receive fixed interest (fair value hedge)
Fixed rate asset investments	Sensitivity to changes in interest rates	Pay fixed interest rate (fair value hedge)
Equity linked savings products	Sensitivity to changes in equity indices	Equity linked interest rate swaps
Investment and funding in foreign currency	Sensitivity to changes in foreign exchange rates	Cross currency interest rate swaps and foreign exchange contracts (fair value hedge)
Issuance of debt securities on different interest bases	Sensitivity to divergence between interest rate bases	Pay floating receive floating interest rate swaps

The Group manages risk within its risk tolerance, regardless of the accounting treatment.

Derivatives for use in hedge relationships are entered into only when the underlying position being hedged contains the same risk features. The derivative used will match the risks of the underlying asset or liability and therefore hedge the associated market risk. Certain financial instruments (including retail products) contain features that are similar to derivatives and in these cases risk is managed by entering derivative contracts that have matching features.

All derivatives entered in to by the Group are used for hedging purposes, however not all are designated as such for accounting purposes. Some derivatives are held as economic hedges to which IAS 39 does not need to be applied. In these cases a natural offset may be achieved; these types of hedge are only entered in to where a high degree of effectiveness can be achieved.

36. Derivative financial instruments continued

The Group utilises fair value hedges. Fair value hedges are designated to manage the interest rate risk associated with fixed rate products (typically mortgages and savings). All hedges are supported by comprehensive hedging documentation, as per the requirement in IAS 39.

Cross currency interest rate swaps are used to reduce both the interest rate risk and exchange rate risk exposures that come from funding in foreign currency.

	Group 2016			Group 2015		
	Contract or underlying principal amount £M	**Positive market value £M**	**Negative market value £M**	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M
Interest rate swaps designated as fair value hedges	**15,503.0**	**116.9**	**(100.0)**	13,312.2	75.7	(47.7)
Derivatives not designated as hedges:						
Equity swaps	**173.3**	**14.1**	**(69.8)**	198.9	12.6	(53.7)
Cross currency swaps	**1,544.5**	**131.6**	**(40.7)**	1,255.4	16.0	(31.5)
Floating swaps	**1,148.5**	**0.5**	**(1.5)**	750.0	0.5	(1.6)
Bank base rate swaps	**149.2**	**–**	**(2.4)**	528.8	0.1	(1.2)
Total derivatives held for hedging	**18,518.5**	**263.1**	**(214.4)**	16,045.3	104.9	(135.7)

	Society 2016			Society 2015		
	Contract or underlying principal amount £M	**Positive market value £M**	**Negative market value £M**	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M
Interest rate swaps designated as fair value hedges	**14,292.1**	**82.6**	**(98.7)**	12,383.5	46.8	(48.0)
Derivatives not designated as hedges:						
Equity swaps	**173.3**	**14.1**	**(69.8)**	198.9	12.6	(53.7)
Cross currency swaps	**945.8**	**77.1**	**(40.7)**	1,009.1	16.0	(31.4)
Floating swaps	**1,148.5**	**0.5**	**(1.5)**	750.0	0.5	(1.6)
Bank base rate swaps	**149.2**	**–**	**(2.4)**	528.8	0.1	(1.3)
Total derivatives held for hedging	**16,708.9**	**174.3**	**(213.1)**	14,870.3	76.0	(136.0)

The Group discounts its collateralised and un-collateralised positions based on overnight interest rate curves.

Notes to the Accounts

For the year ended 31 December 2016

Continued

36. Derivative financial instruments continued

The following tables analyse the derivatives by contractual and residual maturity:

	Group 2016		Group 2015	
	Notional principal amount £M	Replacement cost £M	Notional principal amount £M	Replacement cost £M
Interest rate swaps	16,974.0	131.5	14,790.0	88.9
Cross currency swaps	1,544.5	131.6	1,255.4	16.0
Total derivatives	18,518.5	263.1	16,045.4	104.9
Under 1 year	4,573.1	13.3	4,076.3	15.3
Between 1 and 5 years inclusive	12,003.2	137.6	9,293.7	59.0
Over 5 years	1,942.2	112.2	2,675.4	30.6
Total derivatives	18,518.5	263.1	16,045.4	104.9

	Society 2016		Society 2015	
	Notional principal amount £M	Replacement cost £M	Notional principal amount £M	Replacement cost £M
Interest rate swaps	15,763.1	97.2	13,861.2	60.0
Cross currency swaps	945.8	77.1	1,009.1	16.0
Total derivatives	16,708.9	174.3	14,870.3	76.0
Under 1 year	4,573.1	13.3	4,076.3	15.3
Between 1 and 5 years inclusive	10,443.0	74.3	8,456.0	30.1
Over 5 years	1,692.8	86.7	2,338.0	30.6
Total derivatives	16,708.9	174.3	14,870.3	76.0

36. Derivative financial instruments continued

Market risk

Market risk is the risk that the value of, or income coming from, the Group's assets and liabilities changes adversely due to movements in interest rates (including interest bases) or foreign currency rates. These risks are measured and managed at Group level.

The Group recognises that the effective management of market risk is essential to the maintenance of stable earnings and the preservation of member value.

The Group's exposure to market risk is governed by a policy approved by ALCO. This policy sets out the nature of risk which may be taken and aggregate risk limits. Based on these aggregate limits, ALCO assigns risk limits to all Group businesses and monitors compliance with these limits. At each meeting ALCO reviews reports showing the Group's exposure to market and liquidity risks.

The Group's exposure to market risk is managed by the Treasury Function by using appropriate hedging instruments or by taking advantage of natural hedges within the Group. Market risk is managed within a clearly defined framework of policy limits.

Market risk is measured and reported using a variety of techniques, according to the appropriateness of the technique to the exposure concerned. The techniques used include interest rate gap analysis, duration analysis, basis point value analysis, scenario analysis and earnings at risk.

There has been no change in the year to the Group's approach to managing and measuring the market risk.

Other price risk

Other price risk is the risk resulting from the possibility that the price of a security may decline.

The Group's policy is to have no material exposure to equity markets and to purchase only high quality liquid assets. Any exposures arising from the Group's products are eliminated as far as it is practicable by appropriate hedging contracts.

37. Fair values

The following tables summarise the carrying amounts and fair values of those financial assets and liabilities not carried at fair value. Where available, market values have been used to determine fair values. Where market values are not available, fair values have been calculated for other financial instruments by discounting cash flows at prevailing interest rates.

			Group		Society	
		Fair Value Hierarchy Level 2016	Carrying Value 2016 £M	Fair Value 2016 £M	Carrying Value 2016 £M	Fair Value 2016 £M
Financial assets:						
Cash in hand and balances with the Bank of England		Level 1	938.9	938.9	938.9	938.9
Loans and advances to credit institutions	i)	Level 2	187.3	187.3	66.3	66.3
Loans and advances to customers:						
Loans fully secured on residential property	ii)	Level 2	13,120.9	13,545.0	13,120.9	13,545.0
Other loans		Level 2	104.9	109.8	104.9	109.8
Investment securities:	iii)					
Loans and receivables		Level 2	24.1	22.6	24.1	22.6
Financial liabilities:						
Shares	ii)	Level 2	11,123.8	11,270.8	11,123.8	11,270.8
Amounts owed to credit institutions	iv)	Level 2	572.1	572.1	572.1	572.1
Amounts owed to other customers	ii)	Level 2	357.5	357.5	1,232.8	1,232.8
Debt securities in issue	v)	Level 1	2,188.6	1,926.7	2,158.0	2,535.7
Debt securities in issue	v)	Level 2	282.6	287.4	–	–
Subscribed capital	vi)	Level 1	25.0	25.0	25.0	25.0

For the year ended 31 December 2016 **Continued**

37. Fair values continued

			Group		Society	
		Fair Value 2015	Carrying Value 2015 £M	Fair Value 2015 £M	Carrying Value 2015 £M	Fair Value 2015 £M
Financial assets:						
Cash in hand and balances with the Bank of England		Level 1	701.0	701.0	701.0	701.0
Loans and advances to credit institutions	i)	Level 2	126.4	126.4	43.4	43.4
Loans and advances to customers:						
Loans fully secured on residential property	ii)	Level 2	11,146.0	11,578.4	11,146.0	11,578.4
Other loans		Level 2	162.2	164.2	162.2	164.2
Investment securities:						
Loans and receivables	iii)	Level 2	28.2	26.6	28.2	26.6
Financial liabilities:						
Shares	ii)	Level 2	9,810.3	9,867.8	9,810.3	9,867.8
Amounts owed to credit institutions	iv)	Level 2	55.9	55.9	55.9	55.9
Amounts owed to other customers	ii)	Level 2	418.3	418.3	1,703.4	1,703.4
Debt securities in issue	v)	Level 1	1,625.4	1,758.0	1,599.1	1,727.8
Debt securities in issue	v)	Level 2	431.4	441.8	–	–
Subscribed capital	vi)	Level 1	25.0	25.0	25.0	25.0

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. The following methods and assumptions have been applied in determining fair value:

i) The carrying amount of loans and advances to credit institutions, with a maturity of under 12 months, is assumed to equate to their fair value.

ii) The fair value of loans and advances to customers, shares, and amounts owed to other customers is calculated using the effective interest rate method on the discounted cash flow basis, which also includes an assessment of future credit loss where appropriate.

iii) Fair values are based on quoted market prices where available. For instruments where quoted market prices are not available the market price is based on discounted cash flows using interest rates for securities with similar credit, maturity and yield characteristics.

iv) The fair value of floating rate and overnight deposits is approximately equal to their carrying amount. The estimated fair value of fixed rate loans and deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

v) Debt securities in issue are valued by reference to their market value where an active market exists. Where no active market exists, a discounted cash flow approach is used.

vi) The fair value of subscribed capital is obtained from market prices.

37. Fair values continued

The following table analyses the Group's assets and liabilities by the class of financial instrument to which they are assigned under the measurement basis:

31 December 2016	Fair value through Income Statement £M	Available for sale £M	Amortised cost £M	Non financial assets/ liabilities £M	Total £M
Assets:					
Cash and balances with the Bank of England	–	–	938.9	–	938.9
Loans and advances to credit institutions	–	–	187.3	–	187.3
Derivative financial instruments	263.1	–	–	–	263.1
Loans and advances to customers:					
Loans fully secured on residential property	–	–	13,120.9	–	13,120.9
Other loans	251.9	–	104.9	–	356.8
Investment securities	–	753.7	24.1	–	777.8
Non financial assets	–	–	–	284.9	284.9
Total assets	515.0	753.7	14,376.1	284.9	15,929.7
Liabilities:					
Shares	109.4	–	11,123.8	–	11,233.2
Derivative financial instruments	214.4	–	–	–	214.4
Amounts owed to credit institutions	–	–	572.1	–	572.1
Amounts owed to other customers	–	–	357.5	–	357.5
Debt securities in issue	–	–	2,471.2	–	2,471.2
Subscribed capital	–	–	25.0	–	25.0
Non financial liabilities	–	–	–	182.0	182.0
General and other reserves	–	–	–	874.3	874.3
Total reserves and liabilities	323.8	–	14,549.6	1,056.3	15,929.7

37. Fair values continued

31 December 2015	Fair value through Income Statement £M	Assets available for sale £M	Amortised cost £M	Non financial assets/ liabilities £M	Total £M
Assets:					
Cash and balances with the Bank of England	–	–	701.0	–	701.0
Loans and advances to credit institutions	–	–	126.4	–	126.4
Derivative financial instruments	104.9	–	–	–	104.9
Loans and advances to customers:					
Loans fully secured on residential property	–	–	11,146.0	–	11,146.0
Other loans	236.1	–	162.2	–	398.3
Investment securities	–	821.1	28.2	–	849.3
Non financial assets	–	–	–	180.7	180.7
Total assets	341.0	821.1	12,163.8	180.7	13,506.6
Liabilities:					
Shares	122.6	–	9,810.3	–	9,932.9
Derivative financial instruments	135.7	–	–	–	135.7
Amounts owed to credit institutions	–	–	55.9	–	55.9
Amounts owed to other customers	–	–	418.3	–	418.3
Debt securities in issue	–	–	2,056.8	–	2,056.8
Subscribed capital	–	–	25.0	–	25.0
Non financial liabilities	–	–	–	91.4	91.4
General and other reserves	–	–	–	790.6	790.6
Total reserves and liabilities	258.3	–	12,366.3	882.0	13,506.6

37. Fair values continued

The following table analyses the fair value measurement basis used for assets and liabilities held at the Statement of Financial Position date at fair value.

2016 Group	**Level 1 £M**	**Level 2 £M**	**Level 3 £M**	**Total £M**
Financial assets				
Investment securities – available for sale	**298.6**	**455.1**	**–**	**753.7**
Derivative financial instruments	**–**	**221.3**	**41.8**	**263.1**
Loans and advances to customers	**–**	**–**	**251.9**	**251.9**
Financial liabilities				
Shares	**–**	**109.4**	**–**	**109.4**
Derivative financial instruments	**–**	**116.8**	**97.6**	**214.4**

2015 Group	Level 1 £M	Level 2 £M	Level 3 £M	Total £M
Financial assets				
Investment securities – available for sale	359.8	461.3	–	821.1
Derivative financial instruments	–	104.9	–	104.9
Loans and advances to customers	–	–	236.1	236.1
Financial liabilities				
Shares	–	122.6	–	122.6
Derivative financial instruments	–	82.0	53.7	135.7

Level 1: Relates to financial instruments where quoted prices (unadjusted) in active markets can be found for identical assets or liabilities.

Level 2: Valuation techniques are used to value these instruments for which significant inputs are taken from observable market data for the asset and liability, either directly (market prices) or indirectly (derived prices) other than quoted prices included in Level 1. These include valuation models used to calculate the present values of expected future cash flows, using curves from published market sources and are employed when no active market exists or when no quoted prices for similar instruments can be obtained.

Level 3: The valuation of asset or liability is not based on observable market data and includes unobservable inputs. Valuation techniques include net present value and discounted cash flow methods. The assumptions used in such models include risk-free benchmark interest rates, foreign currency exchange rates, equity index prices, and expected price volatilities. The objective of the valuation techniques is to determine a fair value that reflects the price of the financial instrument that would have been used by two counterparties in an arm's length transaction.

Certain items have been reclassified from level 2 to level 3 during the year. A reconciliation of the level 3 balance is provided below.

Reconciliation of level 3 fair value measurements of financial instruments

	Financial assets £M	**Financial liabilities £M**
Balance at 1 January 2016	**236.1**	**(53.7)**
Transfer from level 2 to level 3	**13.8**	**(1.1)**
Total (gains)/losses in the Income Statement	**44.1**	**(42.8)**
Net repayment in the year	**(0.3)**	**–**
Balance at 31 December 2016	**293.7**	**(97.6)**

The transfer made between level 2 and 3 in the year relates to certain securitisation and equity linked swaps for which unobservable inputs have been identified.

Total gains/(losses) for the year are included in fair value gains less losses from financial instruments in the Income Statement.

For the year ended 31 December 2016 **Continued**

37. Fair values continued

Recurring fair value measurements

Financial assets/ Financial liabilities	Fair value as at 2016	Fair value as at 2015	Fair value hierarchy	Valuation technique(s) and key input(s)	Significant unobservable input(s)	Relationship of unobservable inputs to fair value
1. Investment Securities (Gilts and Treasury Bills)	Assets – £298.6m	Assets – £359.8m	Level 1	Quoted bid prices in an active market sourced from third party data providers.	N/A	N/A
2. Investment Securities (Excluding Gilts and Treasury Bills)	Assets – £455.1m	Assets – £461.3m	Level 2	Valuations are sourced from third party data providers. The nature of these instruments means that whilst a market exists, pricing activity may be limited.	N/A	N/A
3. Interest rate swaps	Assets – £89.7m and Liabilities – £76.0m	Assets – £75.1m and Liabilities – £49.4m	Level 2	Discounted cash flow. Future cash flows are estimated based on forward interest rates (from observable yield curves at the end of the reporting period) and contract interest rates, discounted at a rate that reflects the credit risk exposure to the various counterparties.	N/A	N/A
4. Cross currency interest rate swaps	Assets – £131.6m and Liabilities – £40.7m	Assets – £16.0m and Liabilities – £31.5m	Level 2	Discounted cash flow. Future cash flows are estimated based on forward interest rates (from observable yield curves at the end of the reporting period) and contract interest rates discounted at a rate that reflects the credit risk exposure to the various counterparties. Any foreign currency amounts are translated into sterling at the contract exchange rate.	N/A	N/A
5. Equity interest rate swaps	Assets – £14.1m	Assets – £12.6m	Level 3	The assets and liabilities are equity linked derivatives with external counterparties which economically match the investment return payable by the Group to investors on equity linked savings products. The derivatives are linked to the performance of specified stock market indices and have been valued by the counterparties.	Assumption on future balance movements.	An increase in equity markets will increase the fair value of the swaps.
6. Equity release interest rate swaps	Liabilities – £69.8m	Liabilities – £53.7m	Level 3	Discounted cash flow. The liabilities are linked to equity release mortgages and are economically offset by movements in the corresponding mortgages. The valuations are provided by the counterparty and are based on a discounted cash flow model which uses a projection of interest rates, a discount rate to reflect the counterparty risk and assumptions for future mortality.	Assumptions on future life expectancy of customers based on best estimate mortality data. On this basis no reasonable alternative assumption is considered appropriate.	An increase in life expectancy will increase the value of the liability.
7. Securitisation interest rate swaps	Assets – £27.7m and Liabilities – £27.9m	Assets – £1.2m and Liabilities – £1.1m	Level 3	Discounted cash flow. The notional profile of the swaps tracks the balance of a loan portfolio which is subject to prepayment. The valuations are provided by the counterparty and are based on a discounted cash flow model which uses a projection of interest rates, a discount rate to reflect the counterparty risk and assumptions for future mortality.	Assumptions on future notional balances related to mortgage prepayment rates.	An increase in prepayment rates will change the fair value of swaps.

Notes to the Accounts

For the year ended 31 December 2016

Continued

37. Fair values continued

Recurring fair value measurements continued

Financial assets/ Financial liabilities	Fair value as at 2016	Fair value as at 2015	Fair value hierarchy	Valuation technique(s) and key input(s)	Significant unobservable input(s)	Relationship of unobservable inputs to fair value
8. Loans and advances to customers	Assets – £251.9m	Assets – £236.1m	Level 3	The assets are valued using the valuation of the associated derivatives as all critical terms match and the conditions associated with the loans and derivatives match.	Assumptions on future life expectancy of customers based on best estimate mortality data. On this basis no reasonable alternative assumption is considered appropriate.	An increase in life expectancy will decrease the value of the asset.
9. Shares	Liabilities – £109.4m	Liabilities – £122.6m	Level 2	These are equity linked savings products on which the return is linked to the performance of specific stock market indices. The liabilities are valued using the valuation of the associated derivatives as all critical terms and conditions match.	N/A	N/A

Notes to the Accounts

For the year ended 31 December 2016 **Continued**

38. Operating segments

Products and services from which reportable segments derive their revenues

The information reported to the Group's Chief Executive Officer for the purposes of resources allocation and assessment or segment performance is specifically focused on the category of customer for each type of activity. Reporting is made on a Group basis. The Group's reportable segments under IFRS 8 are therefore as follows:

Core activities
Commercial lending
Euro lending

Information regarding the Group's reporting segments is reported below.

Segmental income statement

The following is an analysis of the Group's Income Statement by reportable segment:

	Core Activities 2016 £M	**Commercial Lending 2016 £M**	**Euro Lending 2016 £M**	**Total 2016 £M**	Core Activities 2015 £M	Commercial Lending 2015 £M	Euro Lending 2015 £M	Total 2015 £M
Interest receivable and similar income	**400.0**	**4.3**	**2.0**	**406.3**	394.6	5.8	2.3	402.7
Interest payable and similar charges	**(201.9)**	**(2.3)**	**(0.3)**	**(204.5)**	(191.0)	(3.8)	(0.4)	(195.2)
Net interest receivable	**198.1**	**2.0**	**1.7**	**201.8**	203.6	2.0	1.9	207.5
Fees and commissions receivable	**10.4**	**–**	**–**	**10.4**	12.3	–	–	12.3
Fees and commissions payable	**(0.8)**	**–**	**–**	**(0.8)**	(1.0)	–	–	(1.0)
Fair value gains less losses from derivative financial instruments	**(1.1)**	**(0.2)**	**–**	**(1.3)**	(0.7)	(0.2)	–	(0.9)
Other operating income	**1.9**	**–**	**–**	**1.9**	1.0	–	–	1.0
Total income	**208.5**	**1.8**	**1.7**	**212.0**	215.2	1.8	1.9	218.9
Administrative expenses including depreciation and amortisation	**(91.0)**	**(0.3)**	**(0.6)**	**(91.9)**	(79.0)	(0.3)	(0.4)	(79.7)
Impairment gains/(losses) on loans and advances to customers	**(2.2)**	**5.8**	**(2.7)**	**0.9**	(8.3)	(12.3)	2.1	(18.5)
Provisions charge	**(3.9)**	**–**	**–**	**(3.9)**	(8.8)	–	–	(8.8)
Impairment losses on land and buildings	**(0.5)**	**–**	**–**	**(0.5)**	(3.4)	–	–	(3.4)
Profit/(loss) before tax	**110.9**	**7.3**	**(1.6)**	**116.6**	115.7	(10.8)	3.6	108.5
Tax expense	**(29.4)**	**(1.5)**	**0.3**	**(30.6)**	(21.1)	2.2	(0.7)	(19.6)
Profit/(loss) for the financial year	**81.5**	**5.8**	**(1.3)**	**86.0**	94.6	(8.6)	2.9	88.9

Segment loans and advances to customers

The following is an analysis of the Group's loans and advances to customers by reportable segment:

	Core Activities 2016 £M	**Commercial Lending 2016 £M**	**Euro Lending 2016 £M**	**Total 2016 £M**	Core Activities 2015 £M	Commercial Lending 2015 £M	Euro Lending 2015 £M	Total 2015 £M
Loans and advances to customers	**12,841.3**	**125.3**	**243.3**	**13,209.9**	10,932.8	194.0	218.8	11,345.6
At fair value through profit and loss	**251.9**	**–**	**–**	**251.9**	236.1	–	–	236.1
Total	**13,093.2**	**125.3**	**243.3**	**13,461.8**	11,168.9	194.0	218.8	11,581.7
Less: impairment provisions	**(14.2)**	**(25.7)**	**(14.3)**	**(54.2)**	(16.0)	(35.7)	(12.4)	(64.1)
Fair value adjustment for hedged risk	**65.0**	**5.1**	**–**	**70.1**	26.7	–	–	26.7
Total loans and advances to customers	**13,144.0**	**104.7**	**229.0**	**13,477.7**	11,179.6	158.3	206.4	11,544.3

39. Events after the Date of the Statement of Financial Position

There have been no other material subsequent events between 31 December 2016 and the date of approval of these Annual Report and Accounts by the Board.

Annual Business Statement

For the year ended
31 December 2016

1. Statutory percentages

	31 December 2016	Statutory Limit
Lending limit	**6.9%**	25%
Funding limit	**23.5%**	50%

Explanation

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 (as amended by the Building Societies Act 1997).

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property. Business assets are the total assets of the Group as shown in the Statement of Financial Position plus impairment provisions for loans and advances to customers, less liquid assets and tangible fixed assets.

Loans fully secured on residential property are the amount of principal owing by borrowers and accrued interest not yet paid. This is the amount shown in the Statement of Financial Position plus provisions for impairment.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals.

2. Other percentages

	31 December 2016	31 December 2015
As a percentage of shares and borrowings:		
Gross capital	**6.11%**	6.55%
Free capital	**6.01%**	6.44%
Liquid assets	**13.01%**	13.45%
Profit for the financial year as a percentage of mean total assets	**0.58%**	0.69%
Management expenses as a percentage of mean total assets	**0.62%**	0.62%

The above percentages have been prepared from the Group's consolidated accounts and in particular:

- 'Shares and borrowings' represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.
- 'Gross capital' represents the aggregate of general reserve, other reserve, revaluation reserve and subscribed capital.
- 'Free capital' represents the aggregate of gross capital and collective impairment provisions for loans and advances to customers less tangible and intangible fixed assets and investment properties.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities.
- 'Management expenses' represent the aggregate of administration expenses, depreciation and amortisation.

Annual Business Statement

For the year ended
31 December 2016

Continued

3. Information relating to the Directors and Other Officers at 31 December 2016

Name	Occupation	Date of Birth	Date first appointed
Chairman			
R J Ashton	Chairman	19.01.58	26.04.11
Vice Chairman			
L M Platts	Senior Independent Director	10.02.54	26.10.10
Chief Executive Officer			
*P A Hill	Chief Executive Officer	28.07.61	01.08.06
Directors			
P A Brown	Company Director	31.03.66	15.01.13
S H Cooklin	Company Director	04.04.60	25.02.14
*R G Fearon	Chief Commercial Officer	16.07.78	19.02.16
D Fisher	Company Director	02.08.58	27.03.12
*A J Greenwood	Chief Risk Officer	11.12.69	08.01.15
G J Hoskin	Company Director	18.09.60	16.11.15
J A Hunt	Company Director	25.09.54	29.04.15
P A Jenks	Company Director	03.01.51	27.03.12
*R S P Litten	Chief Financial Officer	11.05.63	10.01.12
*K R Wint	Chief Operating Officer	02.05.65	01.12.12

(*executive directors)

The Group's executive director service contracts can be terminated on twelve months' notice by either the Group or the Director.

Documents may be served on the above named Directors c/o Deloitte LLP (Ref DH), 1 City Square, Leeds LS1 2AL.

Details of directors – other directorships

(*Society subsidiary)

R J Ashton	Shawbrook Bank Ltd Shawbrook Group plc (listed on the London Stock Exchange)
P A Hill	CML Premises Ltd New TA Ltd
P A Brown	PHD International Ltd Omnicom Media Group UK Ltd M2M International Ltd OMD International Ltd
S H Cooklin	Network Rail Consulting Ltd
R G Fearon	None
D Fisher	Leeds Building Society Staff Pension Scheme Ltd Amicus Finance plc
A J Greenwood	None
G J Hoskin	The British Diabetic Association Diabetes UK Services Ltd
J A Hunt	JCH Associates Ltd

Annual Business Statement

For the year ended
31 December 2016

Continued

Details of directors – other directorships continued

P A Jenks	Broadlands Finance Ltd Charter Court Financial Services Group Ltd Charter Court Financial Services Ltd Charter Mortgages Ltd Exact Mortgage Experts Ltd
R S P Litten	Arkose Funding Ltd Leeds Mortgage Funding Ltd*
L M Platts	AJ Bell Holdings Ltd Lancashire County Cricket Club
K R Wint	None

Executive management

Name	Occupation	Directorships (*Society subsidiary)
K G Bassett	Chief Internal Audit Officer	None
T W Clark	Chief Information Officer	Ongo Homes Limited
K J Green	Director of Products and Distribution	None
R Hewitt	Director of People	None
N Marsh	Director of Customer and Digital	None
A Mellor	Director of Prudential and Enterprise Risk	None
G M Mitchell	Director of Finance Operations	Headrow Commercial Property Services Ltd* Leeds Building Society Staff Pension Scheme Ltd Leeds Mortgage Funding Ltd* Leeds Financial Services Ltd*
A R A Moody	Deputy Chief Risk Officer and Director of Credit Risk	None
A Port	Director of Strategy	None
M J Richardson	Director of Operations	Leeds Building Society Charitable Foundation
I P Riley	Director of Treasury	Leeds Building Society Staff Pension Scheme Ltd
T A Tinkler	Director of Change	None
K Tong	Director of Compliance and Secretary	None
S J Whittle	Deputy Finance Director	None

Country by Country Reporting

For the year ended
31 December 2016

The Capital Requirements (Country by Country Reporting) Regulations 2013 introduce reporting obligations for institutions within the scope of the European Union's Capital Requirements Directive (CRD IV). The requirements aim to give increased transparency regarding the activities of institutions.

The information below has been audited in accordance with the standards required by Directive 2006/43/EC.

Nature of the Group's activities

Leeds Building Society is the UK's fifth largest building society with 62 branches, total assets of £15.9bn and 756,000 members.

The consolidated entities, their country of incorporation and their principal activities are detailed in note 13 on page 102. The Group has branches in Gibraltar and the Republic of Ireland and their results are included within the Group.

Total income, profit before tax and average number of employees

Total income and the average monthly number of employees on a full-time equivalent basis during the year ended 31 December 2016 are analysed below. The information presented is at a full Group level of consolidation, which has been prepared under IFRS. Total income is defined as net interest receivable plus fees and commission's receivable (net of fees and commissions payable), fair value gains less losses from derivative instruments, together with all other components of operating income. Total income of £212.0m (2015: £218.9m) and profit before tax of £116.6m (2015: £108.5m) are as disclosed in the Group's Income Statement on page 84.

	UK	Spain	Republic of Ireland	Total
Total income (£m)	210.3	2.8	(1.1)	212.0
Profit before tax (£m)	118.2	0.4	(2.0)	116.6
Average number of FTEs	1,219	–	2	1,221

Return on assets

The return on assets, calculated as profit before tax divided by mean total assets, was 0.79% (2015: 0.85%) for the year ended 31 December 2016.

Corporation tax paid

The Group made payments of £27.1m (2015: £19.8m) in respect of corporation tax during the year ended 31 December 2016. This was wholly payable to HM Revenue & Customs in the UK.

Public subsidies received

The Group received no public subsidies in the year ended 31 December 2016.

Glossary of Terms

For the year ended
31 December 2016

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears

A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue. Such a customer can also be said to be in a state of delinquency.

Basel III

Basel III is the third capital adequacy framework issued by the Basel Committee on Banking Supervision, which defines the capital and liquidity rules for Banks and Building Societies. The framework has been embedded into UK law through the European Capital Requirements Directive IV (CRD IV).

Basis point

One hundredth of a per cent (0.01%), so 100 basis points is 1%. Used in quoting movements in interest rates or yields on securities.

Commercial lending

Loans secured on commercial property.

Common Equity Tier 1 capital

The highest form of capital as defined in Capital Requirements Directive IV, comprising accumulated reserves and qualifying instruments after regulatory deductions.

Common Equity Tier 1 ratio

Common Equity Tier 1 capital as a percentage of risk weighted assets.

Contractual maturity

The final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal and interest is due to be repaid.

Cost to income ratio

Total administrative expenses, including depreciation, and amortisation, as a percentage of total income.

Cost to mean assets ratio

Total administrative expenses, including depreciation and amortisation, as a percentage of mean total assets.

Covered bonds

Debt securities backed by a portfolio of mortgages that is segregated from the issuer's other on Statement of Financial Position assets solely for the benefit of the holders of the covered bonds. The Group issues covered bonds as part of its funding activities.

Credit risk

This is the risk that a customer or counterparty is unable to pay the interest or to repay the capital on a loan when required.

Credit risk weighted amount

The notional value of derivative contracts adjusted to determine their inherent credit risk using PRA predetermined risk weights.

Debt securities

Assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.

Debt securities in issue

Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.

Delinquency

See Arrears.

Derivative financial instruments

A derivative financial instrument is a type of financial instrument (or an agreement between two parties) whose value is based on the underlying asset, index or reference rate to which it is linked. The Group uses derivative financial instruments to hedge its exposures to market risks, such as interest rate and currency risk.

Effective interest rate (EIR)

The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense to produce a level yield over the relevant period.

Fair value

Fair value is the amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.

Financial Services Compensation Scheme (FSCS)

The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FCA and PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.

Forbearance strategies

Strategies to assist borrowers in financial difficulty, such as agreeing a temporary reduction in payments, extending loan terms and temporarily converting loans to an interest-only basis. Forbearance strategies aim to avoid repossession where it is in the interest of the borrower.

Free capital

The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and investment properties.

Funding limit

Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals.

General reserves

The accumulation of the Group's post-tax profit since inception. It is the Group's main component of Common Equity Tier 1 capital which is a measure of strength and stability.

Gross capital

The aggregate of general reserve, other reserve, revaluation reserve and subscribed capital.

Impaired loans
Loans where there is objective evidence that an impairment event has occurred, meaning that the Group does not expect to collect all the contractual cash flows or expect to collect them when they are contractually due.

Individually/collectively assessed
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 Basel II requirements, of the levels of capital that it needs to hold in respect of regulatory capital requirements for risks it faces under a business-as-usual scenario and a variety of stressed scenarios.

International Swaps and Derivatives Association (ISDA) master agreement
A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions granting legal rights of offsetting for derivative transactions with the same counterparty.

Law of Property Act (LPA) receiver
LPA Receivers are appointed by the Group to deal with the management and disposal of commercial property held as security for loans in default.

Lending limit
Measures the proportion of business assets not in the form of loans fully secured on residential property.

Liquid assets
Total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, and investment securities.

Liquidity Coverage Ratio (LCR)
A regulatory standard ratio implemented by the Basel III Reforms. It is calculated as the stock of high quality liquid assets divided by the total net stressed cash outflows over the next 30 calendar days expressed as a percentage. The measure is being phased in gradually with full compliance required by 1 January 2019.

Liquidity risk
The risk that the Group is not able to meet its financial obligations as they fall due, or will have to do so at an excessive cost. This risk arises from timing mismatches of cash inflows and outflows.

Loan to value ratio (LTV)
A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).

Loans past due/past due loans
Loans are past due when a counterparty has failed to make a payment when contractually due.

Management expenses
Management expenses represent the aggregate of administrative expenses, depreciation and amortisation. The management expense ratio is management expenses expressed as a percentage of mean assets.

Market risk
The risk that movements in market risk factors, including foreign exchange rates, interest rates and customer-driven factors will create losses or decrease portfolio values.

Mean total assets
Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.

Member
A person who has a share investment or a mortgage loan with the Society which satisfies the Society's rules for membership.

Mortgage backed securities (MBS)
A category of asset backed security that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).

Net interest income
The difference between interest received on assets and similar income and interest paid on liabilities and similar charges.

Net interest margin
Net interest income as a percentage of mean total assets.

Net Promoter Score®
The Net Promoter Score® is a measure of customer loyalty to the Group.

Net Stable Funding Ratio (NSFR)
A regulatory standard ratio implemented by the Basel III Reforms which is the total amount of stable funding divided by the total amount of required stable funding, expressed as a percentage. The NSFR is currently an observable measure which is intended to become a minimum standard by 1 January 2018.

Notional principal amount
The notional principal amount indicates the amount on which payment flows are derived at the Statement of Financial Position date and does not represent amounts at risk.

Operational risk
The risk of loss arising from inadequate or failed internal processes, people and systems or from external events.

Permanent interest bearing shares (PIBS)
Unsecured deferred shares that are a form of capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing members of the Group. Also known as subscribed capital.

Replacement cost
The amount the Group would need to replace derivative contracts that are favourable to the Group if the counterparty with whom the contract was held were unable to honour their obligation.

Glossary of Terms

For the year ended
31 December 2016

Continued

Repurchase agreements (Repo)
A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a commitment to repurchase the asset at a specified price on a given future date. For the party selling the security and agreeing to repurchase the asset in the future, it is a repo.

Residential loans
Loans that are made to individuals rather than institutions and which are secured against residential property.

Residential mortgage backed securities (RMBS)
A category of asset backed security that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).

Risk appetite
The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Group's members whilst achieving business objectives.

Shares
Money deposited by a person in a retail savings with the Group. Such funds are recorded as liabilities for the Group.

Shares and borrowings
This is a measure of indebtedness which represents the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Solvency ratio
Measures the Group's reserves as a proportions of its risk weighted assets.

Sovereign debt
Sovereign debt is bonds issued by a national government. Historically sovereign debt has been viewed as less risky than other forms of debt issued.

Subscribed capital
See permanent interest bearing shares (PIBS).

Tier 1 capital
A measure of financial strength as defined by the PRA. Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital comprises general reserves from retained profits. The book values of goodwill and 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 (not Common Equity Tier 1).

Wholesale funding
The total of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue less balances deposited by offshore customers.

Notes

Get in touch

Find your nearest branch
leedsbuildingsociety.co.uk/branch

UK-based contact centre
7 days a week, 8am-8pm
Call 03450 50 50 75

We may monitor and/or record your telephone conversations with the Society to ensure consistent service levels (including staff training).

Leeds
Building
Society