Leeds Building Society

Annual Report & Accounts 2019

Leeds Building Society

2019: a year in review

Gross residential lending exceeded
£3.5bn
(2018: £3.8bn)

We helped **36,000** more people have the home they want.

Total assets up 7% to
£20.8bn
(2018: £19.4bn)

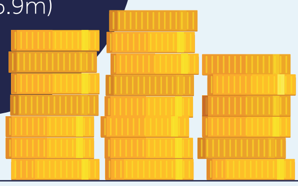
Savings balances up 4% to
£14.5bn
(2018: £13.9bn)

We helped over **46,000** more people save for their future.

We paid an average of
1.38%
to our savers compared to the rest of market average of 0.75%[1]

An annual benefit to all our savers of **£88.5m**.

Profit before tax
£88.0m
(2018: £116.9m)

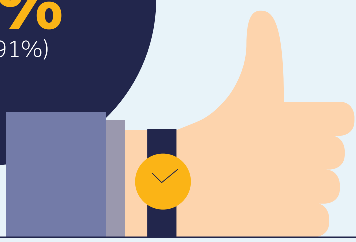


Common Equity Tier 1 capital is
33.6%
(2018: 31.3%)

Reserves available to protect us from future problems.

Member satisfaction
91%
(2018: 91%)

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



Colleague engagement score up 1% to
82%
(2018: 81%)

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

1. CACI's CSDB, Stock. January to December 2019, latest data available.

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Strategic Report
Chairman's Welcome

Year ended
31 December 2019

In my final year as Chairman, I'm pleased to report Leeds Building Society has once again delivered a good financial performance in 2019 despite intense competition in our core savings and mortgage markets, prolonged uncertainty around the UK's future relationship with Europe and a snap General Election.

We remain focused on sustainable growth by delivering value to our members and helping them save and have the home they want. As a result our assets increased to over £20 billion for the first time in our history. This, combined with a focus on efficiency and managing costs led to a good level of profit, enabling us to increase our capital and reserves, and further invest in improving our technology and service for the long term benefit of our members.

Economic background

The uncertainty around the UK's expected departure from the EU has prevailed for over three years and continues to influence the economic landscape. Consumer confidence remains weak[1] and market activity has been subdued.

Growth of the UK economy has continued to slow in 2019[2]. Unemployment levels are at near record lows, however, earnings growth slowed in the second half of the year and earnings in real terms have only recently recovered to levels seen prior to the 2008 to 2009 recession[3]. Inflation remained close to the Bank of England's (BoE's) 2% target until July then fell consistently month-on-month ending the year at 1.3%[4]. Inflation is projected to remain below the BoE's target this year and most of 2021[5].

Bank Base Rate (BBR) remained at 0.75% throughout 2019 and market expectations indicate a fall to 0.5% by Q3 2020[6].

The UK mortgage market has contracted with gross lending of £268 billion in 2019, down 0.4% year-on-year[7], and buyer demand remains subdued despite an uplift in enquiries at estate agencies in the final month of the year[8]. Intense competition in the mortgage market remains with average new mortgage rates falling further[9].

Rates paid to savers increased modestly at the start of the year but have since reduced as providers reacted to competitive market conditions[10].

Regulation

The busy regulatory agenda shows no sign of abating. Your Society has continued to review and prepare for any changes, as well as monitoring the key areas of focus of the BoE, Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA).

The FCA mortgage and savings market reviews continued to progress, with a particular focus on better access to products and services for consumers. We remain committed to providing products that meet the needs of our members and will continue to review these in line with any emerging regulatory guidance.

Throughout the year we have also reviewed and refreshed our approach to customer vulnerability, enabling us to identify and respond to customer needs more quickly and effectively.

We continue to monitor and plan for BoE, PRA and FCA joint proposals on the operational resilience of firms and financial market infrastructure. This remains a key priority and is being managed through a programme of continuous improvement and investment. We are also continuing to prepare for the discontinuation of the London Interbank Offered Rate (LIBOR) from the end of 2021 and transition to Sterling Overnight Interbank Average Rate (SONIA).

During 2019, the EU finalised amendments to the Capital Requirements Directive IV and the Capital Requirements Regulation, which will be fully effective from 2021. The Society is well capitalised and expects to be able to meet the regulatory requirements in full.

Succession

This will be my last Chairman's Welcome, as I will retire at the Annual General Meeting (AGM) in April. Well managed succession planning is key to our long term success and in line with best practice, recommended by the UK Corporate Governance Code, we must maintain a high level of skill and expertise on the Board.

Richard Fearon became only the eighth CEO in our 145-year history last February. He is proving to be an excellent leader. The Society faces intense competition combined with economic and political uncertainty, and he has set a clear strategy so your Society is capable of meeting the challenges and opportunities both now and in the future.

Iain Cornish, who joined the Board in January last year, is proposed to succeed me as Chairman. He has over 30 years' experience working in financial services. He was Chief Executive of Yorkshire Building Society between 2003 and 2011, and has also held a number of non executive posts including Treasury Select Committee Special Advisor and Independent Director for the PRA.

Iain brings a range of knowledge, skills and expertise to the role and I know he will focus on delivering continued success as we enter a new decade.

Summary

I am able to retire as Chairman in the confidence that your Society is in a strong position. Savings and mortgage balances are at record levels and we have achieved good levels of profitability against a backdrop of intense competition, enabling us to increase capital and reserves.

Competition in our core markets looks set to continue and uncertainty around our future relationship with the EU remains. Nonetheless, while we anticipate more modest growth in the coming years, and lower but still robust levels of profit, our strategic approach means we're well-placed to withstand economic shocks and continue to invest in the long term future of the Society.

I would like to extend my best wishes to my proposed successor, Iain Cornish, and know that my colleagues, led by Richard Fearon, have all the attributes needed so that your Society continues to be successful.

Finally, I would like to thank you, our members, for all your support and commitment. Leeds Building Society would not exist without you and I have been privileged to serve you as Chairman for the last seven years.

Robin Ashton
Chairman

25 February 2020

1. GfK Consumer Confidence Index December 2019
2. Office of National Statistics – GDP growth in Q4 2019 was zero versus 0.5% in Q3 2019
3. Office of National Statistics – Average weekly earnings to December 2019
4. Office of National Statistics – CPI inflation December 2019
5. Bank of England – Bank of England Inflation Report projections January 2020
6. Conditioning paths for Bank Rate released as part of Bank of England Monetary Policy Report January 2020
7. UK Finance – Gross mortgage lending for the 12 months to December 2019
8. RICS – UK Residential Market Survey December 2019
9. Bank of England – Effective Interest Rates on secured loans. The average new mortgage rate has fallen from 2.14% in December 2018 to 1.88% in December 2019
10. Bank of England – Effective Interest Rates on timed deposits December 2019

Chief Executive Officer's Highlights

Year ended
31 December 2019

In my first report as Chief Executive Officer (CEO), I'm pleased to report that we've once again delivered a good set of results despite intense competition in our core markets and political and economic uncertainty which has had an impact on our level of profit.

Leeds Building Society has been built on solid foundations and we remained committed to our mission of helping people save and have the home they want. As a result, savings, mortgage balances, assets and capital are all at record levels.

We have evolved our strategy so we can maintain the strengths that have made your Society successful over so many years and also allow us to continue to adapt as the pace of change in modern financial services continues to increase, and invest in our long term future to meet the ever changing needs of members.

The strategy is built on four pillars: **Secure**, **Customer Centred**, **Simple** and **Future Facing**, which can only be delivered by the energy, hard work and commitment of our **People** who are vital to achieving our strategic goals.

Secure

Generate strong, sustainable profit levels through meeting the needs of key customer segments.

Leeds Building Society has provided security and value to its members for over 140 years. This has been achieved by balancing the needs of both savers and borrowers, sustainable growth and generating appropriate profit levels to invest in the Society and deliver long term value to our membership as a whole.

While this period of historically low interest rates has been challenging for savers, borrowers have benefited from mortgage rates falling further. We have also used our expertise to help people have the home they want in key segments that are less well served by the wider market.

We helped over 10,000 people buy their first home through affordable housing initiatives including Help to Buy and Shared Ownership. Our support for first time buyers was recognised by What Mortgage magazine when we received the 'Best Shared Ownership Lender' accolade for the fourth year in a row.

We were the first national high street lender to offer older borrowers more choice, by launching a new Retirement Interest Only (RIO) range in 2018, and continue to lead the RIO market through our innovative long term fixed rate and cashback mortgages. As well as supporting first time buyers and later life borrowers, we remained active in the Buy to Let market, which is a key component of the overall housing mix in the UK.

The quality of our lending remains high. The average loan-to-value on our residential mortgages is only 54%. Mortgage arrears[1] increased slightly to 0.54% at the end of last year compared to 0.46% a year earlier, but still well below the industry average.

The Society has demonstrated its continued support for savers by offering competitive products that suit our members' needs despite the low interest rate environment. We received the Fairer Finance 'Gold Ribbon' for savings accounts for the second year running based on customer happiness and trust, along with our ability to explain things clearly.

Furthermore, we paid an average of 1.38% to our savers in 2019 compared to the rest of market average of 0.75%[2], which equates to an annual benefit to our savers of £88.5 million.

Our balanced approach for the benefit of our membership as a whole, combined with sustained competition in the mortgage market and high levels of refinancing has translated into lower mortgage income and, without an equivalent reduction in funding costs, has suppressed net interest income.

In addition, under International Financial Reporting Standards (IFRS), we have booked a fair value measurement reduction of £19.7 million, which includes the effect of market rate volatility on both our legacy Equity Release portfolio and other mortgage assets. This is an accounting adjustment which will typically unwind in future periods.

As a result, we delivered profit before tax of £88.0 million, which has enabled us to further increase our capital and reserves to £1.3 billion, well above the regulatory requirement.

Doing the right thing when no one is looking is as important to our members as it is to us and I'm delighted that, having been the first national high street financial institution to achieve the Fair Tax Mark[3], we have been reaccredited for a second year. All communities benefit from the public services paid for through tax and we believe it is important we pay our share.

Customer Centred

Deliver an outstanding member and broker experience.

Throughout 2019 we've continued to focus on what matters to members and brokers, who introduce the majority of our mortgage business, to further improve the customer experience we provide.

Our branches play an important role in attracting the funds we need to help borrowers have the home they want. Our aim is to ensure they remain relevant for our members and the Society's branch network is the most efficient in the UK for cash ISAs[4]. We'll continue to offer a face-to-face service where there is sufficient demand. Our newest locations in Edinburgh and Bournemouth, as well as our relocated branch in Moortown, Leeds, continue to perform well.

In line with other banks and building societies, our members are increasingly using the telephone and internet to access our products and services. Following member feedback, we changed our Contact Centre opening hours and increased the number of colleagues available for our members when they want to call us. This has reduced the average call wait time by 61 per cent and improved the member experience.

We have improved the online experience. Our focus has been on the savings and mortgage pages on the website and we've seen visitors stay on the site longer, and more people opening accounts, demonstrating we've made improvements in line with our members' expectations.

This combined with a focus on increasing awareness and consideration of our brand has further improved the perception of the Society and, thanks to member feedback, we are proud to have achieved a 4 star Trustpilot rating.

1. 1.5% or more of outstanding mortgage balances
2. CACI's CSDB, Stock, January to December 2019, latest data available
3. Fair Tax Mark – A business with the Fair Tax Mark is certified as paying the right amount of tax in the right place at the right time and applying the gold standard of tax transparency
4. eBenchmarkers Autumn Savings Report 2019, 1 May to 31 October 2019

Chief Executive Officer's Highlights

Continued

We've focused on creating efficiencies in our mortgage process to further improve the service we provide to our broker partners, and help people move into their homes faster. Just over a year ago, we launched Broker Webchat which gives quick and direct access to our expert Business Development Managers and complements our telephone and field teams. Our approach to providing good service and support was recognised by the industry with the Society receiving a '4 Star' rating at the 2019 Financial Adviser Service Awards.

As a result of all the improvements we've made, independent member surveys show overall customer satisfaction remains very high at 91%.

Simple

Drive efficiency by removing complexity.

Our focus on efficiency means we are able to continue to invest for the long term benefit of our membership as a whole, while controlling costs, growing sustainably and returning superior value to members. We anticipate our cost to income ratio of 53.5% and cost to mean asset ratio of 0.50% will remain among the best in the building society sector.

We are making good progress with our new head office, which will enable us to consolidate the three existing office sites we currently have in Leeds into one, and improve the ways of working for colleagues.

Throughout this process, we're recycling as much as possible, including all of the glass we've removed, some of which will come back into the structure in a new form such as worktops. The power supply will be electric from 100% renewable sources, and we will offset all the carbon emissions created in undertaking the refurbishment work. The building is also located in the heart of Leeds, close to existing transport links and when complete, will make us even more efficient, reduce associated operating costs and further reduce our impact on the environment.

Over and above the benefits our new head office will bring, I'm delighted we have once again achieved the Carbon Trust Standard (CTS) for Carbon. Successful certification against the CTS requires organisations to demonstrate good all-round carbon management performance in their day-to-day operations, deliver carbon reductions year-on-year and realise the benefits of associated efficiencies.

Future Facing

Invest in our capabilities and technology to meet the evolving needs of members.

The rapidly changing external environment in which we operate, combined with the evolving needs of our members, means we must continue to adapt and invest in the right technology so we remain successful, relevant and responsive for generations to come. We need to make sure our people, processes and technology are set up to deliver our strategy at pace, and we've made good progress in this area.

In addition to our new head office, which will allow us to enhance the way our colleagues interact with technology, we're also investing to future-proof our digital capabilities; to increase the pace of change and deliver a new mortgage system.

Our new mortgage system is an end-to-end mortgage solution from application through to completion. It will offer a more efficient and streamlined journey to brokers and customers. It will also set us up for the future, support mortgage growth and create capacity for the Society to develop additional segments to help more people who are less well served by the wider market. We remain on track to launch the new system later this year.

We continue to develop our digital capability, improving the most popular webpages and making it much easier and faster for members to do what they want to do at their convenience.

We've also further improved the service we offer members who wish to transfer funds, by extending the use of Faster Payments. This has increased speed and efficiency, as well as reducing costs, cash handling and cheque processing in our branches.

To further drive efficiency and improve member experience, we have increased the use of Robotic Processing Automation (RPA) to automate highly repetitive processes and release our colleagues to carry out more skilled work. Deploying this technology is supporting how we are transforming our operations, making us more efficient and enabling us to deploy more colleagues on to customer facing activity.

People

The strategy can only be successful because of our highly engaged people who are central to the delivery of our whole strategy.

Our colleagues are committed to delivering the best and I'd like to thank them for their passion and energy to deliver all aspects of our strategy. Regular reviews demonstrate high colleague engagement with the latest survey showing 82%, well above the financial services benchmark.

We believe in fair pay for all colleagues and this year we've published our Fair Pay Charter (FPC). The charter contains a number of commitments including providing a competitive total reward package to attract, motivate and retain colleagues, and a range of benefit options to support health and wellbeing. Furthermore, all executive directors voluntarily opted to move to the existing colleague pension scheme without any compensation for the loss in benefits thus reducing the cost to the Society.

While the Society has paid all colleagues at least the Real Living Wage for a number of years, we've gone even further this year and extended it to our third party cleaning and security colleagues, who regularly work on our sites but who are not directly employed by us. Accredited by the Living Wage Foundation, this is higher than the government's minimum, or National Living Wage, and provides a voluntary benchmark for employers that choose to provide a wage that meets the costs of everyday life.

I'm particularly proud of how our colleagues and members have contributed to the communities where they live and work. Together, over the last two years, they have raised more than £300,000 for our first ever national charity partner, Samaritans.

Following this success, we invited applications to become our new charity partner. After an extensive selection and shortlisting process, which saw 33 charities apply, I'm delighted to reveal both members and colleagues chose to support Dementia UK. From April this year, we'll be supporting this charity to take their vital care services into communities across the UK.

Furthermore, the Leeds Building Society Foundation has surpassed £2 million for donations to local worthy causes since it was founded and our colleagues have given over 6,000 volunteering hours in the community to help people of all ages improve their lives.

Outlook

Competition in our core markets looks set to continue and this, combined with political uncertainty and ambiguity around our future relationship with the EU, means we expect operating conditions will remain challenging. As a result, margin will remain under pressure and we anticipate lower levels of profit than we generated during recent years.

Notwithstanding this, I'm confident we have the right strategy so your Society remains relevant and successful for many years to come. Our financial strength means we can continue to invest for the future, grow sustainably by helping more people save and have the home they want and generate appropriate levels of profit to deliver balanced results for our membership as a whole.

Finally, I would like to thank you, our members, for the support you have given to Leeds Building Society over so many years and to me, in my first year as CEO.

Richard Fearon
Chief Executive Officer

25 February 2020

Business Model and Strategy

Year ended
31 December 2019

The Society's business model

Leeds Building Society is the fifth largest building society in the UK, with assets of £20.8 billion. Our mission is to help people save and have the home they want, continually adapting to anticipate our members' changing needs, to help our members get on with life. This is delivered through providing mortgages and savings, which are core to our business model.

Our strategy and business model have served us well and remain broadly unchanged. However, in light of the changing external environment, we need to consider how we adapt our business for future success.

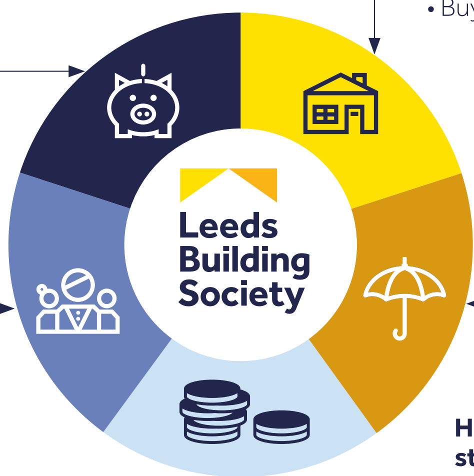
Where our funding comes from

- Savers (via our branch network, phone, online, post)
- Wholesale markets
- Reserves of previous profits

How we use our funding

The Society lends to help members have the home they want, including:

- Mainstream residential
- First time buyers
- Shared ownership
- Buy to let



How we remain financially stable and operationally resilient

- By maintaining liquid investments with strong credit rated institutions and central banks
- By making sufficient profit to maintain a strong capital base
- By having a prudent lending approach
- By maintaining a long term strong credit rating
- By maintaining a multi-channel business model
- Ongoing investment and focus on operational risk reduction including a robust cyber strategy

Why we need to make profit

We are member-owned and do not pay any shareholder dividends, however we need to make profit to:

- Maintain financial strength
- Invest in the Society for the benefit of our membership as a whole (for example, maintaining our branch network, improving digital capability and customer experience) and to set up the business for future success
- Provide benefits for the communities in which we operate

What we need to spend

- Costs of running the business and investing to provide the right level of service in an efficient way
- Paying our colleagues fairly to attract and retain talent
- Paying our fair share of tax
- Putting money aside for bad debts

The Society funds the majority of mortgage lending with members' savings, through a range of channels. The remainder is funded from wholesale money markets on competitive terms.

We provide residential mortgages in the UK, through a network of approved mortgage brokers and directly to customers via online and telephone services. We offer mortgage products across mainstream residential, buy to let and a range of other segments, such as shared ownership and retirement interest only.

Our strong liquidity position helps to make sure that 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 across a range of counterparties.

We aim to generate sufficient profit through cost efficiency and management of the net interest margin, in order to maintain a strong capital position. As a result, we can continue to invest to improve customer experience, build digital capability, maintain branches and enhance the colleague working environment.

The core markets in which we operate remain challenging for the Society and other financial services providers. Low interest rates have impacted profitability and political and economic uncertainty has affected demand in the mortgage and savings markets. While we believe our core product lines are sustainable into the future, we expect the markets we operate in to remain fiercely competitive and we will need to adapt accordingly.

We are investing in our digital proposition and improving efficiency within the business in order to face future challenges from a more digital marketplace with more diverse customer requirements, both in terms of channel preferences and product needs. We continue to review opportunities to better meet existing and new members' needs, including the development of our products and distribution channels.

Creating value for members and other stakeholders

The Society delivers value to its membership as a whole and other stakeholders in a range of areas:

- We maintain a strong capital base from the reinvestment of sustainable profits and a prudent lending approach, to provide security for members, colleagues, bondholders and communities over the longer term.
- We offer competitive products, with savings rates higher than the market average, enabling our members to save for the future.
- We help families and first time buyers to have the home they want and a focus on customer needs means we can lend to borrowers who are typically less well served by the wider market.
- The highest standards of trust and integrity are observed in all engagement with members and other stakeholders. This, along with competitive products and ongoing investment, helps build member and broker satisfaction and strong long term relationships.
- We offer high levels of customer service and we recognise the importance of face to face contact for members. We are committed to operating a branch network where there is sufficient demand, while also investing in digital solutions for those members who want them.
- We are committed to making a positive social contribution to the communities in which we operate. This includes supporting our national charity partner (Samaritans in 2019), providing funding to the Leeds Building Society Foundation and offering a volunteering scheme for all colleagues.
- We respond meaningfully to the social issues our members, colleagues and communities care about, as demonstrated by becoming a Real Living Wage Employer, achieving the Fair Tax Mark and being certified with the Carbon Trust Standard for Carbon.

Business Model and Strategy

Year ended
31 December 2019

Continued

The Society's strategy and strategic pillars

Our vision to be Britain's most successful building society is supported by our strategic pillars: Secure, Customer Centred, Simple and Future Facing, all underpinned by our People.

Given the changing environment in which we operate and the increasing need to adapt, these pillars were refreshed at the beginning of 2019 to incorporate our new Future Facing pillar. This will help us to focus on adapting our business model for ongoing success in response to changing member needs and the external environment.

Progress on strategic pillars

Good progress has been made during 2019 on activity under our strategic pillars.

Strategic pillars	How this is delivered	Progress in 2019
Secure Generate strong, sustainable profit levels by meeting the needs of key segments	The Society is well capitalised, providing the resources to grow mortgage lending, invest and meet future regulatory changes, while maintaining a secure business for members. The Society uses its strong risk management and experienced product teams to develop competitive products which meet customer needs in areas of the market which have historically been less well served. Legacy portfolios are proactively managed to reduce the credit risk associated with these loans.	• Whilst we have opted to reduce our gross (new) lending volumes compared to 2018, mortgage balances have grown as we continue to meet the needs of members with mortgage products reaching maturity. • In line with expectations, our net interest margin reduced as a result of falling new lending margins and a lower proportion of balances paying the Standard Variable Rate driven by competitive market conditions. • Whilst our profit performance was lower than last year, we remain well capitalised with Common Equity Tier 1 and leverage ratios being well above regulatory requirements. Our future capital plans incorporate our expected Minimum Requirements for Own Funds and Eligible Liabilities (MREL) (see page 50). • Our financial stability has improved during the year through further reducing legacy portfolios, such as the commercial mortgage portfolio.
Customer Centred Deliver an outstanding member and broker experience	The Society has been a mutual organisation for 145 years, which means customers are also members. We do not have separate shareholders and are therefore able to have a customer centric focus at the heart of our business. The Society offers competitive savings products which provide members with long term value and our highly engaged colleagues provide an outstanding personal service to our members and brokers. Continued development of our communication and distribution channels mean that members can engage with the Society via their preferred channel. Strong relationships are actively maintained with the Society's approved network of mortgage brokers.	• Customer and broker satisfaction remained high in 2019 and our Trustpilot rating improved to a '4 Star' rating. • We received a number of awards in 2019 for our customer service, which recognised our efforts to improve the member and broker experience and demonstrate how we are continuing to meet the needs of our members through our customer centred lending strategy. • During the year, a new Faster Payments service was introduced into branches to further improve the speed and security of transactions. • We continue to work on enhancing our digital proposition for both members and brokers. • As a result of good customer service, products which meet members' needs and competitive interest rates (savings rates were on average 0.63% above the market), our savings and mortgage balances increased.

Business Model and Strategy

Year ended
31 December 2019

Continued

Strategic pillars	How this is delivered	Progress in 2019
Simple Drive efficiency by removing complexity	The Society strives to improve efficiency through a strong focus on cost management and continued streamlining of processes to reduce complexity.	• We have continued to improve efficiency in a number of areas of the business, in particular through our operational transformation programme, which seeks to identify opportunities to simplify and streamline our high volume mortgage and savings processes. • We have continued to review our target operating model to help make sure our operations remain appropriate for the future. • Work is continuing on the new head office building, which will reduce the current three Leeds city centre locations to a single site and as a result will save costs. • We decided to close our Gibraltar branch during the year as a result of sustained falling demand for savings and mortgages in this area.
Future Facing Invest in our capabilities and technology to meet the evolving needs of members	The Future Facing pillar was introduced to the Society's strategic framework at the beginning of 2019. It promotes a strong focus on investing in our capabilities and technology in order to evolve and adapt to the changing environment, for the Society to remain relevant and successful in the future.	• We have been working hard to understand members' and brokers' changing needs, technological developments in the market and how the mortgage and savings markets may evolve in the future. • Our ongoing investment programme has increased capacity and capability across the Society, which enables growth whilst meeting the requirements associated with a highly regulated business. • In particular, we have continued to invest in our mortgage technology platform during the year to improve efficiency, enhance our digital capabilities and enable us to compete more effectively in a challenging mortgage market, through meeting evolving member and broker needs and expectations.
People	Our people underpin our strategy and it is through our highly engaged colleagues that we deliver priorities under our strategic pillars.	• In 2019 we have continued to focus on strong colleague experience and engagement. For further details, see the People section on pages 16 to 17.

Key Performance Indicators

The Society measures its performance against a number of key performance indicators (KPIs). These include both financial measures, as defined under IFRS and other measures as defined below.

The Board has recently approved a new set of KPIs for measurement and reporting, as a result of the changes made to our strategic pillars. The following KPIs have been removed: liquidity coverage ratio, credit ratings, percentage of customer administration processing completed within service standards and colleague turnover. Broker Net Promoter Score is a new measure for this year. Our Future Facing pillar KPIs are used internally to measure our performance in adapting to the evolving market and are therefore commercially sensitive.

Key performance indicator	What is measured	Performance	2019 update
Secure			
Profit before tax	Profit before tax, as reported in the Income Statement, creating capital to support future business growth.	2019 £88.0m 2018 £116.9m 2017 £120.9m 2016 £116.6m 2015 £108.5m	Profit before tax has reduced from 2018 due to lower net interest income, primarily caused by increased market competition and a higher fair value charge due to volatility in interest rates, as a result of economic uncertainty.
Net interest margin	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.	2019 1.00% 2018 1.15% 2017 1.24% 2016 1.37% 2015 1.62%	In line with expectations, our net interest margin continued to reduce as a result of falling new lending margins and a lower proportion of balances paying the Standard Variable Rate.
Common Equity Tier 1 (CET1) ratio	The highest quality form of capital that mainly comprises retained earnings and other reserves, as a proportion of risk weighted assets (RWAs). This is measured to help make sure that the Society retains an excess over the regulatory minimum.	2019 33.6% 2018 31.3% 2017 14.5% 2016 15.2% 2015 15.5%	CET1 capital increased slightly during the year, with solid annual profit being offset by balance sheet growth. The increase in 2018 was due to the Society being granted Internal Ratings Based (IRB) permission.

Year ended
31 December 2019

Continued

Key performance indicator	What is measured	Performance	2019 update
Secure (continued)			
UK leverage ratio	Another measure of capital strength. Measured as the Society's Tier 1 capital as a proportion of relevant total assets excluding central bank reserves.	2019 5.3% 2018 5.5% 2017 5.5% 2016 5.6% 2015 5.8%	Leverage ratio was broadly maintained through sustainable profit generation supporting controlled growth in assets. The ratio remains well above the regulatory minimum of 3.25%.
New (gross) residential lending	The value of residential lending advanced by the Society during the year, including loans for house purchases, remortgages and further advances.	2019 £3.5bn 2018 £3.8bn 2017 £4.1bn 2016 £4.0bn 2015 £3.1bn	We decided to reduce new (gross) lending in 2019 to optimise profitability within difficult market conditions. However, it remained above our natural market share.
Net residential lending	Gross residential lending, less repayments of principal and redemptions.	2019 £1.0bn 2018 £1.0bn 2017 £1.8bn 2016 £1.9bn 2015 £1.4bn	Net lending is slightly lower, primarily due to lower gross lending following management actions to optimise new lending margins.
Customer Centred			
Customer satisfaction	The percentage of customers surveyed who described themselves as quite, very or extremely satisfied with the service received from the Society.	2019 91% 2018 91% 2017 91% 2016 92% 2015 91%	Customer satisfaction has remained consistently high. We won a number of awards during 2019 that demonstrate our focus on member experience and product needs.
Broker Net Promoter Score	Demonstrates how likely brokers are to recommend the Society to their peers. Calculated using the percentage of people who are extremely likely to recommend and subtracting those who are unlikely to recommend.	2019 54 2018 49 2017 N/A 2016 N/A 2015 N/A	Significant investment in new systems, processes and products have been positively received by the broker community, driving up the net promoter score.

Key performance indicator	What is measured	Performance	2019 update
Customer Centred (continued)			
Savings balances	The value of shares and deposits held by the Society's members and other customers as reported in the Statement of Financial Position.	2019: £14.5bn 2018: £13.9bn 2017: £13.1bn 2016: £11.2bn 2015: £9.9bn	Above market average savings interest rates and maintaining a strong savings franchise have resulted in higher savings balances through the year.
Society membership	The number of Society members. Increasing the number of members is part of achieving the Society's vision.	2019: 797,000 2018: 804,000 2017: 791,000 2016: 751,000 2015: 719,000	Overall, member numbers have declined slightly by 0.9% to 797,000, due to lower gross lending and the reduction of interest rates on some savings products.
Savings rate benefit	The annual benefit to all our savers of paying above market rates to savers, based on the Society's weighted average savings rate compared to the rest of market rate[1].	2019: £88.5m 2018: £81.5m 2017: £75.0m 2016: £69.0m 2015: N/A	We paid an average rate of 1.38% against the rest of market average of 0.75%, benefitting members by £88.5 million in the year.
Simple			
Cost to income ratio	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.	2019: 53.5% 2018: 44.8% 2017: 43.2% 2016: 43.3% 2015: 36.4%	Significant ongoing investment in order to future proof the business, in conjunction with income pressures from a challenging market, have led to a rise in our cost to income ratio compared to 2018.
Cost to mean asset ratio	An additional 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.	2019: 0.50% 2018: 0.52% 2017: 0.56% 2016: 0.62% 2015: 0.62%	Our cost to mean asset ratio fell as the business grew more quickly than our costs, reflecting the efficiency in our business model.

1. CACI's CSDB, Stock, January to December 2019, latest data available.

Business Model and Strategy

Year ended
31 December 2019

Continued

Key performance indicator	What is measured	Performance	2019 update
Simple (continued)			
Number of days from mortgage application to offer	The number of business days it takes to issue a mortgage offer from initial receipt of the application.	2019: 15 2018: 16 2017: 16 2016: 19 2015: 22	Encouragingly, as a result of improvements made to the process and increased efficiency, the overall average turnaround time for mortgage application to offer has improved by one day compared to 2018.
People			
Colleague engagement score	Colleague engagement is measured annually across all colleagues. Society goals are delivered by highly engaged colleagues.	2019: 82% 2018: 81% 2017: 80% 2016: 78% 2015: 76%	Colleague engagement remains high and is ahead of our sector benchmark. Our colleague engagement has improved year-on-year.

People

Our overarching aim is to ensure delivery of strategic priorities through our highly engaged colleagues.

We have continued to focus on strong colleague experience and engagement, to enable all our people to understand and contribute to delivering great service to our members.

Colleague engagement

In 2019, we improved our already high levels of colleague engagement, with an overall colleague engagement score of 82%, ahead of our sector benchmark. 95% of colleagues took part in the survey.

There have been further improvements in areas of personal growth and leadership, reflecting our efforts around career development and personal performance. This follows our successful 2* Best Companies accreditation and attaining 77th in the Sunday Times Top 100 Best Companies to work for in 2019.

The Board recognises the crucial role that our colleagues play in our success and the service we provide to members and is provided with regular and detailed information about our workforce. In 2019, Lynn McManus, non executive director and Chair of the Remuneration Committee, assumed responsibility for representing colleagues' views at the Board. Lynn has met with our Colleague Association regularly throughout the year, as well as meeting colleagues face to face. Lynn and two other non executive directors have provided well attended round table learning and engagement sessions for colleagues on a range of topics, aimed at developing understanding of the role that the Board plays and Board diversity. During the year, colleagues were kept up to date with business performance, through roadshows and briefings, led by executive committee members, as well as team meetings and monthly briefings, creating the opportunity for discussions to embed understanding.

Our colleague turnover is 17.7%, which is within our target range (2018: 19.2%).

Diversity and inclusion

In 2017, we launched our diversity and inclusion strategy. Our single statement ambition is to 'have an inclusive culture which enables colleagues with a diverse range of skills, experiences and backgrounds and opinions to flourish, without barriers'. We have continued to make significant progress against these aims.

We have focused efforts specifically on gender diversity, mental health and, for the first time in 2019, Black, Asian and Minority Ethnic (BAME), through colleague led forums. Our Accountable Executive for Diversity is Andrew Greenwood, Chief Risk Officer and Executive Director.

On gender diversity, our Director of People, Becky Hewitt, was appointed as Chair of HM Treasury's Women in Finance Charter Board. We have continued to make progress on our gender diversity agenda, including:

- Investing in the Women Ahead Mentoring Programme, with 30 women selected to participate in the scheme and receiving mentoring from senior leaders in other organisations. We have also provided mentoring for 30 women in other organisations.
- Publishing gender diversity targets, as part of our commitment to the Women in Finance Charter. We were pleased to report in September 2019 that we had achieved our target for gender diversity in the senior leadership team (33%) and are making progress towards the achievement of our Board diversity target, which is 33% by the end of 2021.
- Receiving a number of awards for our diversity progress from the National Centre for Diversity, where we most recently achieved recognition as the Best Financial Services Company for the second year running in January 2020, as well as accolades from the Yorkshire Leadership Awards and the Yorkshire Financial Awards.

Information on the composition of our workforce at the end of 2019 is shown below.

		2019 Females	**2019 Males**	2018 Females	2018 Males
Colleagues	Number	838	486	827	468
	Percentage	63%	37%	64%	36%
Managers	Number	33	66	31	62
	Percentage	33%	67%	33%	67%
Directors*	Number	3	8	3	10
	Percentage	27%	73%	23%	77%

* number includes executive and non executive directors

At the end of 2019, we have 118 colleagues from ethnic minorities, comprising 8% of our workforce. Our BAME forum has commenced work to define the areas of focus which will be implemented in 2020.

Mental health

A total of 279 people, including 143 people leaders and 136 colleagues, have been trained on mental health awareness since the Society started its formal approach to mental health training in 2018.

We also continued to train smaller numbers of colleagues on an in depth basis to be on hand to offer early intervention support, guidance and signposting to others who may be experiencing a mental health concern. We have trained a further 16 colleagues as Mental Health First Aiders in 2019, bringing the total trained since the scheme launched in May 2018 to 51.

In addition, since 2018 and through our membership of the Building Societies Association (BSA), the Society has trained more than 60 people in other financial services and private sector organisations as Mental Health First Aiders.

Reward

We were proud to achieve accreditation from the Living Wage Foundation in 2019, reflecting our ongoing commitment to paying the real Living Wage. Our fair reward principles ensure we offer fair pay, which is benchmarked externally and is designed to attract candidates with the skills and experience needed. All colleagues participate in a bonus scheme, which is linked to the Society's financial performance, delivery of our customer experience and their own individual contribution. We have a Fair Pay Charter which is available to view on our website.

Developing our talent

Our positive learning culture helps colleagues to develop their skills and, in turn, their careers. In 2019, we delivered 17,966 hours of face to face training for colleagues. Many more hours were delivered via online learning methods, including a mobile learning app, enabling colleagues to manage their learning where and when they want. During the year, we supported 124 colleagues to study for professional qualifications. Career development is important to us and we are pleased that 65% of all opportunities available were filled by colleagues moving to new roles internally. We further support colleagues with secondment opportunities, helping them to learn and develop new skills and in 2019, 70 colleagues commenced a secondment opportunity.

We are proactively upskilling colleagues within areas in which streamlined and automated ways of working are being introduced. The development will enable these colleagues to undertake more complex work which does not lend itself to automation. We have invested £1.6 million in training and development, through the provision of external training and through our dedicated internal training teams.

Business Model and Strategy

Continued

Our values

The Society's values explain the behaviours which all colleagues are expected to display in everything they do. They underpin the delivery of our business model and strategy.

Our values form a key part of the performance management process for all colleagues and we support demonstration of those values in the workplace through regularly recognising our colleagues' achievements around these behaviours.

Straightforward
doing the right thing

Collaborative
nurturing positive relationships

Integrity
trusted custodians

Progressive
always moving forward

Responsible
taking personal ownership

Passionate
determined to succeed

Directors' regard to stakeholder interests

Our approach to corporate governance is based on the Principles and Provisions of the new 2018 version of the UK Corporate Governance Code (available at www.frc.org.uk). Therefore in order to meet the new requirement for a Section 172 Statement (in so far as it is relevant to a building society), we have included information on how the Board has carried out its duties in promoting the success of the company, including how it engages with stakeholders and remains cognisant of their needs when running the business.

The Board's approach

The Society considers the needs of a diverse range of stakeholders, as noted below. These stakeholders have been identified as those who may be affected by our activities and those groups whose actions can affect the operation of the business. These stakeholders are also actively considered in the development of the Society's strategy, specifically members' product and servicing needs, the expectations of regulators, the needs of mortgage brokers, views of investors and credit rating agencies and any potential impact on colleagues. For example, customer insight and feedback has formed the basis of the decisions around digital developments. The Board recognises that agreeing a strategy which is cognisant of key stakeholders will optimise long term value creation and will ensure relevance in a fast changing environment.

Board members, including non executive directors, receive training on all aspects of their role including fiduciary duties and an overview of our stakeholders and how we engage with them. In addition, competencies within their job role requirements have a customer focus, with a requirement for strong internal and external relationships with stakeholders.

Report writing guidance has been updated to require Board and other committee reports to include the views of and potential impacts on our stakeholders. The Chair directs debate so that appropriate consideration is given to relevant stakeholders when decisions are made and this is then documented within the meeting minutes. For example stakeholder impact was discussed when making decisions on the head office relocation and our new mortgage technology platform. Board reports are reviewed by the relevant committees, they are considered by second line (Risk and Compliance) and are approved by relevant subject matter experts.

Our values help to underpin a strong culture appropriate for a mutual organisation, encouraging behaviours that are in the best interests of members and other stakeholders. As previously noted, assessment of colleague behaviour in line with our values forms a key part of our performance management approach.

Further information on engagement with our key stakeholders can be found within the Corporate Governance Report on pages 69 to 71.

Maintaining our licence to operate

Members and brokers

The Society has an online panel (TalkingPoint) for receiving member feedback on various topics, including product and service improvements. This year we launched an industry-first broker panel for the same purpose. The Board sees output of this research, as appropriate, within relevant papers and the Board also receives quarterly reporting on both member and broker satisfaction. A view of our membership base is reported through annual analysis of the five year forecast of our member joiners and leavers, as well as monthly reporting on recent joiner/leaver numbers. The Board balances the interests of borrowing and saving members, as well as brokers, when making decisions about its short and longer term strategy.

Competitor activity is monitored regularly and reported to the Board through bi-annual reviews. External environment monitoring is undertaken continually, with regular reporting to the Board on potential future market disruptions which could have a significant impact on our core markets and our business.

Sales processes comply with relevant regulations, with independent quality assurance and oversight via the Conduct and Operational Risk Committee (CORC). Post sale product performance is monitored and considered routinely as part of our Lifecycle Review governance, with oversight via CORC and customer complaints handling is reported via the Chief Customer Officer, with oversight by CORC and an annual update to the Board.

Procedures are in place to ensure customer data is stored and used appropriately and kept in line with our Privacy Policy.

Colleagues

We have a number of ways of engaging with colleagues directly employed by the Society, so that we can understand their needs and views. There is a yearly colleague survey and Lynn MacManus, non executive director, meets regularly with the Colleague Association. Lynn and two other non executive directors also host a number of learning and engagement sessions.

Consideration of diversity in the workplace is a key focus for Leeds Building Society, which we achieve through our mental health, gender diversity and BAME colleague forums, as well as being a signatory to the government's Women in Finance Chart and achieving 'Leaders in Diversity' status from the National Centre for Diversity. Please see the People section for further information on pages 16 to 17.

The Colleague Association meets regularly to discuss issues affecting colleagues, such as health and safety, colleague engagement, colleague pension performance, salary and bonus expectations, as well as disciplinary and grievance matters. The agenda is set by seeking feedback from colleagues on the items they wish to raise.

Suppliers

Suppliers are an important part of our business operations. The Board is involved in decisions on suppliers for our key strategic projects including change of suppliers, where these are of a significant value as defined under the Delegated Authorities Manual. As part of the refresh of our third party management framework, management information on suppliers will be reported to the Board in 2020, including more comprehensive information on our critical suppliers, as well as evidence of suppliers' compliance with laws, regulations and internal standards.

As part of the refreshed framework, the relevant due diligence is carried out by relationship managers on each contract, with the necessary checks dependent upon the size of the contract and its impact on our strategy.

There is a relationship management model in place, with governance meetings at appropriate levels taking place in accordance with the materiality of the relationship. In terms of payment performance, we pay around 90% of suppliers within 30 days. Further information on engagement with suppliers can be found in the Corporate Governance Report on pages 70 to 71.

Business Model and Strategy

Continued

Communities

Leeds Building Society was set up to help members save and have the homes they want. We also aim to make a positive difference in wider society and the Board understands that our mortgage and savings business needs to be underpinned by a broader commitment to the communities in which we operate. An example of this is our commitment to pay our fair share of tax as evidenced by our Fair Tax accreditation. Our communities are defined as the places where our members and colleagues live and work, however we consider social issues as well as geography in defining where we focus our efforts.

The Board receives regular updates on our Corporate Responsibility framework and 2020 targets, in order to understand our progress and what we may need to focus on. The framework highlights how we aim to do what is right for our members, colleagues and communities. Further information on our framework and our progress against the targets can be seen in the Corporate Responsibility Report on page 22.

The Board gains awareness of member views on various topics including communities, through inclusion of TalkingPoint panel research within relevant Board papers and through questions at the Annual General Meeting.

Further information on corporate responsibility at Leeds Building Society can be found within the Corporate Responsibility Report on pages 22 to 31.

Environment

Climate change remains a key focus for the Society. One of the ways in which we have demonstrated this is by broadening carbon reporting within this year's Annual Report and Accounts. This reporting helps the Board to understand our carbon footprint and highlights the steps we are taking to reduce this. These include gaining re-certification of the Carbon Trust Standard for Carbon, demonstrating the ongoing reductions in our carbon footprint and that we have the right processes in place to continue to reduce it in the future, recycling all paper and using 100% green tariff electricity (see Corporate Responsibility Report on pages 27 to 29 for further information).

We are also currently assessing the risks and opportunities from climate change to our business. Following the publication of the PRA's policy statement on managing climate change risks, the Board appointed our Chief Risk Officer, Andrew Greenwood, as the Senior Manager responsible for risks associated with climate change. We have submitted a high level plan to the regulator setting out how we expect to meet these requirements and manage risks associated with climate change over the medium term. Periodic updates on progress against this plan will be provided to the Board Risk Committee, to which the Board has delegated oversight.

Regulators

The Society has an open and transparent relationship with both the FCA and the PRA. At each Board meeting a regulatory update report is presented. The report includes: (i) material regulatory requirements over the horizon, together with the impact and readiness of such items on the Society, which is informed by external information sources such as peer benchmarking and UK Finance; (ii) a summary of any new, closed or current actions agreed with the PRA/FCA during the period; and (iii) any other material dialogues with the PRA/FCA.

Investors

We have a variety of different types of investors who support our wholesale funding strategy across secured and unsecured types of debt. Our financing strategy aims to have the appropriate level of diversification of funding, so we are not exposed to only one type of funding.

To facilitate this, we have an active investor relations strategy, including engagement through individual meetings with key institutional investors, group presentations, attendance at investment conferences and specially arranged investor days.

Key decisions made in the year

The Board has made a number of key decisions during the year, remaining mindful of the potential impacts on stakeholders, which benefit the membership as a whole over the longer term. A few examples are below:

Approval of the five year corporate plan	The five year corporate plan was approved by the Board following a comprehensive review of our strategic priorities, the market outlook and challenges our business is likely to face. In setting the plan, customer needs were considered along with product plans, in order to understand the potential impact on members. The expected impact on colleague engagement was also assessed. Our plan sets us up to respond to external challenges and helps us to adapt in order to remain successful in the long term, in the interests of our members, communities and other stakeholders.
Reduction of interest rates on some of our savings products	To maintain profitability and sustainability of the business, following careful consideration of the short and long term impact on members, the difficult decision was made to reduce the interest rates on some of our savings products. While some products had rate reductions, our average rates remain higher than the market average and this action has increased the sustainability of the business over the longer term.
Review of the legacy portfolio, including closure of the Gibraltar branch	To improve the sustainability and efficiency of the core business and reduce our exposure to risk within non-core markets we have, over recent years, reduced our legacy portfolio. This year, we closed our Gibraltar branch, after careful consideration of member needs and consultation with colleagues.
Approval of the operational transformation proposals to enhance customer and colleague experience	Proposals for the operational transformation programme were approved, acknowledging the need to improve efficiency in our mortgage and savings processes to reduce costs, improve scalability and enhance colleague and customer experiences.
Approval of the digital operating model	The digital operating model was developed to maintain the relevance and success of the Society within an increasingly digital environment. This model acknowledges a number of ways in which we need to improve our capability to manage and continuously develop our digital channel through technology, processes, people and governance in order to improve member and broker experiences.
Approval of a new mortgage technology platform	The new mortgage technology platform aims to provide enhanced member, broker and colleague experiences, through improving efficiency of mortgage applications and thereby significantly enhancing the mortgage journey. Over the longer term, this should create capacity for us to lend into additional mortgage segments to help more people who are less well served by the wider market.
Approval to progress to the next stage of the relocation of head office	As part of the decision making process for the head office relocation, environmental, financial and colleague factors were taken into account. A core part of the business case involved understanding the impact of the project on the environment, including energy efficiency, recycling and the use of local suppliers. Colleague needs have been considered throughout the project and colleagues have been kept up to date with progress as well as inputting into the design of the new building.

These decisions aim to improve member, broker and colleague experience as well as increasing our financial stability through improving income performance/reducing costs. This means that we can continue to operate successfully in the future for the benefit of all of our stakeholders.

Corporate Responsibility

Year ended
31 December 2019

Doing business the right way

Leeds Building Society is trusted by 797,000 members to help them save and have the home they want. Trust is not something we take for granted and we know it needs to be underpinned by a commitment to communities and the wider world in which we operate. In 2017, we set ourselves 12 Corporate Responsibility targets to reach by the end of 2020, along with a commitment to report our progress annually.

Since launching these targets in 2017, the Society has helped over 181,000 more people to save and almost 130,000 more people to have the home they want, including over 35,000 first time buyers. In 2019, we have invested over 6,000 volunteering hours into communities, donated more than £381,000 to charities and good causes and maintained member satisfaction scores of 91%.

We continue to work closely with a range of expert partners to deliver our corporate responsibility strategy, including Fair Tax Mark, The Carbon Trust, Living Wage Foundation and Business in the Community.

Our framework

Our Corporate Responsibility framework sets out our commitment to do what is right for our members, colleagues and communities, focusing on four broad areas:

- Money & Homes: helping our members save and have the home they want.

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

- People & Places: looking after our colleagues and reducing the environmental impact in the places where we operate.

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

Highlights

In 2019 the Society:

- was awarded Bronze Global Good Company of the Year by the Global Good Awards UK, which celebrate businesses committed to doing good things for people, the planet and the economy;
- was reaccredited with the Fair Tax Mark and recertified with the Carbon Trust Standard for Carbon, and became a Living Wage Employer, extending its commitment to pay the Real Living Wage to third party contractors who work on site;
- reached our stated target a year early to support 30,000 first time buyers, helping more people into a home of their own;
- raised £160,500 to support Samaritans to be there when it matters, taking the total amount raised since the partnership started in 2017 to over £306,000;
- gifted our Leeds Rhinos shirt sponsorship to Samaritans for one high-profile game to raise awareness of mental wellbeing and the important work of Samaritans;
- saw record numbers of colleagues volunteer their time in communities and piloted a programme of activity to support young people with financial education;
- reduced our carbon footprint by 96% since 2016 and reported our travel footprint for the first time, reaffirming our commitment to procuring 100% renewable electricity for our sites;
- received more than 100 pledges from colleagues to reduce their personal carbon footprint – collectively this equated to a carbon saving of 27 flights between Glasgow and Amsterdam; and
- took part in the Business in the Community Responsible Business Tracker®, for the second year, to proactively identify areas to drive further improvement in responsible business practices.

Our performance

Our targets were selected to reflect the four themes of our Corporate Responsibility framework and we have kept these under review in 2019 to ensure they remain appropriate. We are on track or have completed 11 of our 12 targets.

The mortgage market remains challenging for all lenders and we have to balance our desire to lend with the need to maintain our financial strength and, as a result, we are currently behind on our target to help over 175,000 people to have a home they want.

Money & Homes

Target 1

Help over **225,000** people save for their future

PROGRESS: ON TRACK

We are **80%** of the way towards reaching our target having supported over **181,000** people to save for their future since 2017.

Target 2

Help over **175,000** people have the home they want

PROGRESS: BEHIND

We are **74%** of the way towards reaching our target having supported **130,000** people to have the home they want since 2017.

Target 3

Help **30,000 first time buyers** into a home of their own

PROGRESS: ACHIEVED

We have met our target having supported **35,000** first time buyers to get onto the housing ladder since 2017.

Members & Communities

Target 4

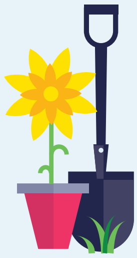
Achieve high member satisfaction scores of over **90%**

PROGRESS: ON TRACK

Our member satisfaction score, as measured as an average over the year, was maintained at **91%** in 2019.

Target 5

Provide **14,000** colleague **volunteering** hours in the community



PROGRESS: ACHIEVED

We have achieved our target in 2019, having invested over **16,500** hours into communities since 2017 and in 2019 seeing record levels of colleague volunteering.

Target 6

Provide **£1.2m** to charities and the community through grants, donations and sponsorship

PROGRESS: ON TRACK

We are **90%** of the way towards reaching our target, having donated **£1.08 million** to charities and good causes since 2017.

People & Places

Target 7

Achieve above sector average **colleague engagement** scores of over **70%**

PROGRESS: ON TRACK

Colleague engagement, as measured through our annual survey, increased from **80%** in 2017 to **82%** in 2019.

Target 8

Recycle all paper and use **100%** green tariff energy

PROGRESS: ON TRACK

All paper is recycled and we purchase **100%** renewable electricity from wind and hydro sources through our energy provider.

Target 9

Reduce carbon emissions within our business operations by **150,000 kg CO_2e**

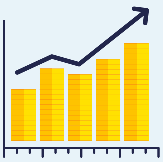
PROGRESS: ACHIEVED

Our carbon emissions decreased by almost **1.2 million kg CO_2 e**[1] between 2016 and 2019[2].

Sustainable & Responsible

Target 10

Maintain financial strength and ability to grow through maintaining Total Capital Ratio in excess of **20%**



PROGRESS: ON TRACK

We remain on track. The Society's Total Capital Ratio was **41.0%** in 2019.

Target 11

Achieve better than the industry average for Financial Ombudsman Service (FOS) upheld complaints

PROGRESS: ON TRACK

On average **11%** of FOS complaints were upheld in favour of our customers[3]. The average for all financial businesses during this period was **29%**[4].

Target 12

Increase the number of active members engaged on TalkingPoint to **2,500**

PROGRESS: ACHIEVED

In 2019, **2,540** of our members were actively involved on TalkingPoint giving their views and helping to shape our decisions.

[1] "Carbon dioxide equivalent" or "CO_2e" is a term for describing different greenhouse gases in a common unit
[2] For reporting against our targets we follow a 'market-based' method that takes into account the procurement of renewable electricity from the market. Emissions have been calculated using DEFRA emission factors for the relevant years
[3] Period covers between 1 January to 30 June 2019
[4] We are using the latest publicly available data from the Financial Ombudsman Service

Corporate Responsibility

Continued

Money & Homes

In 2019, we lent £747 million to first time buyers, which has helped us surpass our published target of helping 30,000 first time buyers a year ahead of target.

Supporting those less well served by the wider market

According to the Office for National Statistics, in the next 50 years there is projected to be an additional 8.2 million people aged 65 years and over in the UK (a population roughly the size of present-day London[5]). We responded by becoming the first national high street lender to launch a Retirement Interest Only product for older borrowers. This new type of product is designed to give flexibility in older age; it can help fund retirement lifestyle choices or help existing interest only customers continue with their mortgage.

Equally, our product range has been carefully considered to support those who are not already on the housing ladder. The challenge of saving up for a deposit can be a significant obstacle facing anyone wanting to buy their first home. We remain strongly committed to the shared ownership model, whereby a customer buys a part of a property and rents the remaining part. This is opening up more opportunities for more people across the UK and we now have nearly 40,000 shared ownership customers, making up an important part of our lending.

Members & Communities

As a mutual, we are founded on the principle of people helping people. Our business model means we bring savers and borrowers together to create a mutually beneficial relationship in which both help to secure the other. Over the past year we have maintained our member satisfaction score at 91% and above our published target of 90%. We are also committed to making a positive social contribution to the communities in which we operate and in 2019, together with our colleagues and members, we invested the equivalent of over £541,000 through time and donations.

Delivering a positive customer experience

Trustpilot

As a responsible business we are committed to improving customer service and giving our members the best possible experience. In 2019, the Society retained its Fairer Finance 'Gold Ribbon' for savings products for the second year and was rated '4 Star' on consumer review site Trustpilot[6].

Some of the changes we have been making include:

- A new Faster Payments service to improve the speed and security of transactions. To date we have moved £50 million by Faster Payments while reducing cash handling and cheque processing in branches; and
- Progression of our operational transformation programme, helping to simplify, standardise and automate many high-volume manual processes, resulting in a smoother, faster service all round.

Investing time and skills into communities

Our volunteering scheme offers every colleague up to 14 hours volunteering time to support their communities. We had our highest ever participation rates in 2019, with 63% of colleagues choosing to volunteer. Collectively, we invested over 6,000 hours into community projects around the UK, which has an equivalent value of over £160,000.

According to the FCA young adults aged 18 to 24 have average unsecured debts of £1,460 and are the UK's fastest growing group in debt[7]. Research also shows only 41% of 16 to 17 year olds are able to correctly read a payslip and 18% are unable to correctly identify how much is in a bank account from looking at a bank statement[8].

We understand the importance of good money management and our colleagues are passionate to share their knowledge with students. In 2019, we piloted financial education workshops in two local Leeds schools, in which our colleagues delivered workshops on 'budgeting' and 'spending and saving'.

Samaritans

2019 marked the second year of our charity partnership with Samaritans and our commitment to help them be there when it matters.

Samaritans answer a call for help every six seconds. Last year, Samaritans answered 3.6 million calls for help over the phone. Increasingly though, people are using messaging channels. In 2018, the charity responded to 675,000 texts and 330,000 emails.

5. https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/articles/overviewoftheukpopulation/august2019
6. Rating correct as 27 December 2019
7. https://www.fca.org.uk/news/speeches/high-cost-credit-what-next
8. https://masassets.blob.core.windows.net/cms/files/000/000/655/original/MAS_Financial_Capability_of_Children_Young_People_and_their_Parents_in_the_UK_Mar17_Final.pdf

The funds we have raised have been ring-fenced to pay for new technology, which ranges from Chrome Books (computers) to new phone lines. The new technology will enable Samaritans to continue to provide support for people, in ways that feel natural to them.

One of the first areas of the country to receive the new technology was Samaritans Aberystwyth. In 2018, Aberystwyth responded to over 2,800 calls for help, sent 89 email replies and 68 SMS responses to support people who were going through a difficult time. Since the arrival of new branch technology, there has been a 52% increase in the number of phone calls, emails and texts answered by Samaritans Aberystwyth in September/October 2019 compared to the same period in the previous year.

Viv, a volunteer at Samaritans Aberystwyth says: "Thanks to the introduction of the new branch technology, we can answer more calls than before because we have gone from just two stations to three. With more volunteers on duty, we're able to respond to more people who are struggling to cope."

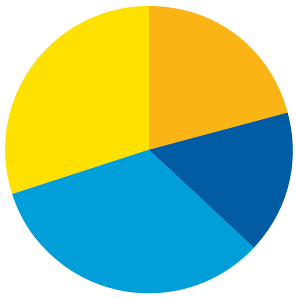
Hearing the difference our fundraising efforts are making to Samaritans volunteers and callers has continued to motivate colleagues and members to support the partnership, and since starting the partnership in 2017 over £306,000 has been raised.

Rhinos takeover

The Society has been the headline sponsor of the Leeds Rhinos since 2007. In September 2019, for one special game, the Society gifted its prized shirt sponsorship of the Rhinos to Samaritans. The #MakingSpaceForSamaritans campaign was designed to raise awareness of mental wellbeing and the important work of Samaritans. It was broadcast to TV viewers across the country through Sky Sports.

The Society, its members and colleagues invested £541,750 in communities in 2019. This includes cash donations of £381,500 and a time equivalent value of £160,250.

Inputs – where our giving comes from



Total Giving £541,750

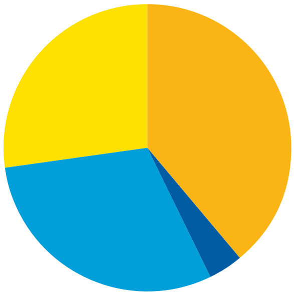
- Member donations – £114,000
- Society donations – £179,000
- Colleague fundraising – £88,500
- Value of volunteering hours[9] – £160,250

9. Value of time includes colleagues volunteering and community based colleague secondments.

Corporate Responsibility

Continued

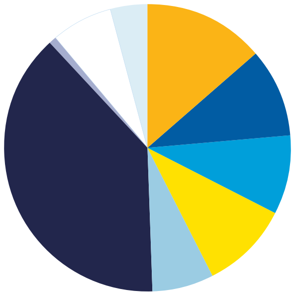
Outputs – where our giving goes



Total Giving £541,750

- Other charities & local causes - £211,750
- Community rewards scheme - £22,250
- Samaritans - £160,500
- Leeds Building Society Foundation -£147,250

Foundation funding by theme



- Disadvantaged – £23,008
- Poverty – £16,068
- Homelessness – £14,150
- Life limiting health issues – £15,267
- Illness – £10,951
- Mental or physical disability – £62,023
- Caring responsibilities – £1,800
- Social inclusion – £10,806
- Other - £6,017

Leeds Building Society
Foundation

The Leeds Building Society Foundation makes donations to UK charities which are improving the lives of people who are disadvantaged or in vulnerable circumstances.

In 2019, the Foundation gave its highest number of grants to date with more than £160,000 donated to 182 charities. This high number of successful applications contributed to the Foundation reaching a significant milestone in its history; surpassing £2 million in donations since its inception in 1999.

In 2019, Trustees agreed to refocus the Foundation's grant giving towards smaller registered charities with annual turnovers of less than £1 million. Smaller charities make a significant contribution to local communities and, with limited funding available for distribution, Trustees consider their need to be greater.

People & Places

Overall colleague engagement in 2019 remained at 82% and we continue to see a high proportion of colleagues giving their views through our "Your Voice" colleague survey each year (95%). The vast majority of our colleagues (91%) tell us they know how their work contributes to the success of the Society and they are clear about what they are expected to achieve in their role (90%).

Climate change remains an important focal point for the Society and in this year's Annual Report and Accounts we have broadened our carbon reporting to incorporate our travel data. The Society first achieved the Carbon Trust Standard for Carbon in 2017 and in 2019 we were recertified for demonstrating ongoing reductions and robust carbon management.

Our Fair Pay Charter

Our colleagues are vital to the success of the Society and to making sure our members receive the best possible service. We think it is only right they share in the Society's successes and we have always strived to make sure they are fairly rewarded.

We have taken this one step further by publishing our Fair Pay Charter, which commits us to:

- aligning executive directors' and colleagues' pension contributions;
- fair salaries based on role, skills, performance and external benchmarks;
- objective pay decisions made regardless of gender, age, ethnicity, disability, sexual orientation or any other protected characteristics;
- competitive total reward package for all colleagues. This includes a range of health and wellbeing options; and
- listening to our colleagues through our Colleague Association for salary and reward decisions.

Paying the Real Living Wage

Underpinning our purpose to help people save and have the home they want, we are proud to have paid at least the Real Living Wage to all our colleagues since 2014. Set by the Living Wage Foundation, this is higher than the government's minimum, or National Living Wage and is an independently calculated hourly rate of pay based on the actual cost of living.

With 'in-work poverty' rising even faster than employment[10] fair pay has never been more important. In 2019, we extended the Real Living Wage to our third party contracted colleagues (people who regularly work on our sites but are not directly employed by us). This includes cleaning and security colleagues.

The Real Living Wage is the only rate calculated according to what people need to make ends meet. It provides a voluntary benchmark for employers that choose to take a stand by ensuring their staff earn a wage that meets the costs and pressures they face in their everyday lives. The UK Living Wage is currently £9.30 per hour. There is a separate London Living Wage rate of £10.75 per hour to reflect the higher costs of transport, childcare and housing in the capital. These figures are calculated annually by the Resolution Foundation and overseen by the Living Wage Commission, based on the best available evidence on living standards in London and the UK.

Continuing our focus on mental health in the workplace

We have continued to invest in mental health, with 51 colleagues trained as Mental Health First Aiders, providing support, guidance and signposting to others who may be experiencing a mental health concern. Further information on our approach to mental health can be found on page 17.

Creating a diverse workplace

We launched our diversity & inclusion strategy in 2017 with the ambition to 'have an inclusive culture, which enables colleagues with a diverse range of skills, experiences, backgrounds and opinions to flourish, without barriers.' Further information on the steps we have taken in 2019 can be found on pages 16 to 17.

Emissions reductions

Since 2016 (our baseline year) we have reduced our scope 1 and 2 emissions (diesel, electric, gas) by 1,188,900kg CO_2e using a 'market-based' approach, which is the equivalent of taking 575 average-sized cars off the road for a year[11]. This method of reporting reflects the decision we have taken to purchase 100% renewable electricity, backed by Renewable Energy Guarantees of Origin (REGO) certificates, for all our sites.

10. https://www.jrf.org.uk/report/uk-poverty-2018
11. Based on average-sized petrol cars off the road (each doing 7,100 annual mile average)

Corporate Responsibility

Year ended
31 December 2019

Continued

Using a location-based approach, which does not include the purchase of renewable electricity; our emissions have decreased by 473,388kg CO_2e since 2016[12].

Widening our scope of reporting

For greater transparency we have widened our scope of carbon reporting in this year's Annual Report to include scope 3 travel data (air, car, train) from 2017 onwards. To enable comparisons to be made to previous years, this new data has not been used as part of the calculation to determine progress towards our external target to reduce carbon emissions within our business operations by 150,000 kg CO_2e by the end of 2020 (see page 23).

CARBON TRUST STANDARD
REDUCING CO2 YEAR ON YEAR

In 2019 we were recertified with the Carbon Trust Standard for Carbon. This is a voluntary certification and mark of excellence which is only awarded to organisations that can demonstrate they have reduced their carbon footprint and have the right processes in place to continue to reduce in the future.

Market based approach

CO_2e emissions (kg)	2016	2017	2018	2019
Scope 1				
Diesel	6,285	2,410	–	–
Gas	101,832	106,859	60,731	**50,303**
Total scope 1	108,117	109,269	60,731	**50,303**
Scope 2				
Purchased electricity	1,131,086	–	–	–
Total scope 2	1,131,086	–	–	–
Total scope 1 & 2	**1,239,203**	**109,269**	**60,731**	**50,303**
Scope 3				
Air travel	N/A	11,715	10,889	**12,469**
Car mileage	N/A	155,390	130,474	**113,465**
Rail travel	N/A	38,226	40,772	**31,200**
Total scope 3	N/A	205,331	182,135	157,134
Total scope 1, 2 & 3	**1,239,203**	**314,600**	**242,866**	**207,437**

12. Carbon data is unaudited and a proportion of the Society's electricity and gas data is based on estimated meter readings. We are committed to ensuring data is as robust as possible for carbon reporting and the Society is in the process of installing automated meters at all sites across the UK. We use the UK government's emission factors for each year of reporting.

Location based approach

CO_2e emissions (kg)	2016	2017	2018	2019
Scope 1				
Diesel	6,285	2,410	–	**–**
Gas	101,832	106,859	60,731	**50,303**
Total scope 1	108,117	109,269	60,731	**50,303**
Scope 2				
Purchased electricity	1,532,932	1,336,002	1,072,524	**1,117,357**
Total scope 2	1,532,932	1,336,002	1,072,524	**1,117,357**
Total scope 1 & 2	**1,641,049**	**1,445,271**	**1,133,255**	**1,167,660**
Scope 3				
Air travel	N/A	11,715	10,889	**12,469**
Car mileage	N/A	155,390	130,474	**113,465**
Rail travel	N/A	38,226	40,772	**31,200**
Total scope 3	N/A	205,331	182,135	157,134
Total scope 1, 2 & 3	**1,641,049**	**1,650,602**	**1,315,390**	**1,324,794**

Thinking differently about waste

With over 1,400 colleagues in our 54 branches, contact centre and head office sites we use a variety of materials in the course of doing business. In 2019, we took steps to reduce waste and improve the sustainability of the products we consume, including:

Removing plastic passbook covers

Our passbooks offer our customers a valued record of their savings with us. Each year our branch network issues around 33,000 plastic wallets for additional protection. We know we must act against the unnecessary use of plastic so we have decided to stop offering these wallets. We already make our passbooks sturdy so they can withstand printing and regular use and this decision will avoid the use and disposal of the equivalent of 233kg of plastic.

13. https://www.wearedonation.com/about/

Rethinking volunteering apparel

The T-shirts our colleagues wear when volunteering have been redesigned to be fully traceable. This means colleagues can see who made the garment at every stage of the process from growing the cotton to printing. They are also manufactured to the highest environmental standards and made from organic cotton. Once T-shirts become worn or no longer fit for purpose, or a colleague leaves, we give the garments back to our manufacturer to recycle into new T-shirts.

Encouraging sustainable behaviour change

In 2019, the Society teamed up with Do Nation to support our colleagues to make sustainable lifestyle changes. From taking the stairs to cutting down on meat consumption, during the one month campaign over 100 pledges were made by colleagues. The pledges were estimated to save almost 3,000kg CO_2 or the equivalent of 27 flights from Glasgow to Amsterdam. According to Do Nation there is a 54% chance people will stick to their pledges for two months and a 42% chance they will continue for a year, or more[13].

Corporate Responsibility

Year ended
31 December 2019

Continued

Sustainable & Responsible

According to the 2019 Edelman Trust Barometer report, financial services remains the least-trusted sector. 70% of respondents in their global survey believe it is important for financial services to lead on social issues that make the world a better place for everyone[14]. Our mutual model means members can have reassurance we act in their best interests. We will continue to work on improving our transparency in our Annual Report.

Paying our tax fairly

In 2019, the Society was reaccredited with the Fair Tax Mark. This recognises our commitment to pay the right amount of corporation tax, at the right time and in the right place. Tax is one of the main ways we contribute to society and it funds the vital public services our members, colleagues and communities rely on.

In research released during Fair Tax Week in 2019, our members told us just how important it is for successful and profitable businesses to pay their way. Using our TalkingPoint panel we found:

- 93% of those surveyed said financial services businesses should have to publicly disclose how much tax they pay in the UK;
- 89% said all financial services organisations should commit to not using tax havens or tax avoidance practices;
- 79% said they would trust an organisation with the Fair Tax Mark more than one without the accreditation; and
- 79% said they would consider switching their account if they discovered their provider was not paying their fair share of tax.

In 2019, the Society paid almost £19 million in corporation tax with an average current tax rate over the last four years (excluding the banking surcharge) of 20%. Together, including taxes paid as part of our responsibilities as an employer, we have contributed over £50 million in 2019, through payment of taxes.

Our Tax Strategy

Launched in 2018, this publicly commits us to:

- not maintain any connection to tax havens, other than for legitimate trading activity with the purpose of serving the local community in that jurisdiction;
- not use marketed or abusive tax avoidance schemes, which are likely to fall foul of tax avoidance legislation in any jurisdiction in which we operate. This means we act in the spirit of what the law intends, not just following it to the letter; and
- seek to declare profits in the jurisdiction where their economic substance arises and report our tax position clearly in our Annual Report & Accounts. Full disclosures including country by country reporting can be found on page 191.

Our full tax strategy can be found at: www.leedsbuildingsociety.co.uk/your-society/tax-strategy/

14. https://www.edelman.com/research/trust-in-financial-services-2019

Taxes paid by the Society	2019 £'000	2018 £'000
– Corporation tax	**18,877**	23,320
– Banking surcharge (plus Irish bank levy)	**5,694**	7,854
– Value Added Tax (VAT)[15]	**6,777**	4,293
– Employers National Insurance contribution	**4,809**	4,754
– Business rates	**1,638**	2,110
– Apprenticeship Levy	**232**	226
Taxes paid by colleagues collected on behalf of HMRC		
– PAYE (income tax)	**9,051**	8,890
– Employees National Insurance contributions	**3,471**	3,370
Total tax contribution	**50,549**	54,817

Listening to our members
Our online member panel, TalkingPoint, remains a source of valuable feedback for us. Our public target to grow the numbers of actively engaged members on TalkingPoint was met in 2017. There are now 2,540 actively engaged members providing input on a range of topics and helping to inform how we do business.

Benchmarking our performance
The Society is a member of Business in the Community, the Prince's Responsible Business Network. In 2019, we took part in its Responsible Business Tracker® for the second time. This tool is aligned with the United Nations Sustainable Development Goals (SDGs) and measures performance across a range of responsible business indicators. Results will be used to independently assess our progress and help shape the future direction of our approach to responsibility.

BUSINESS IN THE COMMUNITY

The Prince's Responsible Business Network

Policies
Policies and standards underpin our responsible business strategy, setting out how colleagues are expected to behave and the parameters for decision making. Additionally, the Society's tax strategy, Board Diversity Policy and modern slavery statements can be found on our website.

Corporate Responsibility Steering Group
The Corporate Responsibility Steering Group is responsible for providing strategic direction for corporate responsibility at the Society, supporting the integration of responsible business practice into the way we operate and measuring progress against our 2020 targets. In 2019, it was chaired by the Society's Chief Transformation Officer.

During the year, the Steering Group has reviewed internal metrics and public targets, discussed future responsibility trends, appraised progress against key accreditations and has prepared an update for the Board.

Alongside the Corporate Responsibility Steering Group, the Society has a number of other working groups focusing on specific corporate responsibility priorities. These include mental health, gender diversity and BAME forums.

15. The Society is only able to reclaim a proportion of VAT paid for products and services acquired

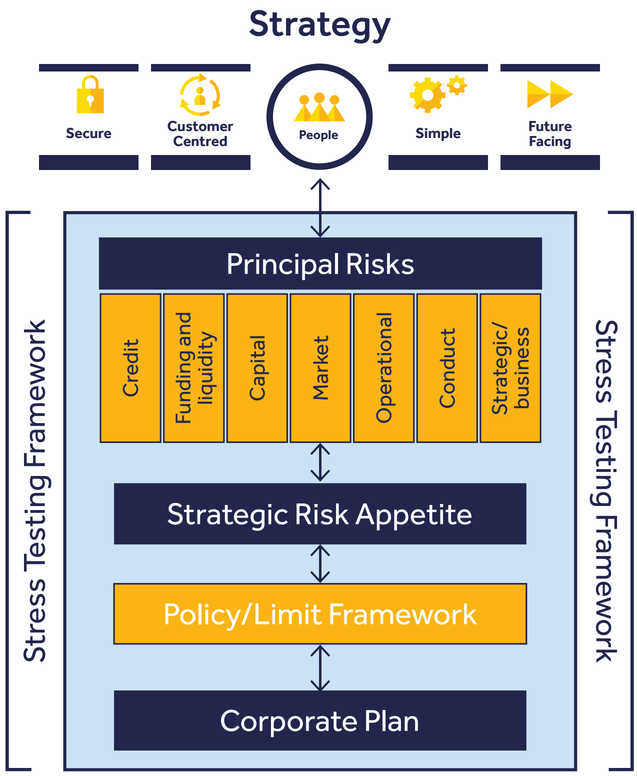
Principal Risks

Year ended
31 December 2019

The Society's vision of becoming Britain's most successful building society can only be achieved if risks are taken and managed effectively. By understanding the nature of our risks, the Board is in a position to make informed decisions that support our longer term viability and protect members' interests.

We deliver our vision through a corporate strategy, which is built upon our strategic pillars (as described on page 10). Inherent within this strategy, are seven principal risk categories.

These are: credit; funding and liquidity; capital; market; operational; conduct; and strategic/business risks. For each of these principal risk categories, we operate appropriate systems of control including a Board defined Strategic Risk Appetite and a suite of policies approved through the committee process. These set the risk parameters within which the corporate plan needs to be delivered, as well as providing appropriate triggers for management response under stressed conditions.



The seven principal risk categories are influenced by underlying subsets of risk types, which comprise our risk universe. Over time, the nature and profile of these underlying risks continue to evolve, reflecting changes in the economic/business cycle and our strategy. Accepting that it is not possible to identify, anticipate or eliminate every risk that may materialise and that risk is an inherent part of doing business, our risk management processes (described on pages 78 to 83) aim to provide reasonable assurance that the Board and management understand, manage and monitor the main uncertainties, which we face in achieving our objectives.

During 2019, there was no change in our principal risk categories; a review is scheduled for 2020. The current risk profile associated with these risks is summarised below, along with how we seek to mitigate these risks. The principal risk categories are not presented in order of materiality, as they all have the potential to affect future performance, depending on the prevailing circumstances. Our current top five emerging risks, which could affect the delivery of our strategy (and may cut across principal risk categories), are set out in the Emerging Risks section on page 38.

Principal risk	Mitigation	Commentary
Credit risk – retail		
• The risk that residential or commercial borrowers are unable to make their loan payments. • This risk arises from the Society's residential lending activities and legacy credit portfolios.	• Focus on lending where the Society has specific expertise. • Board defined risk appetite, which is supported by policies, limit frameworks and management reporting. • Continuous review of performance versus appetite. • Forward looking assessments of adherence to appetite and limits. • Robust underwriting processes including the use of credit scoring models, affordability stress testing, automated decisioning and suitably qualified underwriters. • Independent appraisal of collateral. • Dedicated second line Credit Risk team providing oversight of the Society's lending portfolios. • Retention of appropriately skilled colleagues to manage the ongoing wind down of the legacy euro and commercial portfolios. • Stress testing to assess vulnerabilities within credit portfolios and inform pre-emptive actions. • Benchmarking of credit controls and performance.	• Overall indexed LTV of the UK mortgage book has reduced from 54.6% in 2018 to 53.8% in 2019, driven by positive house price growth and a lower LTV for new lending year-on-year. • We have grown the size of the buy to let book (31% versus 29% in 2018) while maintaining lower than average LTVs and higher than average interest coverage ratios. • Only 6% of new lending in 2019 had a loan to income ratio greater than 4.5 times (5% in 2018), which is significantly below industry averages and the regulatory limit of 15%. • Strengthened credit controls with regards to treatment of customer indebtedness and maintained tighter credit scorecard cut-offs for customers with weaker affordability positions and/or higher LTVs. • Maintained arrears levels lower than UK Finance averages while focusing on improvements to processes and customer experience. • Evolved the approach to IFRS9 and implemented a second downside scenario in line with evolving best practice. • IFRS9 provision coverage rates remained relatively stable during the year, with the proportion of balances at stage 3 1.0% (2018: 1.1%). • We have continued to reduce our legacy exposures, with total commercial and euro balances of £100 million at the year end (2018: £123 million).

Principal Risks

Year ended
31 December 2019

Continued

Principal risk	Mitigation	Commentary
Credit risk – wholesale		
• The risk that wholesale counterparties default on their obligations. • This risk predominantly emanates from the Society's liquidity holdings and derivative portfolio, which is used for hedging market risk.	• Board defined risk appetite, which is supported by the Wholesale Credit Policy (including concentration limits). • Monthly review of performance versus appetite (more frequent during times of stress). • Each counterparty credit line is reviewed at least annually, based on an internal analysis, credit default swap spreads, geographic location and other market intelligence. • A dedicated first line team monitors the portfolio on a daily basis, with oversight provided by the Risk function. • Daily exchange of collateral through clearing and other netting arrangements for derivative exposures.	• During 2019, the composition and credit quality of the wholesale portfolio, relative to our balance sheet and risk mitigation strategies, has remained stable. • As at the end of 2019, 100% of the portfolio was invested with counterparties with an external credit rating of A- or better (2018: 100%). • The majority of our derivative portfolio is centrally cleared, which mitigates bilateral counterparty risk. Where this is not possible, derivative exposures are restricted to high quality counterparties and are managed with collateral and netting arrangements.
Funding and liquidity risk		
• Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due. • The Society's primary liquidity risk exposures arise through withdrawal of retail deposits where customers are permitted to withdraw funds with limited or no notice. • Funding risk is defined as the inability to generate sufficient funding, or only do so at excessive cost. • This risk applies to both the Society's retail and wholesale franchises.	• Board defined risk appetite, which is supported by the Funding and Liquidity Policy (including concentration limits). • A dedicated first line team monitors the Society's liquidity position daily, with oversight provided by the Risk function. • Conducting an Internal Liquidity Adequacy Assessment Process (ILAAP), at least annually, to determine the level of liquidity resources required under stressed conditions. • Maintenance of a portfolio of high quality liquid assets. • Access to central bank funding, through pre-positioned collateral. • Monthly review of performance versus appetite (more frequent during times of stress). • Frequent stress testing to understand the impact of severe but plausible scenarios and to inform pre-emptive actions. • Maintenance of a recovery plan, including liquidity actions.	• As at the end of 2019, we retained a strong liquidity position, which was comfortably above minimum regulatory requirements (Liquidity Coverage Ratio (LCR) of 235%). • Our funding profile remains predominantly funded by retail savings (76% of Share and Deposit Liabilities) through a strong retail franchise. • We also support funding requirements through our well established wholesale franchise. Here, we retain access to capital markets through a diversified investor base. During 2019, we utilised this investor base to issue a £600 million covered bond and a £400 million securitisation (Albion No. 4). • Capital market access is also supported by our strong credit ratings (Fitch: A- and Moody's: A3). During the year, the outlook on our credit rating was downgraded from stable to negative by both Fitch and Moody's, reflective of challenges within the UK operating environment. Following the outcome of the General Election in December, Fitch revised the outlook for our credit rating back to stable.

Principal risk	Mitigation	Commentary
Market risk		
• The risk that market movements adversely impact the Society. • The Society's market risk exposures mainly relate to interest rate risk (including basis and optionality risks) and foreign currency risk.	• Board defined risk appetite, which is supported by the Market Risk Policy (including concentration limits). • A dedicated first line team monitors the Society's market risk exposures frequently, with oversight provided by the Risk function. • The offsetting of assets and liabilities and use of derivatives to manage market risk positions. • Where a natural hedge is not feasible, derivatives are used to hedge market risk exposures. • Where possible the Society applies the hedge accounting rules under IFRS to mitigate volatility through the income statement arising from changes in market rates. • Frequent stress testing to understand the impacts of movements in interest and foreign exchange rates on the Society to influence the desired balance sheet shape. • Monthly review of performance versus appetite (more frequent during times of stress).	• During 2019, our interest rate risk profile and mitigation approaches have remained broadly unchanged. Management continue to closely monitor swap volatility and respond accordingly. • We operate with a small foreign exchange exposure relating to wholesale funding activity and a legacy residential mortgage portfolio in Spain. These exposures continue to be managed comfortably within Board approved limits. • We have commenced the implementation of our plan for the transition towards the market reference rate SONIA from LIBOR, which is to be phased out by 2021. • We have further developed our interest rate stress testing capabilities during the year, aligned to European Banking Authority (EBA) Guidelines. • We have continued to evaluate and monitor the impact of macro-economic and market competition risk, as set out on page 38, on our market risk strategies and positions.
Capital risk		
• The risk that the Society has insufficient quality or quantity of capital resources to meet current or future business requirements.	• Board defined risk appetite, which is supported by the Capital Policy and Capital Strategy. • Monthly review of performance versus appetite. • Conducting an Internal Capital Adequacy Assessment Process (ICAAP), at least annually, to determine the level of capital required to support current and future business activities. • A dedicated first line team monitors the Society's capital position, with oversight provided by the Risk function. • Stress testing to understand the impact on the Society's capital position, under a range of severe but plausible scenarios. • Maintenance of recovery plan actions. • Progression of capital plans with regards to potential future MREL requirements.	• We maintain strong capital ratios, with capital resources significantly above minimum regulatory requirements. • As at 31 December 2019, our Total Capital Ratio stood at 41.0% (2018: 38.5%), as the growth of capital resources outpaced the growth in capital requirements over the year. • Our leverage ratio reduced marginally during 2019 to 5.3% from 5.5% in 2018. • We continue to plan for, and respond to, regulatory reforms in respect of capital, including the potential requirements of MREL. • A key strategic priority for us in 2020 is capital optimisation, to ensure that we are investing our capital as efficiently as possible, within the parameters of risk appetite.

Principal Risks

Year ended
31 December 2019

Continued

Principal risk	Mitigation	Commentary
Operational risk		
• The risk of financial or reputational loss, as a result of inadequate or failed processes, people, systems or external events. • The drivers of operational risk are: legal and regulatory; people; information security (including cyber); IT; business continuity; data (including modelling); financial crime; and financial reporting risks. • Alongside operational risk, the Society also considers operational resilience (defined as the ability of the Society to prevent, adapt, respond to, recover from and learn from operational disruptions).	• Board defined risk appetite, which is supported by an appropriate suite of operational risk related policies. • Monthly review of performance versus appetite. • Maintenance of an operational risk management framework, outlining the process for identification, assessment, mitigation and monitoring of operational risks, incident management protocols and reporting operational losses. • Risk control self-assessments, control testing and oversight procedures to validate the control environment. • Maintenance of an operational resilience framework and associated testing programme to ensure the provision of resilient services to members. • Training to ensure that colleagues possess the necessary skills and knowledge to fulfil their role. • Risk-based approach to mitigate the financial crime risks the Society faces, reflecting the current and emerging financial crime risks within the market. • A Model Risk Policy, outlining the minimum requirements for the development, maintenance, validation and implementation of models across the Society.	• We continued to embed and refine our operational risk management framework during 2019, which included an upgrade of our enterprise risk management system to further enhance risk and control reporting. • Significant management focus has been placed on developing and implementing an operational resilience framework, designed to prevent business disruption and where this does occur, minimise potential impacts. • As part of implementing the new resilience framework, we have revised our approach to the management of third party service providers, mapped out our business critical services and also conducted business continuity exercises across business critical departments. • Further investment has been made in our IT systems and cyber capabilities to enhance the control environment and resilience. • We have continued to embed revised model risk governance arrangements on an enterprise wide basis (to provide enhanced levels of challenge and oversight across a broader suite of models than previously).

Principal risk	Mitigation	Commentary
Conduct risk		
• The risk that actual or potential customer detriment arises, or may arise, from the way the Society (or third parties), conducts its business. • This risk arises from the design and ongoing suitability of the Society's products and pre and post sales activities.	• Board defined risk appetite, which is supported by the Conduct Risk Policy. • The Society operates a focused business model with limited complexities relative to larger financial institutions that could adversely impact customers. • The product governance framework ensures that products are only developed to meet customer needs and to assess their ongoing suitability. • Processes and controls are in place to ensure product literature is clear and transparent. • Customer facing colleagues are suitably trained, with competency assessed on an ongoing basis. • Through the operation of the three lines of defence model, the Risk and Internal Audit functions oversee and monitor business/colleague activities. • The Society's Complaints Handling Policy and supporting arrangements ensure that complaints are addressed with empathy and sensitivity through a fair and transparent process.	• While there has been no significant overall movement in our conduct risk profile, the volume and scale of regulatory change has continued. In response, we have directed significant project and compliance resources in this area. • Oversight teams continue to deliver risk based plans, which are externally benchmarked, to monitor conduct risks. The oversight findings were reported to the Conduct and Operational Risk Committee. • We continue to monitor the external environment, in order to understand and take necessary actions in relation to any emerging conduct risks. • Increased focus on the conduct of third parties, under our resilience framework which remains a key priority for us.
Strategic/business risk		
• The risk that the Society is unable to deliver its strategic objectives. • This risk mainly relates to poor execution of the Society's strategy or changes within its operating environment, which threaten the sustainability of its business model.	• The strategic planning process sets the business direction and investment activity in the context of the changing regulatory, technological and competitive landscape. • Board defined appetite, which is supported by a suite of appropriate policies. • The Board approved corporate planning process makes an assessment of the business environment on a quarterly basis. • Enterprise risk reporting, including horizon scanning, assesses the Society's general operating environment. • Thematic reviews assess competitor/ market performance. • The Society utilises stress testing to understand its performance under a variety of severe but plausible scenarios.	• Strong levels of competition remain evident within our core markets from established players and new entrants, which continue to erode margins. • Significant focus has been given to the positioning of our business model, future plans and investment activity in the context of emerging technologies and customer platforms. • During 2019, the UK's departure from the EU and the associated uncertainty has continued to provide the backdrop to our operating environment. This uncertainty has supressed activity within the UK housing market and demand for mortgages. • Customer preference for different mortgage and savings durations continues to influence the term structure of our balance sheet. • Although our cost income ratio increased during the year (53.5% versus 44.8% in 2018), driven by further investment in operations and reduced income, we continue to maintain an efficient business model.

Principal Risks

Year ended
31 December 2019

Continued

Emerging risks

Within the context of our principal risk categories, we continue to identify, assess and monitor emerging risks through our Enterprise Risk Management Framework, described on pages 78 to 83. These are new or evolving risks where the impact is uncertain. In assessing emerging risks, we consider the likelihood of the relevant risk materialising and the potential impact on our business strategy and stakeholders. These risks are considered by the Board and the Board Risk Committee, as part of our strategic and business planning processes and throughout the year. As at the end of 2019, we considered the following as our top emerging risks:

Macroeconomic and political risk

Political uncertainty regarding the UK's departure from the EU continued to provide the backdrop to our operating environment during 2019. As a consequence, recent economic activity has been subdued, as businesses and consumers waited for further clarity to emerge.

Following the UK General Election in December, Parliament passed the Withdrawal Agreement, with the UK leaving the EU on 31 January 2020. However, delays to the exit process to date have compressed the timescales to agree the future relationship between the UK and the EU, with the initial transitional period due to expire at the end of 2020. Although we are a UK centric business, with limited exposure to the EU, the wider impacts of leaving the EU without appropriate longer term arrangements would likely have more material implications for the UK economy and more broadly financial service providers.

We consider macroeconomic and political risks on a regular basis, under both central and stressed conditions in order to understand and manage the impact on its business model. With regard to Brexit specifically, we have considered potential impacts across relevant principal risk categories, under a range of outcomes and formulated proportionate response plans.

Competition and business model risk

Competition within UK financial service markets remains very strong. The impact of newly ringfenced banks refocusing on their mortgage propositions and also the refinancing of the BoE's Term Funding Scheme, is expected to intensify competition further, potentially leading to higher levels of customer attrition and lower margins.

Furthermore, the development of new IT/software solutions by the large established banks and also new Fintech companies to enhance customer offerings has the potential to threaten our core market and service proposition. In particular, the advent and expansion of Open Banking is expected to heighten competition further, over the medium term.

We carefully consider these risks as part of our strategic/business planning activities, which have set the future path for strategic investment and development to ensure that the Society is able to adapt accordingly.

Operational resilience risk (including cyber risk)

Operational resilience remains a key focus area for us, to ensure that our systems and processes are able to cope with increased customer demand and provide resilient services to our members.

Cyber crime continues to be a threat across both financial and non financial industries as organisations take advantage of new digital technologies in their product and service propositions. The frequency and sophistication of these threats continues to evolve and increase, through ransomware, malware or Distributed Denial of Service ('DDoS') attacks.

In response to these challenges, we have developed and are in the process of embedding, an operational resilience framework, to enhance and align our approach across the various 'resilience' disciplines (including IT services, cyber, business continuity and third party management). Supporting this framework is our cyber strategy, which is focused on managing key threats through investment in technology, processes and colleague awareness. This ensures that appropriate risk based measures are in place to monitor the threat landscape and to protect members and our assets.

Regulatory change risk

The volume, scale and complexity of regulatory change continues to shape our operating environment. There are currently a significant number of regulatory initiatives in the process of implementation, which may require prioritisation over business led initiatives.

In particular, there has been focused momentum by regulatory bodies and industry participants to strengthen practices in order to combat the growing threat of Authorised Push Payments (APP) through the Contingent Reimbursement Model. Separately, there will be industry embedding of Fifth Money Laundering Directive requirements, planning for the Sixth Money Laundering Directive (or equivalent UK requirements, post Brexit) as well as industry progression and application of Confirmation of Payee requirements for appropriate firms. While some of these initiatives are being progressed at different paces at an industry level, with an initial focus on large institutions, the continued progression of fraud prevention controls in response to a changing threat profile remains a key priority for us.

We closely monitor upstream regulation, with developments managed through an oversight framework, which allows management to respond in an efficient and proportionate manner.

Climate change risk

We recognise that climate change is a critical global issue that has significant implications for our operations, members, colleagues and suppliers. The risks surrounding climate change to our business can be classified as either physical (weather related such as flooding of mortgaged properties) or transitional (movement towards a low carbon economy, for example, government initiatives to reduce carbon usage, such as minimum property energy performance ratings).

During 2019, the PRA issued a policy statement for managing the risks associated with climate change. In response, we submitted a high level plan to the regulator outlining our approach to integrating climate change risks into our Enterprise Risk Management Framework, on a proportionate basis. The implementation of this plan will be a focus area for 2020, with oversight from Board Risk Committee (BRC).

Viability Statement

Year ended
31 December 2019

In accordance with the UK Corporate Governance Code, the directors have formally assessed the longer term prospects and viability of the Society, taking into account our current financial position and considering the potential impact of the principal and emerging risks set out on pages 32 to 39.

Longer term prospects

Our business model and strategic priorities are set out on pages 8 to 10. These are kept under review with the Board receiving regular strategic updates throughout the year and holding an annual strategy conference. Our prospects are considered over time periods up to five years and beyond.

These reviews considered the strengths of our business model and financial position, including our established savings franchise, capital strength and levels of profitability, as well as threats from the emerging risks reported on pages 38 to 39. In particular, the Board has considered the potential business models that could emerge in the mortgage and savings markets as a result of digital innovation and our responses to these.

The actions identified as part of these reviews are brought into the corporate planning process and embedded into corporate priorities with the intention of managing and mitigating the impact of these threats and maintaining the relevance of our business model.

Assessment period for viability

The directors have considered the viability of the Society over a three year period to 31 December 2022. The three year review period is considered appropriate for the following reasons:

- uncertainty regarding the economic, competitive and regulatory environments beyond the three year period reduces the reliability of a longer assessment of viability;
- the structure of most mortgages and fixed rate savings products, with a deal term and penalties for early cancellation, provides a reasonable level of certainty about levels of income generation over the three year period, from the balance sheet and pipeline existing at 31 December 2019;
- however, a significant proportion of our assets and liabilities are expected to mature within three years, including repayment of Term Funding Scheme drawings, meaning projections after this point become more assumption based; and
- key drivers of financial performance such as net interest income and impairment losses are heavily influenced by the level of market interest rates, house prices and unemployment which are more difficult to predict beyond a three year horizon.

Viability assessment activities

The corporate planning and stress testing processes assess our forecast financial performance under a range of scenarios against our strategic risk appetite. The following risk factors, among others, were specifically considered in the modelled scenarios:

- a recession causing a reduction in market interest rates resulting in reduced net interest income; and
- a downturn accompanied by a sudden increase in interest rates, which results in increased credit losses.

The directors have also reviewed our viability from a capital and liquidity perspective through the ICAAP and ILAAP. These processes assess our ability to withstand severe capital and liquidity stresses, in line with regulatory requirements, including new and emerging regulation where sufficient information is known about future requirements. They take into account potential management actions and consider the impact and credibility of those actions in mitigating the potential impacts of the stresses applied.

The introduction of IFRS 9 has increased the accounting volatility of stress testing impacts. Despite this, the ICAAP concluded that we maintain sufficient capital resources to meet regulatory requirements under the central planning scenario and also, with management action to reduce the level of new lending, under the modelled economic stress scenario.

The ILAAP similarly concluded that we are able to meet both internal risk capacity requirements and regulatory requirements under modelled stress scenarios.

For each of the principal risks identified on pages 32 to 37, stress testing has been performed to understand our ability to withstand extreme stress scenarios, including adverse movements in economic indicators greater than those experienced at any time previously, major dislocation and volatility in financial markets, significant liquidity outflows and severe operational risk events. This testing has demonstrated that we have the resources, measures and controls in place to manage and withstand such extreme events.

Our risk management process, as detailed on pages 78 to 83, includes ongoing monitoring and reporting of emerging risks and scenario analysis, enabling further enhancements to the control environment to adapt to these risks.

In particular, the above corporate planning and stress testing exercises consider the effects on our financial position and performance from a range of potential scenarios resulting from the UK's departure from the EU. Of particular note is the impact on impairment loss provisions, the sensitivity of which is illustrated in note 2 of the accounts on pages 133 to 137. In the range of scenarios considered, while impairment losses could increase significantly, we retain sufficient capital to meet our needs.

Conclusion

Based on the above assessments, the directors conclude that:

- Our business model remains appropriate and actions have been identified which are intended to enable us to remain relevant as the markets in which we operate evolve;
- We maintain an appropriate level of liquidity, sufficient to meet both the normal demands of the business and requirements which might reasonably arise in modelled stressed circumstances. The availability and quality of liquid assets are structured so that funds can reasonably be expected to be available to repay maturing wholesale funds and cover exceptional demand from retail investors;
- We have sufficient current capital resources in excess of regulatory requirements and credible plans to meet known future requirements, including MREL, under both central and modelled stressed scenarios; and
- While it is accepted that it is not possible to completely eliminate all risk, we have taken reasonable steps to put in place suitable operational capabilities to manage and mitigate the impacts of risk events to within reasonable tolerances.

Therefore, 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 2022.

Financial Review

Year ended
31 December 2019

During 2019, the Society continued to grow its balance sheet in a carefully managed and sustainable manner, delivering a lower but robust profit which is summarised below, along with a review of the financial position at the end of the year.

This report includes a number of alternative performance measures (APMs) which provide useful additional information about our financial performance and position[1]. These APMs are not defined in IFRS but provide additional useful financial information. Further information on the calculation of APMs and reconciliation to an equivalent statutory measure can be found on pages 192 to 195.

Financial performance

The income statement for the year is summarised below:

	2019 £m	2018 £m
Net interest income	200.8	218.1
Fees, commissions and other income	8.2	8.5
Fair value losses	(19.7)	(5.7)
Total income	**189.3**	**220.9**
Management expenses	(101.2)	(98.9)
Impairments on loans and advances to customers	(2.8)	1.2
Other impairments and provisions	2.7	0.2
Loss on sale of portfolio of loans and advances to customers	–	(6.5)
Profit before tax	**88.0**	**116.9**
Tax expense	(21.8)	(27.7)
Profit after tax	**66.2**	**89.2**

Profit before tax reduced by £28.9 million, down 25% compared to 2018, to £88.0 million, albeit this included elevated fair value losses that will typically unwind in future periods. The remaining reduction was primarily driven by lower net interest income.

Net interest income

	2019 £m	2018 £m
Net interest income	200.8	218.1
Mean total assets	20,099	18,937
	%	%
Net interest margin	1.00	1.15

Our primary source of income is net interest income. Therefore, it is important to balance the need to offer competitive rates for both borrowing and saving to our members.

Net interest income reduced by £17.3 million (8%) in 2019, primarily due to an increase in funding costs and relatively lower mortgage income.

The main drivers for the reduction in net interest income for 2019 were:

- An increase in the average interest rate paid on savings accounts across the year. We pay above market rates to our savers, offering competitive products to both new and existing customers. On average, we paid 1.38% (2018: 1.32%) on our savings range, compared to the rest of market average of 0.75%[2] (2018: 0.70%).
- Competition in the UK mortgage market has continued to increase which has squeezed the margin on new mortgage products. Despite offering mortgage products to customer groups not well served by the wider market, the positive margin effect of this lending has been insufficient to offset pressure on the wider lending market.
- We offer competitive rates to retain customers at the end of their initial mortgage term. These new mortgage products are at a lower rate than Standard Variable Rate (SVR), therefore reducing net interest income. The number of customers moving away from SVR at the end of their initial term has accelerated through the last 12 months.

Further reductions in net interest margin are expected in the coming years as competition in the mortgage and savings markets continues. This will lead to reduced margins on new lending and encourage customers to switch their mortgage product at the end of the initial term.

1. Financial information refers to the performance of the Group, as reported on pages 122 to 187.
2. CACI's CSDB, Stock, January to December 2019, latest data available.

Fees, commissions and other income

We offer home insurance, life cover, funeral planning and probate services to our members through a number of relationships with third parties.

Other income consists of commissions earned on these products, as well as rental income, foreign exchange movements and other ancillary fees. In 2019, other income reduced slightly to £8.2 million (2018: £8.5 million).

Fair value losses

Fair value movements represent changes in the value of certain financial assets and liabilities that are carried at their current market value. Changes in fair value typically unwind as the asset or liability reaches maturity. Fair value movements in 2019 resulted in a charge of £19.7 million (2018: £5.7 million).

This increased charge in 2019 is due to:

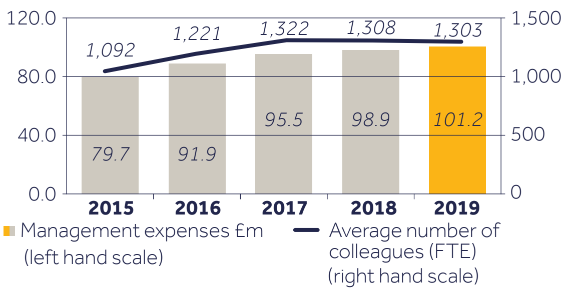
- Significant movements in benchmark interest rates, including LIBOR, which reduced the value of derivatives used to manage interest rate risks (see pages 180 to 181). Although these hedges work well in economically managing the risk, not all of them are in accounting hedge relationships, for example mortgage pipeline swaps, resulting in some fair value movements impacting on profit (2019: £11.2 million charge; 2018: £2.1 million gain).
- A reduction in the value of equity release mortgages purchased from a third party in the mid-2000s (represented in our balance sheet as a collateral loan). There are no market prices for these assets, so we estimate this value using a financial model. During the year a number of the key assumptions and estimates that drive the value in the model changed and this resulted in a reduction in the calculated value by £8.5 million (2018: £7.8 million).

Management expenses

Management expenses for the year are summarised below:

	2019 £m	2018 £m
Colleague costs	60.8	61.4
Other administrative expenses	33.0	33.5
Depreciation and amortisation	7.4	4.0
Total management expenses	**101.2**	**98.9**
	%	%
Cost to income ratio	53.5	44.8
Cost to mean asset ratio	0.50	0.52

Management expenses £m and colleague numbers



We recognise the need to invest in the business to meet the changing needs of members, balanced with the need to maintain a close control on costs.

Management expenses increased by 2% in the year, driven by our continued commitment to investing in future proofing and maintaining relevance, along with developing our digital capabilities in order to deliver long term value to our members. The cost to income ratio has increased to 53.5% from 44.8% in 2018, predominantly due to the reduction in income in 2019, but remains a solid performance, with costs being managed tightly. This is supported further in the cost to mean asset ratio, which has reduced from 0.52% to 0.50%, reflecting the positive aspects of our existing business model, with the marginal cost of growth maintained at a minimum.

The average number of Society colleagues was broadly unchanged in 2019, with investment in supporting project delivery and the digital team offset in other areas. The slight reduction in colleague costs is broadly as a result of a one off pension cost in 2018.

Depreciation and amortisation have increased in the year due to continued investment in our technological capabilities. This trend is expected to continue.

Financial Review

Year ended
31 December 2019

Continued

Impairments and provisions

The table below summarises the impact of impairments and provision charges/(releases) on the Income Statement in the year:

	2019 £m	2018 £m
Residential loans	5.0	2.4
Commercial loans	(2.2)	(3.6)
Impairments on loans and advances to customers	**2.8**	**(1.2)**
Property, plant and equipment	(0.1)	–
Other provisions	(2.6)	(0.2)
Other impairments and provisions	**(2.7)**	**(0.2)**
Total impairments and provisions	**0.1**	**(1.4)**

Overall in 2019, the Society recorded charges of £0.1 million in relation to impairments and provisions, compared to releases of £1.4 million in 2018.

Residential impairment

We make provisions for expected credit losses across all loans, based on the probability of each loan defaulting and resulting in a loss, taking into account a range of assumptions about future economic scenarios and an assessment of whether the credit risk of the loan has increased.

Our arrears ratio (measured as those loans either in possession or in arrears of more than 1.5% of the balance) has increased to 0.54% (2018: 0.46%), but remaining well below the industry average. This increase in arrears, together with a worsening view of key economic variables incorporated into provision models, has resulted in an increase in impairment loss provisions over the year. The economic scenarios modelled within our expected credit loss models include allowance for the potential impacts on the UK economy of the UK's departure from the EU.

Total balance sheet impairment loss provisions against residential mortgages at 31 December 2019 were £28.7 million (2018: £27.7 million), as summarised below:

	2019 £m	2018 £m
UK residential provisions	20.9	20.4
UK residential mortgages	16,645	15,706
UK provision coverage (%)	0.13	0.13
Legacy overseas provisions	7.8	7.3
Total residential provisions	**28.7**	**27.7**

UK provision coverage is broadly in line with 2018.

Commercial impairment

We continue to manage down successfully our legacy commercial lending portfolio with exposure to commercial loans falling to £17.6 million at 31 December 2019 (2018: £30.8 million). All loans remain up to date and no losses have been realised in the year, with impairment provisions released as loans redeemed, resulting in a credit of £2.2 million (2018: £3.6 million).

Provision coverage has reduced following improvements in credit quality of the commercial portfolio. At the end of 2019, balance sheet impairment provisions against commercial mortgages were £2.0 million (2018: £4.0 million).

Other provisions

The deadline for new mortgage payment protection insurance (MPPI) claims passed in 2019. All claims have now been processed and minimal payments are outstanding, all of which have been provided for.

We recorded provision releases of £2.6 million in the year, due to the remaining release of customer redress provisions that are no longer needed.

Taxation

The income tax expense of £21.8 million (2018: £27.7 million) represents 24.8% (2018: 23.7%) of profit before tax. We pay UK corporation tax at the prevailing rate of 19% for 2019 (2018: 19%) and also pay the 8% surcharge on banking profits over a £25 million threshold introduced in 2016.

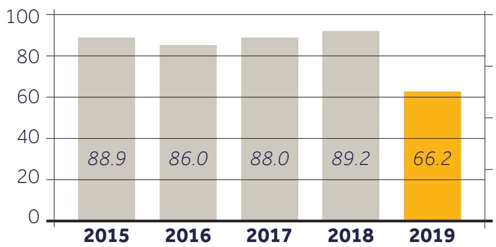
We have adopted the Code of Practice on Taxation for Banks and established appropriate procedures, controls and oversight to ensure we meet our obligations under the Code. We manage our tax obligations to ensure full compliance with all statutory requirements and do not intentionally structure transactions to give a tax result which is contrary to the intentions of Parliament. We maintain 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. This policy has been fully complied with throughout the year. Our tax strategy is published on our website and we are committed to transparency in the reporting of our tax affairs. We have been a proud holder of the Fair Tax Mark since 2018.

Profit after tax

Profit after tax is the primary source of new capital for the Society and is essential in ensuring long term security for members, as well as meeting the regulator's capital requirements. Despite increasing market pressures, the level of profit and hence capital generated, remains at solid, sustainable levels and continues to be sufficient to support future lending plans.

Profit after tax £m



The chart reflects the downward pressure on profit from intensifying competition in our core markets. When considered in light of the desire to maintain relevance against a backdrop of changing customer preferences and evolution in technology, we anticipate this lower level of profit is likely to continue, but are confident that it will remain sufficient to sustain the long term future of the Society.

Financial position

Total assets increased by 7%, to £20.8 billion. This growth is consistent with 2018 as we continue to manage carefully overall balance sheet growth in support of the long term strength and stability of the Society.

	2019 £m	2018 £m
Residential loans	16,768	15,805
Commercial loans	18	31
Other loans	222	232
Impairment provision	(33)	(34)
Loans and advances to customers	**16,975**	**16,034**
Liquid assets	3,323	2,827
Derivative financial instruments	183	273
Fixed and other assets	327	256
Total assets	**20,808**	**19,390**
Residential mortgage asset quality	**%**	**%**
Proportion of mortgages in arrears	0.54	0.46
Balance-weighted average indexed LTV of mortgage book	53.8	54.6
Balance-weighted average LTV of new lending	59.9	61.5

Loans and advances to customers

Our loans and advances to customers mainly comprise UK residential mortgages, which include residential owner occupied, buy to let and shared ownership.

We have actively managed down our legacy commercial loan portfolio, with no new commercial lending taking place. This now only represents 0.11% of the total lending book. Other loans include a collateral loan that represents a pool of equity release mortgages purchased from a third party, where some of the risks relating to those mortgages were retained by the third party.

New lending

Gross new lending during the year was £3.5 billion (2018: £3.8 billion), with the reduction on last year primarily from targeting lower growth due to increased competition in the mortgage market. Despite this, our share of new mortgage lending remained above our natural market share at 1.3% (2018: 1.4%) compared to 1.2% (2018: 1.1%)[3].

3. Leeds Building Society defines market share as follows:
Mortgages – market share statistics published by UK Finance
Savings – mutual sector net retail savings as published by the Building Societies Association

Financial Review

Continued

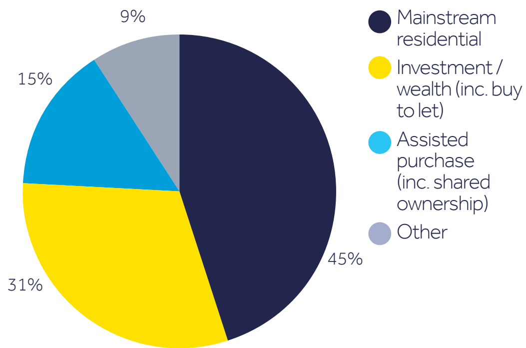
We continue to focus on borrowers not well served by the wider market, such as buy to let or shared ownership and first time buyers or later life homeowners, utilising our funding capacity and strong capital position to support a wide range of borrowers. In total, lending to these segments represented over 60% of new lending. This focus on higher margin lending supports our profitability and strengthens our position for existing and future members, while remaining within a clearly defined risk appetite. The average loan to value (LTV) of new lending in 2019 was 60% (2018: 61%).

Net lending was £956 million in 2019, £70 million lower than the previous year, due primarily to our lower level of new lending.

UK residential mortgage balances

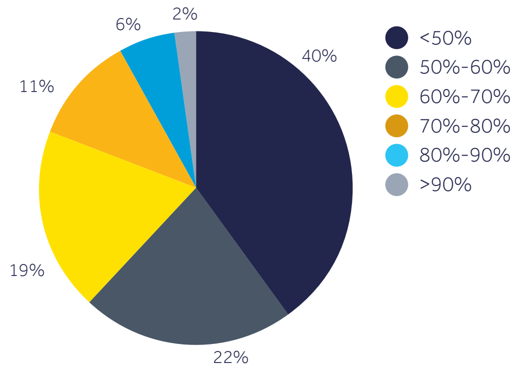
The mix of new lending in recent years means residential mainstream balances now make up less than half of UK residential mortgage balances, with buy to let increasing from 29% of the book at 31 December 2018 to 31%.

2019 UK residential mortgage balances by type



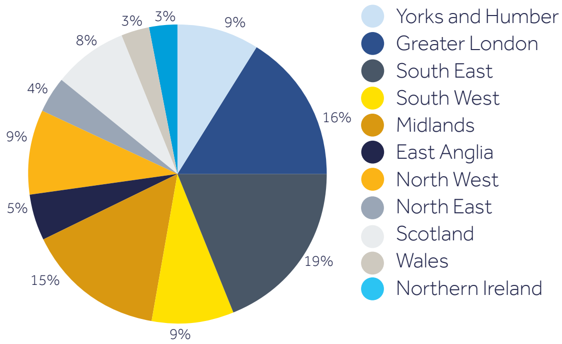
At 31 December 2019, the weighted average indexed LTV of the portfolio as a whole was 54% (2018: 55%). The distribution of the LTV profile of the portfolio is shown below.

2019 UK residential mortgage balances by indexed LTV



The portfolio is geographically diverse with the largest exposures in Greater London and the South East, reflecting the higher property prices in these areas.

2019 UK residential mortgage balances by region



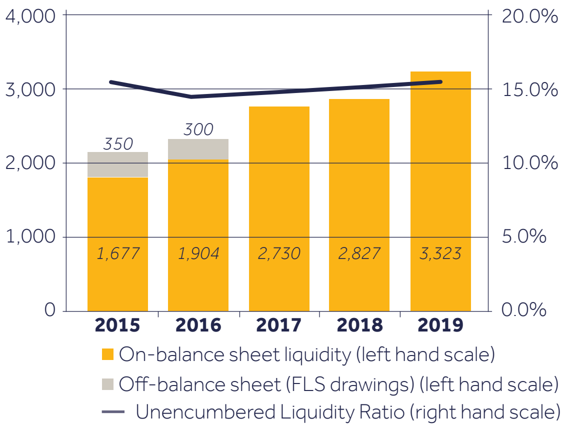
Liquid assets

Liquidity ratios	2019 %	2018 %
Liquidity Coverage Ratio (LCR)	235	214
Net Stable Funding Ratio (NSFR)	142	145
Total unencumbered liquidity	15.5	15.1

We hold liquid assets (including reserves with the BoE and other High Quality Liquid Assets) to ensure we can meet our financial obligations under both normal and stressed scenarios. We have maintained liquidity in excess of the regulatory minimum throughout the year.

The chart below shows our total liquid assets. We also have access to additional contingent liquidity through the BoE's Sterling Monetary Framework.

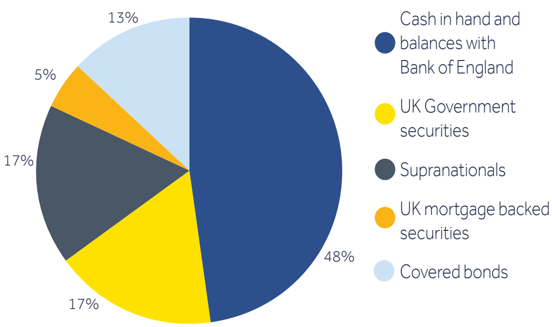
Liquidity £m / %



Total liquid assets at the end of 2019 were £3.3 billion, compared to £2.8 billion at the end of 2018. The level of liquidity can vary due to the timing of funding receipts compared to mortgage completions and other refinancing obligations. Liquidity included £2.9 billion of High Quality Liquid Assets (2018: £2.6 billion), which are either in cash or are readily realisable as cash when required. 100% of assets are rated 'A' or above (2018: 100%).

The mix of liquid assets at 31 December 2019 is shown below.

2019 liquidity portfolio



The PRA monitors liquidity under the Capital Requirements Directive IV (CRD IV) framework. Our LCR is 235% (2018: 214%), in excess of the regulatory minimum of 100%. The NSFR is currently calculated based on our interpretation of expected requirements as 142% (2018: 145%).

Our unencumbered liquidity ratio, which is another measure of readily realisable assets, was 15.5% at 31 December 2019 (2018: 15.1%).

Liabilities

A summary of the Society's liabilities is below:

	2019 £m	2018 £m
Shares	14,518	13,910
Wholesale funding	4,647	3,871
Derivative financial instruments	200	133
Other liabilities	125	226
Subscribed capital	232	224
Total liabilities	**19,722**	**18,364**
Equity attributable to members	1,086	1,026
Total liabilities and equity	**20,808**	**19,390**

Key ratios	**%**	**%**
Wholesale funding ratio	22.7	20.3

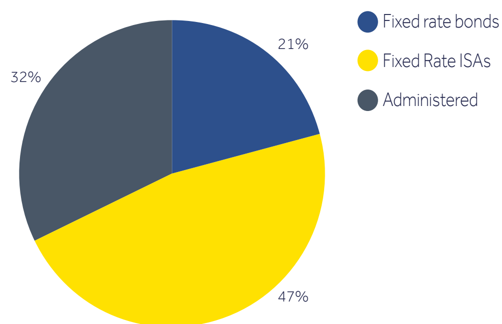
Achieving an appropriate level, mix and duration of retail savings and wholesale funding is essential to ensure we have the necessary resources to meet lending growth aspirations.

Shares (retail savings)

We continue to offer competitive savings rates to both existing and new members with a simple and attractive product proposition. We support members with a range of products to meet their savings needs, including easy access, fixed rate bonds and ISAs.

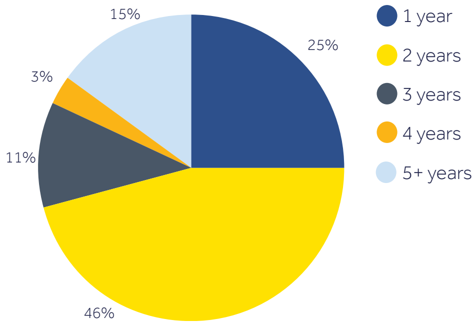
Savings balances increased by £0.6 billion, representing growth of 4% to a record £14.5 billion (2018: £13.9 billion), with the majority of the growth driven by fixed rate ISAs. The mix of savings balances at 31 December 2019 is shown below:

2019 savings balances by type



The split of our fixed rate savings balance by term is as follows:

2019 fixed rate savings term



Savings balances make up 71% of our total funding. This is a reflection of the core building society principles, with the provision of a safe place for members' funds being the primary source of funds to meet lending needs.

Wholesale funding

We continue to access wholesale markets to complement retail savings activity. We seek to maintain wholesale balances at approximately one fifth of total funding, although as we seek to take advantage of favourable funding conditions the proportion of wholesale funds can increase above this level. Total wholesale funds at 31 December 2019 were £4.6 billion (2018: £3.9 billion), representing 22.7% of total funding.

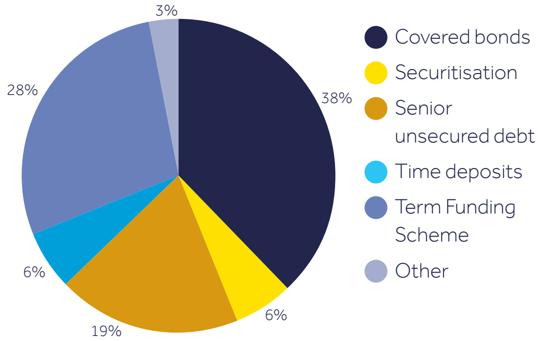
In April 2019, we issued our largest Covered Bond to date and raised £600 million of wholesale funding. The issuance was linked to SONIA as we move to reduce our exposure to LIBOR led by the interest rate benchmark reform. More information on the changes to the interest rate benchmark can be found on pages 180 to 181.

We also raised £250 million of external wholesale funding through our Albion No.4 residential mortgage backed securities (RMBS) issuance. This was to replace the Albion No.3 issuance which was repaid in the year. Another of the Society's RMBS issuances, Guildford No.1 will be repaid in January 2020.

At 31 December 2019, our outstanding Term Funding Scheme (TFS) funding drawings were £1.3 billion (2018: £1.3 billion). TFS drawings are repayable four years after drawdown.

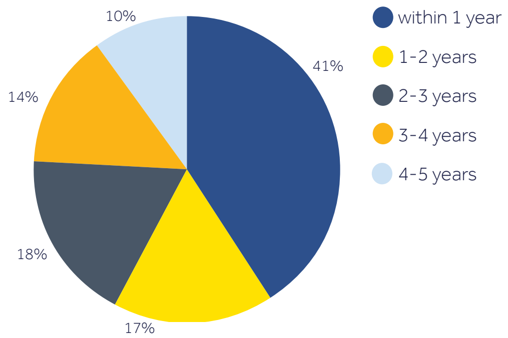
The mix of our wholesale funding portfolio at 31 December 2019 is shown below:

2019 wholesale funding portfolio



The maturity profile of our wholesale funding is illustrated below:

2019 wholesale maturity profile



We maintain strong credit ratings from two key agencies reflecting our strong capital base, good profitability and strong funding position.

	Long Term	Short Term	Outlook
Moody's	A3	P-2	Negative
Fitch	A-	F1	Stable

Derivatives

We transact derivatives to mitigate the risks within the balance sheet, primarily interest rate risk associated with offering fixed rate mortgage and savings products. Historically, we used LIBOR as the risk free rate that these derivatives are traded against. However this rate is set to be discontinued at the end of 2021 and in preparation we have a project in place to manage the transition from LIBOR to the preferred risk free rate, SONIA. Further details on this project can be found in note 35 of the accounts on page 180.

Capital

Our regulatory capital principally comprises accumulated retained profits in the general reserve and subscribed capital provided through subordinated debt and Permanent Interest Bearing Shares (PIBS). Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses. Our capital is assessed under the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), together referred to as CRD IV.

We maintained our strong capital position throughout the year, with all capital ratios significantly in excess of the regulatory minima. Since 2018 we have used the IRB approach to calculate our capital requirement for most of our residential mortgage book.

Total regulatory capital has increased by £46 million during 2019 to £1,271 million (2018: £1,225 million). This is mainly due to retained profits accumulated during the year, which are added to the general reserve. Risk weighted assets (RWAs) have reduced by £79 million during 2019 to £3,104 million (31 December 2018: £3,183 million) driven by a reduction in capital requirements on the Society's swaps. As a result of these movements, the CET1 ratio, calculated on a transitional basis, has increased to 33.6% from 31.3% at 31 December 2018.

The following table shows the composition of our regulatory capital as at 31 December 2019. More detailed disclosures can be found in the Pillar 3 document available on our website.

Capital resources	**2019 £m**	**2018 £m**
Total equity attributable to members	1,086	1,026
Less pension surplus, intangible assets and other regulatory adjustments	(42)	(29)
Common Equity Tier 1 (CET1) capital	**1,044**	**997**
Additional Tier 1 capital	8	10
Total Tier 1 capital	**1,052**	**1,007**
Tier 2 capital	219	218
Total regulatory capital resources	**1,271**	**1,225**
Risk weighted assets (RWAs)	**3,104**	**3,183**
CRD IV capital ratios[4]	**%**	**%**
CET1 ratio	33.6	31.3
Total capital ratio	41.0	38.5
CRR leverage ratio	5.0	5.1
UK leverage ratio[5]	5.3	5.5

Capital management

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

Pillar 1

We hold capital to meet Pillar 1 requirements for credit risk, operational risk and market risk. The IRB approach to capital modelling is applied which allows us to calculate our capital requirements for assets in scope using internally determined risk parameters that reflect the specific risks of our mortgage book. The standardised approach is applied to all other exposures, operational risk, market risk and credit valuation adjustments.

Pillar 2A

The PRA requires us to hold additional Pillar 2A capital for the risks not covered under Pillar 1. At 31 December 2019, the regulatory requirement was 3.40% of risk weighted assets, a point in time estimate set by the PRA during 2019.

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

Capital buffers

CRD IV requires the holding of capital buffers that can be used to absorb the impact of a stress scenario. For the Society, the buffer framework comprises a sector wide Capital Conservation Buffer, introduced in 2016 at 0.625% of RWAs and set at 2.5% in 2019 and a macro-prudential Countercyclical Capital Buffer currently set at 1% of RWAs for exposures to the UK. In addition, the ICAAP considers whether any additional capital is required over and above the regulatory buffers, to satisfy our risk appetite over the planning horizon and to absorb the impact of a severe stress scenario. The ICAAP is reviewed by the PRA when setting our Total Capital Requirement (Pillar 1 and Pillar 2A). We have performed regular stress tests on our capital base and these tests have consistently demonstrated a capital surplus above requirements after applying management actions.

We have utilised available transitional arrangements in relation to the impact of adopting IFRS 9 on regulatory capital and the figures above reflect those arrangements. Had the transitional arrangements not been adopted, at 31 December 2019, the CET1 ratio would have been seven basis points lower and the CRR leverage ratio would be unchanged.

New and emerging regulation

MREL is being phased in over a transitional period to July 2022. The transitional MREL period set for the Society, by the BoE, is equal to the minimum regulatory capital requirements for the period to 31 December 2019. It then changes to the higher rate of 18% of RWAs by 1 January 2020 for the period to 31 December 2021. MREL at the end of the transitional period is subject to review by the Bank of England and may change. Compliance with MREL is reflected in our latest Corporate Plan.

Recent reforms issued by the EBA on the application of the IRB aim to address concerns about undue variability of own fund requirements for credit stemming from the application of internal models across credit institutions. These reforms aim to harmonise the notion of a default to be used for estimiating the relevant parameters and clarify the use of credit mitigation. We have initiated activity to respond to these changes which is on track to meet all new requirements in advance of implementation. Our existing approach is closely aligned to the new requirements but current expectations are for our RWAs to increase. We are confident that we will remain well above the regulatory minimum and maintain a solid capital position that supports future growth plans.

Changes to accounting standards

We adopted IFRS 16 – Leases from 1 January 2019. This means that leased properties are now recognised on the balance sheet, as is a corresponding liability for the future lease payments. At the date of adoption, this has increased both assets and liabilities by £13.4 million. Further information on the adoption of IFRS 16 can be found in note 38 to the accounts on page 186.

Financial outlook

2019 has been another successful year for the Society, as we have grown our balance sheet in a sustainable manner and continued to deliver a level of profit that supports future growth.

The outlook for the UK economy remains uncertain going into 2020, with the impact of leaving the EU on 31 January 2020 and the outcome of negotiations over trade deals unknown. However, the level of profits generated in recent years mean we have a strong capital position and financial security meaning we are well placed to withstand market uncertainty.

Profits are expected to remain at lower levels in the short to medium term, compared to 2015-2018, but they remain robust and at an appropriate level to allow us to manage our growth and prioritise investment in technology and infrastructure to support the needs of existing and future members.

We retain a strong franchise in mortgage lending and retail savings which will help support future growth. Strong efficiency ratios and a conservative risk appetite are expected to support continuing strong profitability underpinning the financial security that is so important to members' confidence.

Non financial information statement

We have included certain non financial information in the Strategic Report, in accordance with the requirements of s414CB of the Companies Act 2006. The required information can be found as follows:

- Our business model is described on pages 8 to 9 and key indicators of performance are on pages 13 to 16.
- We have set targets to reduce our impact on the environment within our corporate responsibility targets. These are included in more detail on pages 22 to 31. A formal Environmental, Social and Governance Policy is currently under development and due to be implemented in 2020.
- Our Colleague Policy is designed to ensure the fair, transparent and consistent treatment of colleagues in accordance with legislative and regulatory requirements. Further information on our strategy in relation to colleagues is detailed on pages 16 to 17.
- We have a zero tolerance approach to bribery and corruption and uphold ethical behaviours in our business activities at all times. The Prevention of Financial Crime Policy sets out the requirements of colleagues in this respect and all colleagues undertake regular mandatory training.
- Additionally, our Third Party Management Policy ensures that we only enter into third party arrangements with suppliers that have the policies and procedures in place to comply with all applicable anti-bribery and corruption laws, including the Bribery Act 2010 and the Modern Slavery Act.

Managers throughout the Society are responsible for ensuring colleagues in their teams comply with these policies. Attestation of compliance is provided by first line management annually. Periodic independent reviews of compliance are undertaken by the Risk function (second line) and Internal Audit (third line), using a risk based approach.

Approval of the Strategic Report

This Strategic Report (on pages 2 to 51) has been approved by the Board of Directors and is signed on behalf of the Board.

Richard Fearon
Chief Executive Officer

25 February 2020

Governance Chairman's Introduction

Year ended
31 December 2019

Dear member, I am pleased to present the Corporate Governance Report for the year ended 31 December 2019.

Highlights from 2019

- Richard Fearon takes over as Chief Executive Officer
- Two new non executive directors join the Board
- Senior leadership changes to enhance focus on key strategic initiatives and operational areas
- Compliance with the Corporate Governance Code
- Successful search for a new Chief Financial Officer

I report to you in my capacity as Chair of the Board, a position I have held since 2013 and before that as a non executive director of the Board. Having spent nine years as a member of the Board and in line with best practice, I will be retiring from the Board at the 2020 AGM and will not be standing for re-election.

Corporate governance can be described as a framework which enables management and the Board to operate more effectively and ensures that appropriate decision making processes and controls are in place, so that the interests of all stakeholders are balanced. Corporate governance remains a high priority for the Board, which welcomes the implementation of the new revised 2018 Corporate Governance Code (the 'Code') which became effective for accounting periods starting on or after 1 January 2019.

Leadership and purpose

We have a strong and inclusive culture across the Society, which is in line with our values and enables all colleagues with a diverse range of skills, experiences, backgrounds and opinions to flourish, without barriers. The Board recognises the ongoing importance of a strong culture and seeks to make decisions which are consistent with the Society's values and supports our long term sustainable success. It is important we ensure that the Board remains effective and after our annual Board effectiveness review in 2019, I am pleased to report that the Board, including the committees, were found to be operating effectively.

In February, 2019 Richard Fearon succeeded Peter Hill and became the Society's eighth CEO. Following his appointment, Richard introduced a number of leadership changes, extending the membership of the Executive Committee ('ExCo') to include new (non Board) members, to strengthen and bring focus to a number of strategically important areas. More information about the members of ExCo has been included in the Corporate Governance report on pages 65 to 66.

This year, the Board welcomed two new non executive directors, Iain Cornish and Annette Barnes, both of whom were elected at the AGM in April 2019. Biographies for all of the Board of Directors as at 31 December 2019 have been included within this report for your information.

In April 2019, Robin Litten, Chief Financial Officer (CFO) decided to leave the Society after seven successful years, to pursue the next stage of his career. I would like to take this opportunity to thank Robin for his contribution to the success of the Society in recent years. Andrew Conroy joined the Society in July 2019 as Interim Chief Financial Officer and was appointed to the Board from January 2020, subject to regulatory approval (for which an application is underway).

Philippa Brown, a non executive director, resigned from the Board to focus on her executive career and left at the end of April 2019. I would like to thank Philippa for her valuable insights during her time on the Board.

Karen Wint, Chief of Staff retired from the Board on 31 December 2019, to pursue her non executive career. I would like to take this opportunity to thank Karen for her service, over many years, to the Society.

After eight years on the Board as a non executive director, Phil Jenks has decided to retire from the Board in March 2020. I would like to thank Phil for his valuable contribution over the years.

Division of responsibilities

The Board has clearly defined the roles and responsibilities of its directors, for example, as the Chair, my principal responsibility is the effective running of the Board, whereas, Richard Fearon, your Chief Executive Officer (CEO), is responsible for the running of the Society's business. Further information has been provided on page 57 summarising the Board's role and activity on pages 59 to 60.

Composition, succession and evaluation

The Board's composition, appointments and succession planning is kept under ongoing review to ensure the Board continues to have the right mix of skills, experience and diversity to serve you, our members and to remain true to our mutual status. Further details can be found within the Nominations Committee Report on pages 72 to 77.

Audit, risk and internal control

The Society's internal governance arrangements continue to support the independence and effectiveness of the Internal Audit Function and the integrity of the Society's financial statements. The Audit Committee Report on pages 84 to 93 provides further information in this regard. We also have in place an Enterprise Risk Management Framework, designed to manage risk, oversee internal control effectiveness and determine the principal risks, so that we may achieve our long term strategic objectives. The Board Risk Committee Report on pages 78 to 83 provides an overview of our approach to risk and internal control.

Remuneration

The Board continues to support a remuneration policy and practices designed to promote the long term sustainable success of the Society, with executive remuneration aligned to our values and linked to delivery of our long term strategy. A summary of the work undertaken by the Society's Remuneration Committee can be found within the Directors' Remuneration Report on pages 94 to 108.

The New UK Corporate Governance Code (the 'Code')

The Board's approach to corporate governance is based on the Principles and Provisions of the new 2018 version of the UK Corporate Governance Code, which became effective for accounting periods starting on or after 1 January 2019. The Code sets higher standards of governance within businesses and I am pleased to confirm that the Society's governance arrangements meet the new requirements, where appropriate. We will continue to comply with the Provisions of the Code in so far as it is relevant to a building society. A copy of the Code is available at www.frc.org.uk.

This report sets out how the Board has operated throughout 2019 and applied the Provisions of the Code.

In conclusion, I would like to thank you for electing me as a non executive director over the last nine years and thank the Board for electing me as your Chair for the last seven years. I would also like to take this opportunity to welcome Iain Cornish as your new proposed Chair of the Board. Please see the Nominations Committee Report on pages 72 to 77 for further details.

Robin Ashton
Chairman

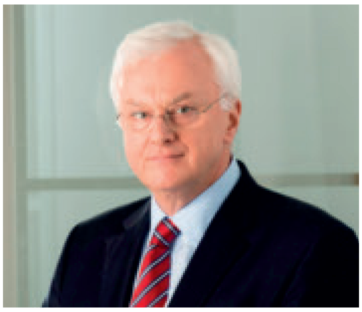
25 February 2020

Board of Directors

The biographies of each member of the Board are shown below and serve to demonstrate the reasons why the strengths and experience of each director contributes to the Society's long term and sustainable success.

Key to Committee membership (effective as at 31 December 2019):

A Audit Committee B Board Risk Committee N Nominations Committee R Remuneration Committee ◯ Committee Chair



Robin Ashton
Chairman

N

Originally appointed as: Chair of the Board March 2013 and independent non executive director in April 2011[1].

Strengths and experience: Robin is a chartered accountant and spent his executive career in retail financial services. He has developed skills and experience, across a broad range of areas, in particular, credit, treasury, audit and accounting.

As Chair of the Board, he is responsible for overseeing the performance of the Board. He is a strong supporter of the building society sector and the mutual business model, which plays an important role in UK financial services. Robin will retire from the Board in April and will not be standing for re-election in 2020.

Other roles: Robin is the Senior Independent Director of Shawbrook Group plc and its subsidiary Shawbrook Bank Ltd and a non executive director of Domestic & General Ltd.

Richard Fearon
Chief Executive Officer

Appointed: Chief Executive Officer in February 2019 and Executive Director in 2016.

Strengths and experience: Richard started his career at Oliver Wyman & Company and spent 10 years at Lloyds Banking Group in senior mortgage and savings roles. Richard has an excellent understanding of product development to meet customer needs, as well as strong strategic and commercial skills.

As Chief Executive Officer, Richard has responsibility for developing and proposing the Society's strategy, objectives and plans, and maintaining our business model and culture.

Other roles: Richard is a member of the UK Finance Mortgages Product and Service Board and a member of the Business in the Community Yorkshire & Humber Advisory Board.

Iain Cornish
Independent Non Executive Director

A B N*

Appointed: Independent Non Executive Director in January 2019 and proposed Chair of the Board following the AGM.

Strengths and experience: Iain joined the Board with over 30 years' experience working in financial services and was CEO of Yorkshire Building Society between 2003 and 2011. During 2007/2008, Iain was Chair of the Building Societies Association. He has also held a number of non executive posts, was a Treasury Select Committee Special Advisor and Independent Director for the PRA. He also chaired the Financial Services Authority Practitioner Panel. In addition to significant experience of the sector, Iain has relevant risk and audit committee experience.

Other roles: Iain is the Chair of St James Place plc and a trustee and treasurer of Macmillan Cancer Support.

*Iain will be proposed as the Chair of the Nominations Committee after the AGM.

1. Please refer to the Directors' Report on page 111 and the Annual Business Statement on page 189 for further information.

Annette Barnes

Independent Non Executive Director | **Appointed:** February 2019

Strengths and experience: Annette joined the Board in February 2019, having over 30 years' experience within financial services.

Prior to joining the Society, Annette was most recently CEO at Lloyds Bank Private Banking Ltd and Managing Director of Wealth & Mass Affluent for Lloyds Banking Group. Her background in operations, technology and customer experience, combined with her recent board and regulatory experience, has further strengthened the Board.

Other roles: Annette is a non executive director of GlobalData plc, Old Mutual Wealth Ltd and Old Mutual Wealth Life & Pensions Ltd.

David Fisher

Independent Non Executive Director | **Appointed:** March 2012

Strengths and experience: David has over 30 years' experience in financial services, beginning his career with Halifax Building Society.

Prior to joining the Society, he was CEO of Sainsbury's Bank and he also undertakes a number of advisory roles. During his career, he has developed a wealth of knowledge in retail financial services and has a strong understanding of risk management, pensions and human resources.

As Chair of the Board Risk Committee, David's responsibilities include safeguarding the independence of the Risk function. David is also a member of the Society's Remuneration Committee and Audit Committee.

Other roles: David is a non executive director of Pollen Street Secured Lending plc.

Andrew Greenwood

Chief Risk Officer | **Appointed:** January 2015

Strengths and experience: Andrew joined the Board as Chief Risk Officer in 2015. He started his career as a solicitor in private practice and has worked for the Society since 1998 in a variety of legal, compliance and risk-focused roles.

He has developed extensive experience of working in a highly regulated environment. His skills and experience enable him to lead the Risk function, which comprises a number of specialist teams.

Andrew is responsible for the overall management of the risk control framework of the Society, which includes co-ordinating and managing principal risks and risk appetite.

He reports directly to the Board Risk Committee and attends all the Society's management risk committees.

From the start of 2020, Andrew has also taken on responsibility for the Society's Human Resources, Learning and Development and Property and Business Services functions.

Gareth Hoskin

Independent Non Executive Director | **Appointed:** November 2015

Strengths and experience: Gareth has gained extensive experience acquired over his 30 year career in UK and international financial services, as a director of Legal & General plc and CEO of its International Division and previously as a chartered accountant at Price Waterhouse. In January 2019, Gareth was appointed as Vice Chair and Senior Independent Director. As Chair of the Audit Committee, his responsibilities include safeguarding the independence of the Internal Audit function and acting as the Society's whistleblowing champion.

Other roles: Gareth is a non executive director of The British Diabetic Association, Diabetes UK Services Ltd, Saga plc and Acromas Insurance Services Ltd and advisor to the Board of Green Park Partners Ltd.

Board of Directors

Year ended
31 December 2019

Continued

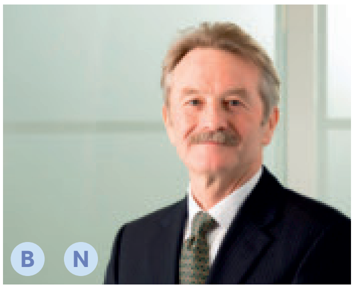
John Hunt

Independent Non Executive Director | Appointed: April 2015

Strengths and experience: John began his banking career with Yorkshire Bank, in Leeds. He has held senior posts in a number of major UK and international banks and was a founder member of the Global Credit Data Consortium.

His areas of particular specialism fall within credit and treasury risk management.

As a member of the Society's Board Risk Committee, John contributes to discussions relating to risk management; risk appetite; risk monitoring and assurance.



Phil Jenks

Independent Non Executive Director | Appointed: March 2012

Strengths and experience: Phil has over 40 years' experience in the financial services and mortgage industries. He has worked as a consultant for various organisations, including the Government, on housing-related projects. Phil has developed a strong understanding in these and other specialist areas including credit, technology and conduct risk management.

As a member of the Board Risk Committee and Nominations Committee, Phil provides input on a range of matters, including risk management, Board composition and succession planning.

Other roles: Phil is a non executive director of Recognise Financial Services Ltd.

After eight years on the Board, Phil will retire as a non executive director in March 2020 and will not be standing for re-election at the AGM.

Lynn McManus

Independent Non Executive Director | Appointed: September 2017

Strengths and experience: Lynn joined the Board in September 2017 bringing over 20 years' experience within financial services.

She has worked within finance, risk, HR and communications. Her most recent role was at Clydesdale Bank, where she was a member of the executive team. Lynn is a chartered management accountant.

Lynn is the designated non executive director for workforce engagement and a member of the Audit Committee.

In January 2019, Lynn was appointed Chair of the Remuneration Committee. In this role, she is responsible for overseeing the development and implementation of the Society's remuneration policies and practices.

Other roles: Lynn is a director of Kane LMMG Ltd and Doggy Day Care Academy Ltd.

Karen Wint

Chief of Staff | Appointed: November 2012

Strengths and experience: Karen was appointed to the Board in 2012 with over 30 years of experience within financial services. She is a chartered banker and has held senior roles within the Society's commercial and operations divisions.

As Chief of Staff, Karen's responsibilities included ensuring that the Society had the right people to deliver great service and value to our members and overseeing the forthcoming relocation to the new head office premises, as well as providing support to the Chief Executive Officer across a number of focus areas. During 2019, Karen chaired the Operational Resilience Committee and was the executive accountable for meeting our targets under the Women in Finance Charter.

Karen retired from the Board on 31 December 2019. Karen's areas of responsibility for the Society's Human Resources, Learning and Development and Property and Business Services functions were transferred to Andrew Greenwood, the Society's Chief Risk Officer.

Corporate Governance Report

Year ended
31 December 2019

The role of the Board

Overview

The Society understands the importance of Board diversity and how this can further support good and effective decision making. Board diversity is overseen by the Nominations Committee, which reviews the skills, knowledge, experience and diversity on the Board, as well as taking a proactive approach to succession planning for appointments to the Board and the Senior Leadership Team. A summary of the activities of the Nominations Committee can be found within its report on pages 72 to 77. The Board's skills matrix supports the ongoing review of the Board's composition which in turn supports our vision, mission and strategic pillars (see pages 10 to 12 of the Strategic Report).

The Board places significant emphasis on effective corporate governance and has in place a robust Enterprise Risk Management Framework which supports the Society's long term success and viability, ultimately for the benefit of you, our members. Further information on our approach to risk management can be found within the Board Risk Committee Report on pages 78 to 83. The Board is also accountable to members, for the strategic direction and financial soundness of the Society and it sits within a governance framework which facilitates effective decision making.

The Board sets the tone from the top, which includes a clear set of key roles and responsibilities of the Board, further details of which can be found on pages 63 and 64.

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;
- The Society's risk appetite;
- Ensuring that the Society operates within its rules, the rules and guidance issued by the PRA and the FCA; and
- Leading, developing and overseeing the Society's culture.

A formal schedule specifies those matters reserved for consideration or approval by the Board, including:

- Establishment of and changes to the Society's strategy;
- 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;
- Annual approval of the Society's Speak Up Policy,
- Capital and liquidity requirements; and
- Annual approval of the Society's risk appetite.

The Schedule of Matters Reserved for the Board is available on the Society's website: leedsbuildingsociety.co.uk/your-society/about-us/board-committees

The Board operates through meetings of the full Board, as often as is necessary in order to discharge our obligations and ensure the smooth running of the business. This comprised 11 meetings in 2019, with two additional meetings dedicated to planning and strategy. A comprehensive and timely set of papers are provided for each meeting. A governance review was carried out during 2019, with a focus on optimising materials sent to the Board and Board committees, to support effective decision making.

Certain responsibilities are delegated to a number of Board committees, each one having clear and detailed Terms of Reference (ToR). The ToR list the duties of the Board committees, copies of which can be found on our website: www.leedsbuildingsociety.co.uk/your-society/about-us/board-committees

The Audit, Nominations, Board Risk and Remuneration Committees and their responsibilities are described in more detail on pages 72 to 108.

Powers are delegated from the Board through documented delegated authorities. These set out the responsibilities, decision making and approval powers of the leadership and management team. These are reviewed and approved by the Board at least annually.

Corporate Governance Report

Continued

Culture

The Board continues to monitor culture using a range of strategic risk assessment measures and receives an annual report and update on culture.

The Society's values help to promote our mutual culture, encouraging behaviours that are in the best interests of our members. Colleagues receive training annually which includes information and examples of our values and how these should be central to the work and attitudes of all colleagues. To support this further, the colleague annual appraisal process requires colleagues to demonstrate how they consistently 'Live our Values'.

The 2019 colleague survey demonstrated high colleague engagement, which helps to maintain a mutual culture and encourages appropriate behaviours throughout the business. The colleague survey also helps to provide 'culture temperature checks' for the Board.

To measure colleague performance and behaviours, there is a robust performance management approach in place. All colleagues have a personal objective plan which links personal objectives to corporate objectives, supported by a personal development plan.

The Board is committed to promoting and supporting a diverse and inclusive culture, with two established diversity forums (Gender Diversity and Mental Health) and introduced the BAME forum in 2019. These forums ensure a focus on promoting colleague awareness and consideration of new opportunities and initiatives to attract, nurture and develop the diverse talent pool. More information on diversity is included in the report of the Nominations Committee on pages 76 and 77.

Whistleblowing

We are committed to conducting our business with honesty, transparency and integrity. However, from time to time, all organisations face the risk of things going wrong, or of unwittingly harbouring malpractice. By encouraging a culture that welcomes an open discussion and challenge, where colleagues feel comfortable about raising their concerns, it allows us to take appropriate action quickly, remedying the situation and preventing malpractice. All colleagues are encouraged to raise a concern without fear of retribution, victimisation or detriment, should they encounter or suspect wrong doing, through the Society's Speak Up procedures.

The Code includes a new provision requiring there to be a means for the workforce to raise concerns in confidence, that the Board should routinely review this and the reports arising from its operation. The annual approval of the Society's Speak Up standards was therefore added to the Schedule of Key Matters reserved for the Board and was approved by the Board in October 2019, based on the recommendation of the Audit Committee.

Annual training is provided to all colleagues, including temporary employees and contractors, which provides information on how to raise concerns, both internally and directly with the regulators. This reinforces the message that colleagues will be protected should they raise a concern. Gareth Hoskin, Senior Independent Director (SID) and Chair of the Audit Committee, is the Society's whistleblowing champion.

What the Board did in 2019

Some of the key areas of Board activity during 2019, linked to our strategic pillars, are shown below. Further information about our strategic pillars can be found within the Strategic Report on pages 8 to 21, along with a more in depth summary of some the key decisions made by the Board.

Secure

Generate strong, sustainable profit levels by meeting the needs of key segments.

- Approval of the Society's interim and full year financial results, announcement sign off and Pillar 3 disclosures
- Business performance updates and quarterly forecast reviews
- Annual approval of risk appetite
- Annual review of lessons learned from the previous year
- Annual review of the Society's systems and controls
- Approval of the annual update of the covered bonds and Euro Medium Term Note (EMTN) programmes
- Approval of the ICAAP and ILAAP
- Approval of the Recovery and Resolution Plan
- Approval of the Lending Policy
- Annual Money Laundering Reporting Officer's report, including approval of the Prevention of Financial Crime Policy

Customer Centred

Deliver an outstanding member and broker experience.

- Monthly updates from the Chief Commercial Officer on mortgage and savings business performance
- Approval of the operations transformation proposals to enhance customer and colleague experience
- Review and approval of the digital operating model
- Receipt of quarterly customer and intermediary satisfaction and research reports
- Review of the annual customer complaints report
- Review and approval of the new mortgage technology platform
- Presentation from the Mortgage Advice Bureau on the mortgage market
- Approval of the AGM resolutions, plans and logistics
- Approval of the AGM minutes and a review of the meeting
- Receipt of conduct risk training
- Annual mutuality review
- Review of potential new products for the future

Corporate Governance Report

Year ended
31 December 2019

Continued

Simple

Drive efficiency by removing complexity.

- Approval of the delegated authorities manual
- Annual review of the legacy portfolio, including agreement to close the Gibraltar branch
- Reviews of Brexit-associated risks and actions taken to date
- Approval to progress to the next stage of the relocation of the head office to new premises in Leeds city centre
- Presentation from a mortgage software supplier demonstrating where efficiencies could be made in mortgage application processes
- Operational risk training
- Annual review of the pricing methodology and key assumptions
- Annual review of the legacy portfolio
- Minutes and updates from all Board committees
- Review of initiatives across the Society designed to improve efficiencies

Future Facing

Invest in our capabilities and technology to meet the evolving needs of members.

- Strategy and planning conferences
- Approval, and monitoring, of performance against the corporate plan and strategic objectives
- Corporate responsibility strategy update
- Business change and project activity updates
- Reviews of the competitive, external economic and strategic outlook including the Monetary Policy Committee's interest rate decisions
- Regulatory updates on new and emerging matters
- Review of the cyber security strategy and technology strategy
- Regular outlook updates on the savings and mortgage markets
- Proposals and discussions on the Society's future corporate and charitable partnerships
- Updates to the Vision Scorecard to articulate the measures of success and how these will evolve over the next five years
- Updates on proposed enhancements to balance sheet management

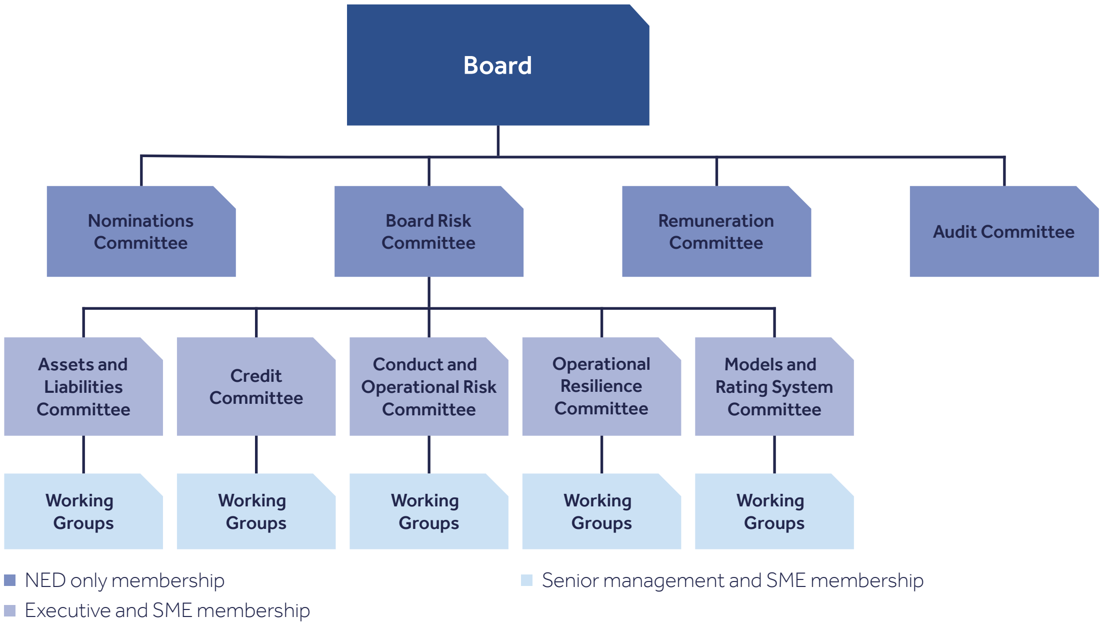
People

- Monthly updates on people matters
- Appointment and re-appointment of non executive directors
- Chair/Vice Chair/SID appointment/re-appointment
- Approval of the division of responsibilities between the CEO, the Chair and the SID
- Succession planning and talent management with specific focus on diversity.
- Approval of the responsibility map for the Senior Managers Regime
- Review and approval of the Remuneration Policy
- Annual approval of the of the Speak Up Policy, which provides a framework to colleagues to raise concerns in confidence
- Annual review and approval of the modern slavery transparency statement
- Updates received from Lynn McManus (Non Executive Director) as the designated representative of the workforce
- Internal Board effectiveness review, including an external assessment on how board members operate together
- Board culture evaluation

Board committees

The Board delegates certain duties to a number of Board committees to assist in carrying out its functions, so that certain matters can be discussed and considered in more detail. Each Board committee is comprised of independent non executive directors most relevant to their skills and areas of expertise. The Chair of each committee is responsible for ensuring receipt of accurate, timely and clear information to assist with their deliberations and decision making. Each committee has its own clearly defined ToR. Board committees have been established in line with the provisions of the Code.

The ToR for the committees are updated on an annual basis (or more frequently, if required) and are available to view on our website: leedsbuildingsociety.co.uk/your-society/about-us/board-committees/ or by writing to the Secretary at Leeds Building Society, 105 Albion Street, Leeds, LS1 5AS. The Board committee and management governance structure is outlined below:



Further details on these committees are contained within the Board Risk Committee Report on page 79.

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 five management committees noted in the chart above. Further details on the risk governance framework and commentary on the types of risks faced by the Society, together with details of how these risks are managed, are set out in the Board Risk Committee Report on pages 78 to 83 and in notes 31 to 34 of the accounts on pages 159 to 175.

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.

Further details on the work of this committee can be found in the Audit Committee Report on pages 84 to 93.

Nominations Committee (NomCo)

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

Further information on the work of this committee can be found in the Nominations Committee report on pages 72 to 77.

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 and senior leaders. The committee also ensures that performance related elements of remuneration are transparent, stretching and rigorously applied, having regard to risk appetite, member interests and other stakeholders.

Further information can be found in the Directors' Remuneration Report on pages 94 to 108.

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 scheduled committee meetings held during the year.

Although not a member of the Board during 2019, following his appointment as Interim Chief Financial Officer, Andrew Conroy attended all Board meetings and his attendance is included in the table below.

Director	Board	Audit	Board Risk	Nominations	Remuneration
Robin Ashton	10/11			5/5	
Annette Barnes	9/9		7/7		
Iain Cornish	11/11	6/6	8/8	1/1	
Richard Fearon	11/11				
David Fisher	11/11	6/6	8/8		6/6
Andrew Greenwood	11/11				
Gareth Hoskin	10/11	6/6	8/8	5/5	5/6
John Hunt	11/11		8/8		
Phil Jenks	11/11		8/8	5/5	
Lynn McManus	11/11	6/6			6/6
Karen Wint	11/11				
Andrew Conroy	4/4				
Philippa Brown (resigned with effect from 30/04/2019)	5/5				2/3
Peter Hill (resigned with effect from 26/02/2019)	3/3				
Robin Litten (resigned with effect from 18/04/2019)	4/4				

Board roles

The roles of the Chair and CEO are distinct and are held by different people. The Chair'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's business and implementing strategy.

The role of the non executive directors is to bring independent judgement and perspective to Board debates and decisions, as well as constructively challenging the work and proposals of the Senior Leadership Team, applying the highest standards of conduct, integrity and probity. As members of the Board and Board committees, they assist in the discharge of the obligations of each committee in line with the relevant ToR. They also have a responsibility to be sufficiently and appropriately informed of the matters under discussion and to represent and have regard to the interests and views of current and future members of the Society. It is anticipated that after induction, non executive directors are required to commit, on average, up to 36 days per annum in the discharge of their duties.

The main responsibilities of the non executive director role are:

Robin Ashton
Annette Barnes
Iain Cornish
David Fisher
John Hunt
Gareth Hoskin
Phil Jenks
Lynn McManus

Strategy	To constructively challenge and help develop proposals on strategy, ensuring fair treatment of members/customers and positive outcomes.
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 and monitor performance against agreed corporate priorities.
People	To have oversight of the culture, reward and talent management strategies whilst ensuring management performance achieves the corporate goals.
Governance	To assist in the discharge of PRA/FCA prescribed responsibilities/FCA business activities via the Society's management forums, in line with our Enterprise Risk Management Framework.
Member/ Customer	To promote the fair treatment of members/customers.

Distinct job descriptions exist for the Chair, CEO and Senior Independent Director and the table below highlights the key accountabilities of these roles:

Role	Key accountabilities
Chair: Robin Ashton	• The effective running of the Board and guardian of the Board's decision making processes. • To support and advise the CEO in the development of strategy and more broadly to support and advise. • To ensure that the Board takes responsibility for the sustainable, long term performance of the Society. • To ensure the Board receives and considers feedback and views from stakeholders including members and colleagues. • 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. • Ensure the independence and provide oversight of the Nominations Committee. • To promote the highest standards of integrity, probity and corporate governance.
Chief Executive Officer: Richard Fearon	• 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 unite all colleagues around the Society's vision, strategy and values. • Responsible for all executive management matters affecting the Society. • To discharge the allocated PRA/FCA prescribed responsibilities and FCA business activities via the Society's management forums in line with the Enterprise Risk Management Framework.

Continued

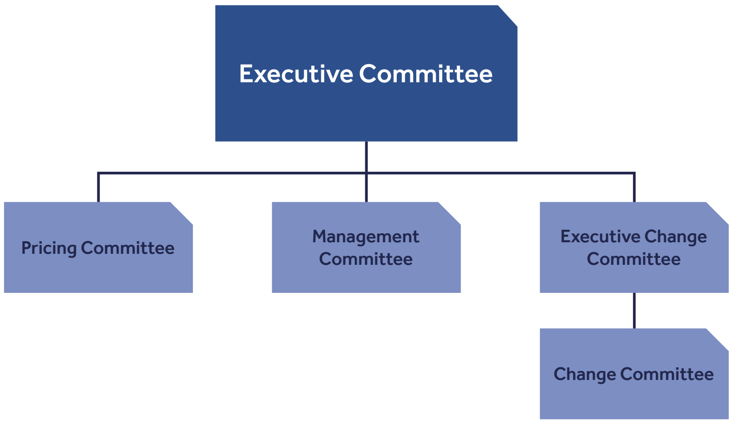
Role	Key accountabilities
Senior Independent Director/Vice Chair: Gareth Hoskin	• To work closely with the Chair, acting as a sounding board and providing support. • To act as an intermediary for other directors, as and when necessary. • Be available to key stakeholders and other non executives to address 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 review the Chair's performance and carry out succession planning for the Chair's role. Feedback on the Chair's performance is also sought from the executive directors. • To deputise for the Chair and chair meetings where the Chair is conflicted.

Executive and management committees

Executive Committee (ExCo)

During 2019, a number of leadership changes were made. This included an extension to the membership of ExCo, resulting in the addition of new (non Board) members to strengthen and bring focus to a number of strategically important areas. The ExCo operates under the direction of the CEO and has the primary purpose of enabling the executive directors and chiefs to manage the Society in a co-ordinated way, taking a broad view of key issues and priorities. The ExCo delegates some of its duties to, and is supported by, the Management Committee (ManCo), the Pricing Committee and the Executive Change Committee (which in turn is supported by the Change Committee). The ExCo does not have a formal role in our risk governance structure, other than in the context of strategy and planning.

The executive management committee structure is outlined below:



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 action(s), as appropriate. 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.

The Pricing Committee

The primary purpose of the Pricing Committee is to approve new product pricing for the Society's savings and mortgage products. The aim is to offer value to members, achieve business volumes (to support long term growth), achieve margin and membership growth, whilst considering the Society's strategic aims, impact on operations, customer experience and risk appetite statements and limits.

The Executive Change Committee

The primary purpose of the Executive Change Committee is to provide oversight of the Society's change portfolio (focusing on the most critical projects) to ensure they are aligned to the overall strategic vision.

ExCo Biographies

Andrew Greenwood, Karen Wint and Richard Fearon are also members of the Executive Committee, whose biographies can be found on pages 54 to 56.

Andrew Conroy
Chief Financial Officer
Andrew started his career at PwC before moving to West Bromwich Building Society. He has more than 15 years' experience in financial services, including a number of senior roles in both building society and banking institutions. He has worked within finance, treasury and corporate strategy and has developed strong technical skills in financial accounting and treasury risk management. Andrew joined the Society in July 2019 as Interim Chief Financial Officer. He is the Chair of the Assets and Liabilities Committee and has responsibility for the Society's Finance and Treasury Management functions along with oversight of the Society's recovery and resolution plan and activities.

Jaedon Green
Chief Customer Officer
Jaedon has worked in financial services for over 30 years with experience across many areas of the industry, some examples of which include telephone and internet banking, credit and risk management and life assurance and pensions. Prior to joining the Society, he worked for Lloyds Banking Group, where he played a lead role in the rejuvenation of mortgage sales through a number of different brands. As Chief Customer Officer, Jaedon is responsible for the Society's branches, contact centre and back office operations, including customer services.

Robert Howse
Chief Operating Officer
Rob has spent the last 10 years in a number of senior technology, operations and change roles at Lloyds Banking Group and Royal Bank of Scotland. Most recently, he was Deputy Transformation Director for Retail at Lloyds and before that Chief Information Officer for Retail. His earlier career included time as a management consultant at McKinsey and Company where, as an Associate Partner, he specialised in advising multi-national clients on the design and execution of transformation programmes. As Chief Operating Officer, Rob is responsible for technology, operational resilience and third party sourcing across the Society.

Nikki Marsh
Chief Digital Officer
Nikki has principal responsibility for the Society's digital channels and operating model, the development and implementation of the customer centricity strategy, including customer experience, brand and communications strategies, alongside contributing to the overall running of the Society as an active member of the Executive Committee. Nikki has over 25 years of customer focused expertise, specialising predominantly in heavily regulated environments across both the public and private sector.

Andy Moody
Chief Commercial Officer
Andy has over 17 years' experience in financial services, having operated in senior risk and commercial management roles at PwC, Skipton Building Society, Northern Rock, National Australia Bank and Bradford & Bingley. Andy joined the Society in 2012 and has held the roles of Director of Credit Risk and Deputy Chief Risk Officer and more recently, Chief Commercial Officer, under which he has overall responsibility for the development and management of the Society's products and intermediated distribution.

Corporate Governance Report

Continued

Nick Young
Chief Transformation Officer
Nick joined the Society in August 2018 and has a background in commercial management and strategic change delivery. He has hands-on experience of driving performance improvement initiatives across a range of industries gained through his time as a management consultant with Boxwood Group. Nick joined the Society from Lloyds Banking Group, where he was responsible for successfully delivering a number of high-profile change initiatives across the savings and personal current account businesses. In Nick's role at the Society, he is responsible for leading the Transformation Division with functional responsibility for strategy, customer insight, corporate communications and change delivery.

Society Secretary

Katherine Tong is the Society's Secretary. Katherine is also the Director of Legal and Compliance and has worked for the Society for 19 years. She 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 as Secretary by the Secretariat and Regulatory Advice team.

Effectiveness

Board effectiveness

The Code requires boards to undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. This evaluation should be externally facilitated at least every three years. The Nominations Committee is responsible for overseeing the board evaluation process. In 2019, an internal effectiveness review was undertaken by way of a detailed questionnaire, in conjunction with an externally facilitated session, by Mission Performance Limited, to further the Board's understanding of the strengths and personal style preferences of the Board members. The Society has no other connection or conflict of interest with Mission Performance Limited. The next externally facilitated review is scheduled for 2021.

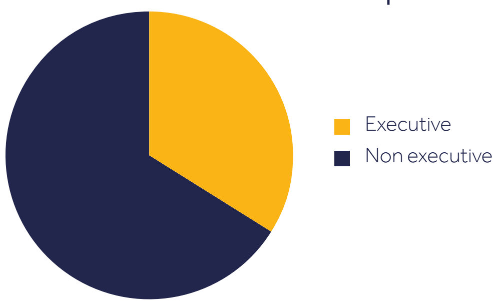
The outcome of the 2019 review concluded that the Board, and Board committees, were operating effectively.

All Board committees also evaluate their own performance and effectiveness annually. This process serves to identify any areas where members may require further training/development to discharge their duties effectively, or where the overall performance or approach of the committee could be improved. More information on the 2019 Board evaluation process is included in the Nominations Committee Report on page 75.

Board composition

As at 31 December 2019, the Board comprised 11 directors, of whom three were executive directors and eight were independent non executive directors. The size, structure, diversity and composition of the Board is reviewed and considered throughout the year by the Nominations Committee. This ensures that succession planning is a key area of focus and promotes the continual refresh of skills and experience on the Board, to support the Society in meeting our strategic objectives.

Executive and non executive composition



The current composition of the Board complies with the Code, which requires at least half of the Board, excluding the Chair, to be made up of independent non executive directors. The Board considers that the current mix of directors' skills, experience, background and opinions complement each other and provide an appropriate balance. This helps ensure members' interests are protected and that the Society has effective 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.

Appointments to the Board

The table below provides a summary of the changes to the Board membership in 2019.

Peter Hill	Chief Executive Officer	Retired Feb 2019
Philippa Brown	Non Executive Director	Resignation April 2019
Robin Litten	Chief Financial Officer	Resignation April 2019
Iain Cornish	Non Executive Director	Appointment Jan 2019
Annette Barnes	Non Executive Director	Appointment Feb 2019
Karen Wint	Chief of Staff	Retired from the Board on 31 Dec 2019

The Board considers and acts upon recommendations for appointments from the Nominations Committee. Additional details of the changes to the Board membership in 2019 can be found in the Nominations Committee report on page 74. All directors must meet the tests of fitness and propriety prescribed by the FCA and PRA and certain roles must be approved by both regulators. Furthermore, they must be elected to the Board by members in a general meeting, at the first opportunity following initial appointment.

The Board elects its Chair and Vice Chair, annually at the next Board meeting following the AGM.

Non executive directors' letters of appointment are available on request from the Society's Secretary and will be available at the next AGM.

Member nominations

In accordance with the Society's rules, members are entitled to nominate candidates for election to the Board, subject to compliance with the PRA and FCA requirements.

Independence

The Board reviews independence annually and considers all non executive directors to remain independent in character and judgement and that there are no circumstances which are likely to impair their independence. None of the non executive directors have been recent employees of the Society, had a material business relationship with the Society, received any additional fees other than their director's fee or have close family ties or significant business links to other directors.

The Board's annual review of potential conflicts of interest did not identify any relationship or conflict which would impair a non executive director's ability to meet the independence criteria set out in the Code.

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 actual or potential conflicts of interest, should they arise. The policy requires that any external positions which a director wishes to take up should first be referred to the Board for consideration and approval, 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 and associated time commitment of all directors which may give rise to a conflict and has authorised potential conflicts, where appropriate. The Board considers that neither the Chair, nor any director, had a material conflict of interest to declare, which would impact the effective discharge of their responsibilities, during the year ended 31 December, 2019.

The Board considers that all individual directors, have sufficient time to discharge their duties at the Society and they do not hold more than the prescribed number of directorships under Article 91 of the Capital Requirements Directive IV.

During the year, Robin Ashton became a non executive director of Domestic & General Limited, Gareth Hoskin became a non executive director of Saga plc, Phil Jenks became a non executive director of Recognise Financial Services Limited and Annette Barnes became a non executive director of Old Mutual Wealth Limited and Old Mutual Wealth Life and Pensions Limited. The Board approved each of these appointments and agreed that the time commitment would not impact their ability to commit to their roles at the Society or its committees. A list of all external appointments held by Board members is shown in the Annual Business Statement on page 190.

Corporate Governance Report

Year ended
31 December 2019

Continued

Directors' induction, development and individual performance evaluation

On appointment, all new directors undertake 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 have agreed development actions which are 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, our values and culture, business and objectives, the regulatory framework and the market in which we operate. Having a strong command of issues relevant to prudential and conduct risk is also essential and will inform Board and committee discussions and decisions.

Throughout 2019, the Board received training on subjects structured around the Society's strategy and matters reserved for the Board to ensure current awareness and informed decision making including:

- Open Banking;
- Recovery and resolution planning;
- Conduct and operational risk; and
- Developments in the intermediated mortgage market.

In addition to the annual performance evaluation of individual non executive directors by the Chair, mid term personal development plan reviews also took place. The Board evaluates the Chair's own performance at a meeting when he is not present. Feedback is then provided to him by Gareth Hoskin, the SID.

Executive directors, including the CEO, are evaluated annually within the framework for all colleagues of the Society and by the Remuneration Committee, in terms of any variable remuneration.

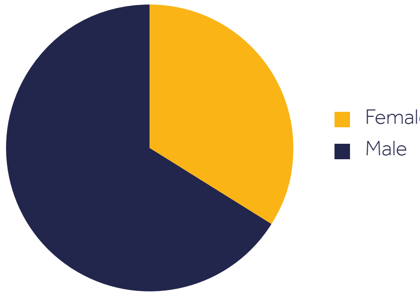
Board and senior leadership diversity

The Society firmly believes in the benefits of diverse Board membership and promotes an inclusive culture across the organisation, in line with our values. The Board believes that the diversity of skills, experience, backgrounds, opinions and other distinctions, including gender and race, strengthens the capability of the Board and, therefore, the effectiveness of its independence, judgement and decision making.

To reflect the importance placed on gender diversity, the Board has agreed a target of 33% for females on the Board, by 2021, in line with our commitment as a signatory to HM Treasury's Women in Finance Charter.

As at 31 December 2019, three members of the Board were female, representing 27% of the total Board membership. In terms of the wider leadership team (our top three levels of management), the current population is 99 of which 33 are female. This equates to 33% female representation in this group. Gender diversity is taken seriously and a priority in the diversity and inclusion strategy is to consider how we can increase the number of females in senior roles, developing talent for the future and removing any potential barriers to the development of their career.

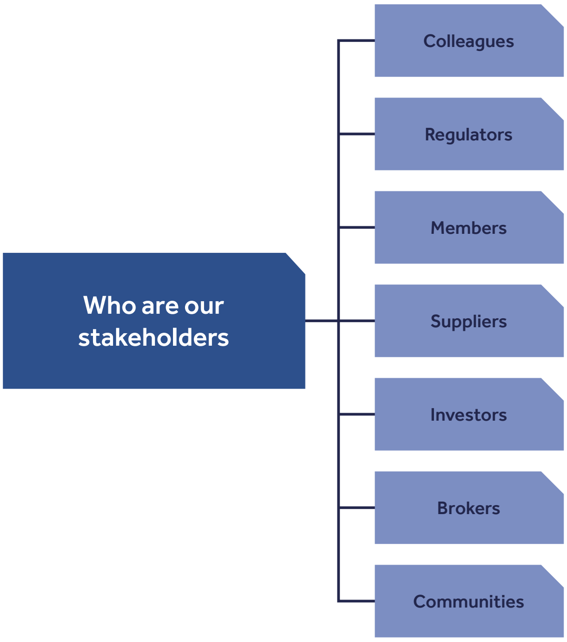
Board Diversity



There is a dedicated diversity page on our website, which can be found at www.leedsbuildingsociety.co.uk/your-society/financial-information/diversity/

Stakeholder engagement

The Board recognises that the Society has a number of internal and external stakeholders. In discharging its duties, the Board considers proposals and makes decisions with relevant stakeholders in mind, before approval or support is granted. To support the Board in this process, reports to the Board aim to include consideration of those stakeholders impacted, so that decisions can be made cognisant of all relevant stakeholders. The Code requires the Board to understand the views of, and to ensure effective engagement with, all relevant stakeholders. Further details on this can be found below and on pages 18 to 21 of the Strategic Report.



Our members

The Society is a member-owned mutual organisation and the views of savers and borrowers are very important. Feedback on any aspect of our business activities is 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.

Member engagement

The Society considers that it is important to know what really matters to members and how products and services can be made even better. With TalkingPoint, our online panel, members have the chance to tell us what they think. It is an opportunity to give feedback on a wide range of subjects, from the Society itself, to new products and services.

The panel now has over 2,500 members actively taking part in research.

Members are encouraged to engage with the Society and each other. A number of forums and research activities have been created. By way of example, we have included below some of the recent research conducted with TalkingPoint where we asked members;

- For their views and opinions on the 2019 AGM and voting process;
- To test draft communications to ensure they drive the right action, for example what members understand, prefer and value from communications they may receive about their account;
- About their views on businesses in general and the payment of taxes, with particular focus on member awareness and opinions on the Fair Tax Mark Initiative and the fact that the Society is already Fair Tax accredited;
- About their expectations in respect of variable ISA products. We used this research to launch a new product called Double Access Cash ISA – putting our members' views at the heart of the product's creation; and
- To provide their thoughts on the design of the welcome pack envelope.

More information can be found on the website: www.leedsbuildingsociety.co.uk/your-society/talkingpoint

The Annual General Meeting (AGM)

The AGM is an important event for members to have their say on the way in which the Society is run. The next meeting will be held on Friday 3 April 2020 at 11.00am 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 details of how to contact us.

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

Building on the 2019 approach, members will again be invited to join TalkingPoint to provide feedback on their voting experience. This helps us to improve customer experience and to understand how members prefer to vote and the information they require.

Further information on member engagement can be found on page 19.

Colleagues

The Colleague Association is the elected colleague forum that works on behalf of its colleague members to ensure the Society is a great place to work. 64% of colleagues are members and the association provides legal assistance, guidance and welfare support. It is the forum for colleagues to provide feedback to senior management and the association's committee has regular meetings with senior managers to discuss business performance.

Colleague representative

The nominated colleague representative, Lynn McManus, Non Executive Director, carries out a number of branch and departmental visits, and meets with the Colleague Association at least twice annually to discuss key themes and ways in which the Board can provide further support. Lynn reports to the Board on her findings and agrees appropriate actions with management. This ensures that colleague views are discussed at Board level, which means culture and colleague opinions can be monitored more closely.

Further information on support for colleagues, including policies and associated key performance indicators, can be found in the Strategic Report on pages 16 and 17.

'In my first year as non executive director representing colleagues, I am delighted to update you on my activities to ensure the Board understands our colleague's views first-hand.

Along with branch and department visits to hear views direct from colleagues, I have also been meeting regularly with the Chair of the Society's Colleague Association.

A range of topics have been covered. In particular, discussions have focused on the change programme the Society has underway and how these activities are communicated to colleagues. I heard how they are feeling well informed of our challenges and opportunities. Conversations also focused on how we are able to recognise and support colleagues with mental health concerns; I am pleased that the Society is forward thinking in this area and how this is recognised and appreciated. The Society now has 44 trained mental health first aiders.

I reviewed the colleague engagement survey in detail and am particularly pleased that we continue to show improving scores in colleagues feeling they can raise any concerns. I update the Board regularly on the detail of my discussion.'

Lynn McManus,
Colleague Representative and
Non Executive Director

Suppliers

The Society's supplier partners are an essential part of our business operations and key to the ability to develop and deliver services to members. It is important that third parties represent us in a manner which supports and enhances our reputation, as well as the relationship with members, colleagues and other stakeholders. The Society's supply chain includes suppliers of goods and services including professional services (such as conveyancing services), IT platform services (access and administration) and IT software licences. The regulated nature of financial services means that we operate within a low risk industry for modern day slavery, but nevertheless we remain vigilant and take our responsibilities under the Modern Slavery Act seriously. Colleagues across the Society are advised by the Procurement team on approaches to due diligence at the point of entry into supplier arrangements, which are proportionate to the risks involved in individual procurement exercises.

Consequently, we aim to partner with organisations that show a commitment to our mutual values, ethics, policies and standards.

In 2019, we have aligned our policy and processes on outsourcing. We classified our third parties to ensure that our contracts, due diligence and management of third parties are proportionate in terms of risk and value to the Society. For those third parties deemed strategic, the contract approval is reviewed by Board Risk Committee, to ensure that appropriate measures have been put in place, along with a second line report on the process. Criteria are also in place to enable ongoing management of the third parties in line with their classification so that the Society manages the risks and drives value in the outsourcing relationship.

Communities

The Society supports a wide range of local and national communities and charities, as well as being partnered with Samaritans. Further information can be found in the Strategic Report on pages 24 to 26.

The Society invested the equivalent of over £541,750 in 2019 into communities and 63% of its colleagues have volunteered their time to support good causes.

Tax funds the essential public services our communities rely on every day. We are proud to pay our fair share of tax and we transparently report the contribution we make. In 2019 the Society paid almost £19 million in corporation tax and was reaccredited with the Fair Tax Mark (see page 30 for details).

Relations with other investors

The Society's Treasury team has developed a programme for investor relations, which includes presentation of the Annual Results at an invited event in the City of London. Regular financial performance updates are provided and/or made available to investors following the publication of the annual and interim results. Engagement with investors is through holding individual meetings with key institutional investors, group presentations and attendance at specially arranged investor days. Attendance at investment conferences and specially arranged investor events provide the opportunity for additional engagement with investors.

An investor relations area is maintained on our website, which gives access to a wide range of materials including the Annual Report and Accounts, investor presentations and the prospectuses for each of the Society's various bond programmes.

Regular and close dialogue is maintained with credit rating agencies, Fitch and Moody's. A formal review meeting is held on an annual basis with each agency. At other times a close relationship and regular dialogue is maintained.

Regulators

The Society has an open and transparent relationship with both the FCA and the PRA.

Intermediaries

Our strategy sets out to distribute mortgage lending predominantly though our intermediary partners.

Our aim is to be rated within the top half of our peer group, through investing and improving our intermediary relationships, while continuing to enhance our technology service propositions.

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

Robin Ashton
Chairman

25 February 2020

Nominations Committee Report

Year ended
31 December 2019

Dear member

Highlights from 2019

- Board evaluation
- Chair succession planning
- Compliance with UK Corporate Governance Code
- Awarded Leaders in Diversity status
- Two new non executive directors join the Board

I am pleased to present our 2019 report on the Nominations Committee, which reviews our activities over the past year and provides more detailed insight into the role and responsibilities of the committee.

The committee has undertaken all matters within its ToR, with focus on corporate governance and compliance with the revised 2018 UK Corporate Governance Code (the 'Code'). Other activities included supporting a board effectiveness review and undertaking succession planning for the Chair.

In early 2019, the committee strengthened the composition of the Board with the appointment of two new non executive directors, Annette Barnes and Iain Cornish. Both individuals have brought a wealth of experience, knowledge and skill to the Board, further contributing to and ensuring the sustainable success of the Society. In addition, the new CEO, Richard Fearon, introduced changes to the senior leadership structure to support the executive directors and the Board as a whole. The Senior Independent Director, Gareth Hoskin and the committee are also overseeing the appointment of Iain Cornish as my proposed successor (subject to re-election as a non executive director and approval by the Board following the AGM), following my nine year tenure with the Society as a non executive director and Chair.

The Board firmly believes in the importance of a diverse Board membership. It strengthens the capability of the Board and the effectiveness of its independence, judgement and decision making. The committee has continued to support the Society's diversity and inclusion programme, which is now firmly embedded into our strategy and culture. To demonstrate this, in 2019, we celebrated National Inclusion Week and established new colleague forums, including a Gender Diversity forum and a BAME forum, in which colleagues set the agenda to consider ways to increase representation in these areas and create a more diverse pipeline for succession. We are delighted to be the first financial services company to achieve Leaders in Diversity status, awarded by the National Centre for Diversity, reflecting our focus and commitment to diversity overall.

In the year ahead, we will continue to focus on diversity and inclusion, whilst maintaining the highest standards of governance.

Who sits on the committee?

The Nominations Committee comprises four independent non executive directors.

Committee members (as at 31 December 2019)

Robin Ashton (Chair)

Phil Jenks

Gareth Hoskin

Iain Cornish

Gareth Hoskin and Iain Cornish joined the committee in 2019 and Richard Fearon, CEO, is a regular attendee. Other members of the Senior Leadership Team are invited to attend, when appropriate. Attendance records for the meetings held in 2019 can be found in the Corporate Governance Report (see page 62).

Katherine Tong, Director of Legal, Compliance and Secretary is Secretary to the committee.

What does the committee do?

The committee is appointed by the Board and was in place throughout the year, meeting five times. Robin Ashton, Chair of the Board, is also Chair of the committee. The committee's key areas of responsibility and focus throughout 2019 have been to lead the process for new Board appointments; ensure plans are in place for orderly succession to the Chair, as well as for other Board and senior leadership positions; oversee the development of a diverse pipeline for succession and ensure compliance with all corporate governance requirements, including those of the Code and the relevant conduct rules of our regulators: the FCA and PRA.

Following each meeting the Chair provides an update to the Board on the matters discussed and agreed.

Terms of reference and key responsibilities

Board composition and effectiveness	The committee is accountable for ensuring that the Board and its committees comprise directors with the appropriate balance of skills, experience, backgrounds and opinions, to fully discharge their duties in a highly effective manner.
Succession planning	The committee is responsible for considering the succession planning of the Board, executive directors and Senior Leadership Team.
Governance	The committee is responsible for ensuring that the Board meets the principles of the new UK Corporate Governance Code, sourcebooks and other appropriate regulatory requirements relevant to its remit.
Diversity	The committee agrees annually, the measurable objectives for board diversity and recommends them to the Board for adoption.

Nominations Committee Report

Year ended
31 December 2019

Continued

Key activities in 2019

Board composition and effectiveness

The committee reviewed the composition of the Board, to ensure it comprised a sufficient number of executive and non executive directors, who meet the requirements as set out by the Code and the Senior Managers Regime. The committee also monitors the composition of Board committees. For further information on Board committees, please see pages 61 and 62 of the Corporate Governance Report. As part of this review, the current mix of directors' skills, experience, backgrounds and opinions were considered using a competency skills matrix. The review concluded that, in the main, there was a good level of diversity and coverage in respect of the Board's requirements. The primary focus is to ensure directors' skills complement each other and achieve an appropriate balance. This in turn ensures members' interests are protected and the business has appropriate leadership and direction to ensure the long term sustainable success of the Society.

The committee reviewed the length of service of each non executive director and the potential impact on Board committee membership of those directors who are nearing the end of their term of appointment. This aided forward planning, promoted the continual refresh of skills and experience on the Board and, together with the composition review, provided insight and direction into the search process for new non executive directors (details of whom can be found below).

Changes to the Board in 2019

January	Iain Cornish, Non Executive Director, joined the Board. Gareth Hoskin was appointed into the role of SID and Lynn McManus was appointed as Chair of the Remuneration Committee.
February	Following the retirement of Peter Hill, Richard Fearon was appointed as CEO. Annette Barnes, Non Executive Director joined the Board.
April	Robin Litten resigned from his positon as Chief Financial Officer and Executive Director to pursue the next steps of his career. Philippa Brown, Non Executive Director, member of the Remuneration Committee, left the Society after six years on the Board to focus on her executive career.
December	Karen Wint retired from the Board on 31 December 2019.

More information about each Board director can be found within the directors' biographies on pages 54 to 56.

Board re-appointments

Non executive directors are appointed for a three year period and are usually expected to serve two terms. These terms are subject to ongoing performance evaluations and to annual re-election by members of the Society at the Annual General Meeting. Directors may also be proposed for a third term, up to a maximum of a further three years (nine years in total), providing they are considered to remain independent from the Society.

As recommended by the committee, each non executive director will receive a tailored refresher training programme following the extension of their appointment for a further three years.

Board and committee effectiveness

The Nominations Committee is responsible for oversight and conduct of the annual Board effectiveness review. As part of a three year cycle, an internally facilitated review was undertaken in July 2019.

Following an external review in 2018, the Nominations Committee recommended - and the Board agreed - that the 2019 evaluation should be conducted internally, using a detailed questionnaire as the basis for discussion. The questionnaire was enhanced in line with the Code and the Financial Reporting Council's (FRC) Guidance on Board Effectiveness, to include an assessment of decision making and to obtain feedback on the Board from other stakeholders. A summary of the results was presented to the Board for discussion in June and relevant actions were agreed. The agreed actions included:

- consideration by the Nominations Committee of the future skills requirements and diversity of the Board; and
- a review of the composition of Board committees to enable the Board to have more time to discuss strategic matters.

This was followed in July with an externally facilitated session, in which Board members undertook an assessment to further understand how individuals, with different preferences and styles, could optimise working together. Overall, the results demonstrated that Board members operate effectively both individually and collectively. The next externally facilitated review is scheduled to take place in 2021.

Committee evaluation

In accordance with its ToR, the committee evaluated its performance and effectiveness over the year. The results of the review were discussed at the committee's meeting in October 2019. The results were positive and, overall, the conclusion was that the committee operated effectively. As part of the annual review, the committee approved a number of changes to its ToR in October 2019, bringing it into line with the recommendations of the Code, best practice and our policy on diversity and inclusion.

Conflicts of interest and directors' independence

The independence of all non executive directors was assessed against the criteria set out in the Code, taking into account their length of service. The committee considered potential conflicts of interest by undertaking a review of all external appointments held by each director, against the limitations on the number of appointments which can be held by an individual in accordance with Article 91 of the Capital Requirements Directive IV. The review concluded that all appointments remained appropriate, with no concerns arising regarding the ongoing independence of each non executive director. The Board's Conflicts of Interest Policy was also recommended by the committee to, and subsequently approved by, the Board. Further details on conflicts of interest are contained within the Corporate Governance Report on page 67.

Succession planning

Chair succession

The Chair, Robin Ashton, has been a non executive director since April 2011 and the Society's Chair since March 2013. As reported last year, following a rigorous review and taking into account his depth of experience and skills, the committee recommended (and the Board agreed) to extend his directorship until April 2020. Robin will retire from the Board on 3 April 2020. Iain Cornish has been proposed as Robin's successor following the AGM. The matter of a potential successor for the Chair has been the subject of attention for the committee throughout 2019. A review of potential candidates in the financial services sector was undertaken using Warren Partners, an external recruitment agency with which the Society has no other connection or conflict of interest. The review concluded that Iain Cornish was the best candidate for the role. In July 2019, the committee recommended to the Board that Iain Cornish be appointed as the Chair following the retirement of Robin Ashton. This was subsequently approved by the Board. Gareth Hoskin, SID, acted as Chair in all Nominations Committee meetings and Board meetings where the Chair's successor was discussed.

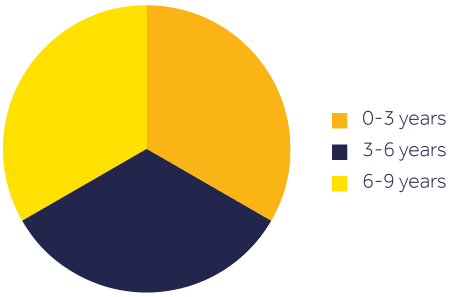
Nominations Committee Report

Year ended
31 December 2019

Continued

Board tenure
At every meeting, members of the committee receive a detailed tenure plan showing the length of each director's service with the Society. It highlights any non executive director who will be nearing completion of three, six or nine years' service within the next eighteen months. This ensures the requirements for succession are continuously kept under review and succession plans are established in advance, allowing time for regulatory approval, where required, for new candidates. As at 31 December, 2019, none of the non executive directors have been in office for more than nine years.

Tenure



Non executive director appointment and succession planning
Before a search and selection process commences, the succession needs of the Society are subject to an evaluation of the balance of skills, experience, backgrounds and knowledge on the Board. The outcome of the annual Board evaluation also forms part of this review. In light of this, the specific responsibilities of the role and appointment criteria are determined. All Board appointments are based on merit against objective criteria, the skills and experience of the Board as a whole, with regard to the benefits of diversity.

Senior leadership talent and succession planning
The committee is responsible for recommending the appointment of new directors to the Board. This is done with a view to ensuring the continued ability of the organisation to compete effectively in the marketplace, for the long term.

Following Richard Fearon's appointment as the new Chief Executive Officer in February 2019, there were a number of changes to the structure of the Senior Leadership Team. This was to provide further support to the executive directors by bringing new skills and knowledge to the ExCo, for example, to further develop the Society's digital capabilities. The changes involved the promotion of four individuals and two new appointments to the Executive Committee. Further information on members of the Executive Committee can be found within the Corporate Governance Report at pages 65 and 66.

Governance
Throughout the year the committee received detailed updates from the Society's Secretary on the actions being taken to ensure compliance with the Code. Additionally, the committee is updated annually with an assessment against the provisions and principles of the Code and in 2019, the Society complied with the Code, as far as is relevant for a building society.

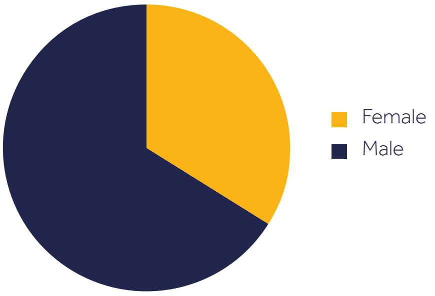
In addition, a number of matters were undertaken by the committee, these included:

- a review of the required capabilities and the job descriptions for the roles captured by the Senior Managers Regime;
- an annual review of the Senior Manager and Certification Regime Selection Policy;
- a review of matters reserved for the Board and the division of responsibilities between the Chair, CEO and Senior Independent Director; and
- an annual review of committee memberships and compositions.

Diversity and inclusion
In 2019, the Nominations Committee agreed measurable objectives, as detailed below for Board diversity and reviewed the Diversity Policy, recommending them to the Board for adoption:

- Proactively aim for, and sustain, female representation of 33%, both on the Board and in the top three layers of the 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 to be considered as part of the attraction methods utilised; and
- Provide enhanced disclosure on the Board appointment process and the consideration of diversity as part of the board evaluation process.

Female representation within the senior management team is 33%



The representation of women at Board level at 31 December 2019 was 27% and the committee is actively supporting actions to meet the target of 33% by 2021. Representation of women at senior management level is on target at 33%.

The Society is a signatory to the HM Treasury's Women in Finance Charter and the committee noted progress is being made in relation to the number of females in senior roles.

Gender pay
The Society welcomes the move to drive fairness of pay for women, having embedded a Fair Reward approach over a number of years. This helps to determine salaries objectively for all colleagues. The Society is proud that over 60% of its workforce is female. However, there are more men than women in more senior, and, therefore more highly paid, roles. This means there is a gender pay gap. Further information can be found on the Society's website at www.leedsbuildingsociety.co.uk/your-society/financial-information/. The activities undertaken to promote wider diversity within the Society are explained in more detail in the Strategic Report on pages 16 to 17.

Key areas of focus in 2020
In the coming year, the committee will continue to focus on ensuring the Society has a strong governance structure. It will provide ongoing oversight of the composition of the Board and succession planning, with particular emphasis placed on diversity and the development of a strong and diverse pipeline of colleagues for the Senior Leadership Team and Board. The committee looks forward to welcoming Iain Cornish as the proposed new Chair of the Board and of the Nominations Committee.

On behalf of the Board.

Robin Ashton
Chair of Nominations Committee
25 February 2020

Board Risk Committee Report

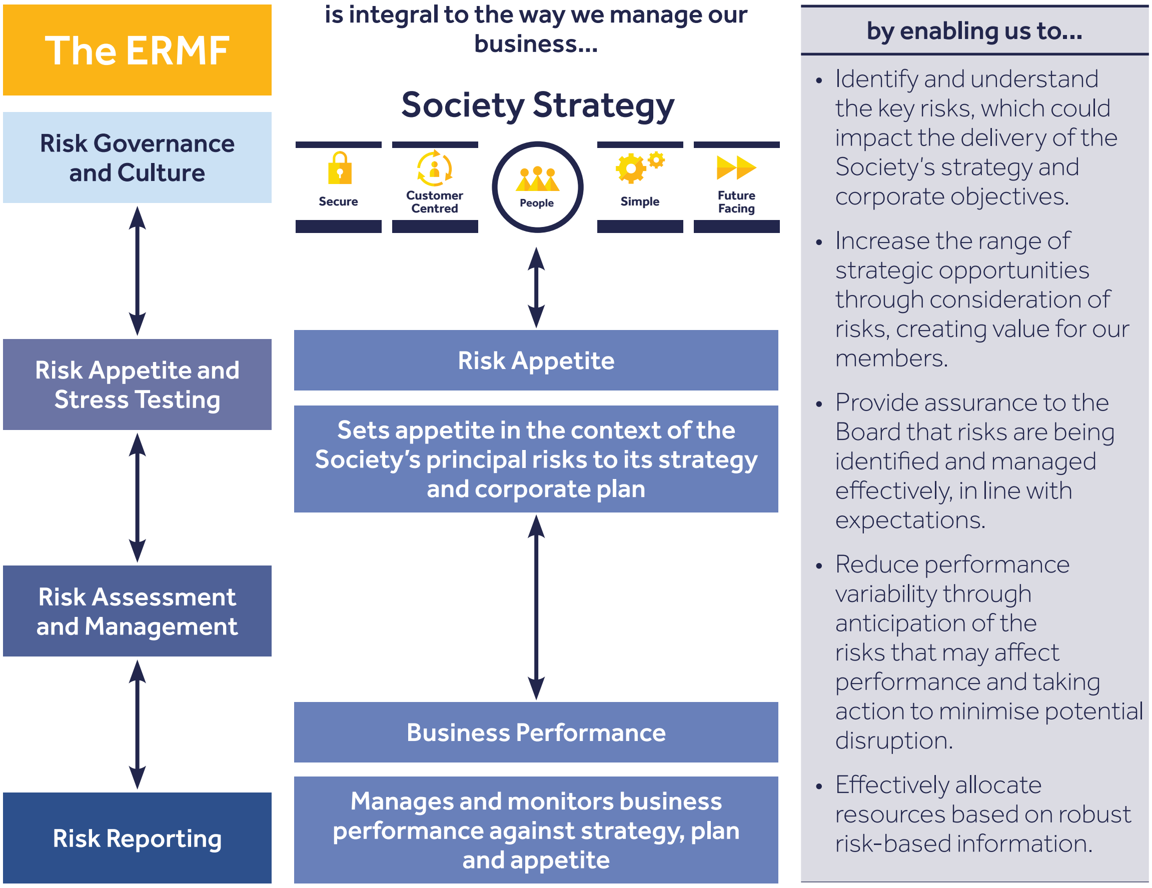
Year ended
31 December 2019

Dear member,

As Chair of the Board Risk Committee (BRC), I am pleased to present the 2019 Risk Management Report. This report provides an overview of the Society's approach to risk management and a summary of the main focus areas of BRC during the year.

Approach to risk management

The Enterprise Risk Management Framework (ERMF) integrates various risk management tools to support the effective development and implementation of our strategy. The framework sets out a structured approach to identifying, assessing, controlling and monitoring risks, which is used to inform decision making at both strategic and operational levels. The ERMF is reviewed annually by the BRC, on behalf of the Board. The Chief Risk Officer (CRO) has responsibility for its implementation.



The main components of the ERMF are outlined below:

Risk governance and culture

Risk governance is the processes followed to support risk-based decision making and oversight across all of our operations, whereas risk culture relates to the behaviours and attitudes of colleagues in making these decisions. These structures, disciplines and values support the Board in carrying out its accountability for risk oversight, with management responsible for day to day decision making.

Committee structure

The Board is our governing body, responsible for overseeing the implementation of the Society's strategy and holding management to account. To support the Board in the delivery of its responsibilities, we operate four Board sub-committees, each with distinct mandates in their ToR.

BRC provides independent oversight of the effective management of our risk universe. BRC is supported by five Executive Risk Committees, each focusing on a particular discipline(s) of risk. These committees are decision making in nature and operate within delegated mandates and limits provided by the Board/BRC. The Society's committee structure as at 31 December 2019 is set out below:

Board

Chair: Robin Ashton

- Safeguarding member interests
- Ensures robust risk management systems and internal controls are in place
- Setting risk appetite
- Leading, developing and implementing the Society's culture

Remuneration Committee

Chair: Lynn McManus

- Ensures remuneration policies, principles and practices support the long term interests of the Society

Board Risk Committee

Chair: David Fisher

- Reviews the Society's risk exposures and oversees the ERMF
- Develops strategic risk appetite and the Society's ICAAP, ILAAP and RRP for Board approval

Audit Committee

Chair: Gareth Hoskin

- Monitors the integrity of external financial reporting
- Reviews the effectiveness of systems of internal controls
- Assesses the effectiveness, performance and independence of the Internal Audit function

Nominations Committee

Chair: Robin Ashton

- Reviews the structure, size, diversity and composition of the Board
- Oversees succession planning and identifies candidates to fill Board vacancies

Models and Rating System Committee

Chair: Andrew Greenwood

- Supports BRC in relation to model risk matters and maintenance of the IRB Rating system

Assets and Liabilities Committee

Chair: Andrew Conroy

- Supports BRC in relation to balance sheet risk matters

Credit Committee

Chair: Andy Moody

- Supports BRC in relation to lending related matters

Conduct and Operational Risk Committee

Chair: Jaedon Green

- Supports BRC in relation to conduct, customer related and operational risk matters

Operational Resilience Committee

Chair Karen Wint*

- Supports BRC in relation to operational resilience matters

*Rob Howse from Jan 2020.

Continued

Policies and delegated authorities

Mandates are also provided by the Board to management via the following routes to manage our day to day activities:

Delegation route	Summary
1. Policy Framework	The Society operates a tiered policy framework, through which mandates and limits are delegated to management. All of our policies are reviewed on an annual basis by relevant committees.
2. Delegated Authorities Manual	The Delegated Authorities Manual is designed to facilitate the effective discharge of responsibilities and continuity of operations within a sound system of financial, operational and budgetary control. It is reviewed by the Board annually.
3. Corporate plan	Subsequent to the approval of risk appetite, the corporate plan provides the annually Board-approved parameters within which management should operate.

Three lines of defence model and the Risk function

The Society's approach to risk management aligns to a 'three lines of defence' model, which is standard practice within the financial services sector. This ensures a clear delineation of responsibilities between control over day to day operations, risk oversight and independent assurance of activities. The key accountabilities under the three lines of defence model are detailed below:

First line (Business lines)	Second line (Risk function)	Third line (Internal Audit)
• Executing strategy. • Identifying and managing risks. • Adhering to appetite, policies and standards. • Implementing and maintaining regulatory compliance. • Identifying emerging risks.	• Oversight of day to day activities of the first line. • Maintenance of the ERMF. • Coordination and oversight of the setting of risk appetite. • Policy co-ordination/refresh. • Identifying emerging risks. • Enterprise risk reporting. • Independent risk based assurance plans.	• Independent risk based assurance of the adequacy and effectiveness of first and second line risk management.

The Risk function is independent from operational business divisions. It ensures we follow a consistent approach to risk management and is led by the CRO, who reports directly to the CEO (and is also accountable to the Chair of the BRC). The Risk function comprises specialist teams, aligned to key risk disciplines, which provide oversight and independent challenge of first line activities.

Risk culture

Risk culture is an essential element of effective risk management, underpinning how our ERMF is embedded across the business and into decision making. In order to maintain a risk aware culture, the ERMF includes a risk culture framework, designed around four components:

- **Tone from the top and desired behaviours** – this reflects our values, which are demonstrated by the Board and the Senior Leadership Team.
- **Accountability** – we hold individuals at all levels accountable for risk management, to support the delivery of our strategy and business objectives.
- **Effective communication** – an environment of open and transparent communication is encouraged about risk management expectations.
- **Incentives and talent management** – we operate an appropriate incentive scheme and other HR frameworks to promote the desired risk culture.

Risk appetite and stress testing

Risk appetite framework

A key element of the ERMF is Strategic Risk Appetite (SRA). This comprises qualitative statements and quantitative metrics to provide the boundaries within which we should operate to deliver our strategy. Our SRA is reinforced through policies and standards, to ensure consistency and alignment to Board defined parameters.

The Board defines SRA across seven principal risk categories (defined on pages 32 to 37). The metrics are reviewed annually and are used in stress testing to measure and validate our long term viability, under both plausible and more severe scenarios. They are also assessed on a forward looking basis, within the corporate planning process.

The Board receives monthly management information on risk exposures in relation to appetite and we have developed appropriate early warning indicators and escalation procedures to anticipate and respond to changes in risk profile.

Stress testing

Stress testing is a risk management tool used throughout the Society to support an understanding of the vulnerabilities within our business model. Our approach to stress testing is defined within the stress testing framework (part of the ERMF) and supports:

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

We have 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:

Increasing Severity

Activity	Description
Corporate Planning	Sensitivity analysis and a suite of alternative scenarios are used to assess the corporate plan under a range of plausible stresses.
Prudential Risk Assessments	ICAAP – an internal assessment of whether we have sufficient capital, given the risks endured, as well as future risks from our strategy, under stressed conditions. ILAAP – an internal assessment of whether we have sufficient liquidity and stable funding to withstand a severe liquidity 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 stress and to set and validate operational protocols.
Reverse Stress Testing	An assessment of the stress scenarios under which we would potentially become unviable. This examines potential weaknesses in our business model under extreme events so that mitigating actions can be identified (as appropriate).

Continued

Risk assessment and management

The Society operates defined risk assessment and management processes to facilitate the consistent identification, analysis, evaluation, treatment and monitoring of risks across the organisation. The framework can be applied to both strategic and operational risk assessments and is set within our business environment, strategy and objectives. A summary of the five stages of this process follows:

Risk identification – we operate both Board and operational level risk identification processes to capture new or emerging risks, which could impact corporate objectives and the delivery of our strategy.

Risk analysis – we utilise a range of methodologies to assess risks, in order to understand their severity and likelihood on the delivery of our strategy and to inform risk evaluation and treatment.

Risk evaluation – we evaluate and prioritise risks to inform decision making and to optimise the allocation of resources.

Risk treatment – management select and deploy appropriate risk responses, balancing the potential benefit derived versus economic cost, effort and implications for key stakeholders.

Risk monitoring – we monitor our risk assessment and management processes to proactively identify and adjust to changes in risk profile and to understand the effectiveness of implementing risk treatment strategies.

Risk reporting

We operate an appropriate risk reporting hierarchy to provide the right information, to the right people, at the right time, to inform and support timely decision making. We use a combination of strategic and business process reporting to understand the current or potential risk profile of the business, which may impact the delivery of our strategy and corporate objectives. These reporting processes are conducted at an appropriate frequency and are co-ordinated by the Risk function.

Board Risk Committee review

Constitution and frequency

Committee membership was expanded during 2019 from four to six, following the appointment of Iain Cornish in January 2019 and Annette Barnes in February 2019. The other committee members are David Fisher (Chair), Phil Jenks, John Hunt and Gareth Hoskin. All members have strong backgrounds within banking and financial services. Full biographies of committee members can be found on pages 54 to 56.

During the year, the committee held eight meetings. At the invitation of the committee, meetings were attended by relevant members of the Executive and Senior Leadership Teams, ensuring that the three lines of defence were adequately represented. In addition, the committee extended an open invitation to all other non executive directors.

BRC responsibilities and 2019 focus areas

The BRC had a full agenda during 2019, which involved balancing oversight over the Society's current risk profile with emerging risks/requirements. An area of focus during the year centred on establishing and developing our approach to operational resilience. To support BRC in this respect, we also created an Operational Resilience Committee in April, which is responsible for more granular oversight of embedding the resilience framework.

A summary of the main responsibilities of BRC and the 2019 focus areas are outlined below:

Responsibilities of the BRC
• Oversee the development, implementation and effectiveness of the ERMF. • Oversee the formation of the Society's risk appetite. • Monitor our risk profile in relation to appetite, through appropriate management information. • Monitor emerging risks. • Monitor the effectiveness of risk management and internal control systems. • Oversee the development and embedding of an appropriate risk culture. • Review and approve the Society's suite of appropriate Level 1 policies. • Review and recommend to the Board key prudential documents (ILAAP, ICAAP, recovery plan). • Ensure that the Society's remuneration arrangements reflect appropriate risk considerations. • Oversee the activities of Executive Risk Committees. The full BRC ToR are available from the Corporate Governance section of our website.

2019 focus areas	
Topic	**Activity**
Frameworks and Policies	• Annual review and approval of the ERMF; and • Review and oversight of the policy management framework.
Risk Appetite	• Review of the Society's approach to setting risk appetite; and • Annual review of risk appetite statements and metrics and recommended changes to the Board.
Stress Testing	• Annual review and recommendation of the ICAAP to the Board; • Annual review and recommendation of the ILAAP to the Board; • Annual review and recommendation of the recovery plan to the Board; and • Review of reverse stress testing outputs.
Remuneration	• Annual review of risk adjustment recommendations for the Senior Leadership Team; and • Risk based assessment of corporate objectives.
Strategies	• Annual review of treasury strategy; • Annual review of financial crime strategy; • Annual review of cyber threat methodology; and • Review of approach to assessing climate change risks.
Operational Resilience	• Receipt of operational resilience updates; • Approval of new operational resilience and third party management policies; • Review of cyber penetration testing results; • Review of disaster recovery testing results; and • Review of cloud outsourcing proposals.
Monitoring of Risk Profile	• Risk exposures in relation to appetite (through management information); • External risk assessment via the CRO report and strategic heat map; • Review of annual Money Laundering Reporting Officer report; • Review of Data Protection Officer report; • Annual review of accepted risks; and • Oversight of Executive Risk Committees.

Effectiveness review

During October, the committee undertook an internal self-assessment of its effectiveness. The review was performed using anonymous questionnaires and was completed by members and regular attendees. Overall, the review concluded that the committee was operating effectively, in accordance with its ToR.

Outlook

It is anticipated that 2020 will be another busy year for BRC in light of the emerging risk environment and the introduction of new regulatory requirements. Key points of focus are as follows:

- assessing the impacts associated with the UK's departure from the EU and future trading relationship across principal risk categories;
- continuing to oversee the development of the operational resilience programme; and
- overseeing the approach to assessing and responding to risks associated with climate change.

I believe that the committee remains well positioned to meet these challenges, as well as supporting the Society in the delivery of our strategy.

David Fisher
Chair of Board Risk Committee

25 February 2020

Audit Committee Report

Year ended
31 December 2019

Dear member,

I am pleased to present my report on the work of the Audit Committee during 2019.

The committee's main areas of responsibility are in respect of the Society's internal control environment and our external financial reporting. The 2018 changes to the Corporate Governance Code, applied by the Society, have not significantly altered these responsibilities.

Matters of particular note for the committee during 2019 were a review of the effectiveness of the external auditor undertaken by our Internal Audit function and in depth reviews, provided by management, in relation to two complex areas of financial reporting: the valuation of the collateral loan which represents a pool of equity release mortgages and hedge accounting.

The committee has continued to receive appropriate assurance over the risk and control environment of the Society (both throughout the year and as part of the annual attestation process) and concluded that the control environment remains effective and proportionate to our operations.

The Internal Audit function continues to provide an effective and independent third line of defence. The committee also satisfied itself that the external auditor remains effective and independent.

Gareth Hoskin
Chair of Audit Committee

25 February 2020

Committee membership

The Audit Committee is composed solely of independent non executive directors. The committee members are:

Gareth Hoskin (Chair)	Member since January 2016
David Fisher	Member since May 2017
Lynn McManus	Member since September 2017
Iain Cornish	Member since January 2019

Full biographies of the committee members can be found on pages 54 to 56.

The committee members have considerable recent and relevant experience in finance and risk management within financial services.

During the year, the committee held six meetings. At the invitation of the committee, meetings were attended by the Chairman, CEO, Chief Financial Officer, Chief Risk Officer and the Chief Internal Auditor. The audit engagement partner from the external auditor also attended, as did representatives from the Finance function and other relevant business areas.

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

In addition to the formal committee meetings, the Chair maintained regular dialogue throughout the year with key stakeholders including the Chairman, CEO, Chief Financial Officer, Chief Risk Officer, the Chief Internal Auditor and the external audit engagement partner.

How the committee works

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

- monitor the integrity and appropriateness of our externally reported financial statements, including the review and challenge, where necessary, of the actions and judgements made by management in relation to the financial statements;
- review the adequacy and effectiveness of our systems of internal control and risk management;
- monitor the effectiveness, performance and independence of the Internal Audit function; and
- assess the independence, performance and objectivity of the Society's external auditor.

What the committee did during 2019

Financial statements and reporting matters

The committee is responsible for reviewing the Society's external financial statements and recommending them to the Board for approval. In preparing these financial statements, management adopt certain accounting policies and form judgements, prepare estimates and make assumptions.

To help us assess the appropriateness of these, management provide reports to the committee before and after the half year and year end, setting out the basis of the accounting treatments adopted, for our review and challenge. The external auditor also provides reports with its opinions on management's approach.

During 2019, in addition to these regular reports, we also asked management for in depth reviews of two key accounting areas: the valuation of the collateral loan representing equity release mortgages and derivatives and hedge accounting. These sessions provided the committee with additional time to explore the economic and accounting issues for these two key areas and gain a more detailed understanding of management's approach. The external auditor also provided input to the sessions detailing the key audit considerations in relation to each area.

The committee is kept up to date with changes to accounting standards and regulatory focus areas for financial reporting through reports from management and the external auditor. In 2019, this has included the introduction of IFRS 16 and disclosure requirements arising from the new Corporate Governance Code.

The following table sets out the committee's work during the year in examining and challenging the key matters affecting the financial statements. Further details on the critical judgements, estimates and assumptions which have a significant impact on the financial statements are set out in note 2 of the accounts.

Year ended
31 December 2019

Continued

Area of focus	Action taken by the Audit Committee	Conclusions
Residential impairment loss provisions Under IFRS 9 – Financial Instruments, the Society is required to hold impairment loss provisions against its financial assets, calculated on an expected credit loss basis. For the residential mortgage book, these provisions are calculated using complex statistical models which incorporate historical default and loss experience information. The level of provision required under IFRS 9 depends on whether a significant increase in credit risk has occurred since origination, the determination of which requires significant management judgement. Provisions are also calculated across multiple forward looking, probability weighted economic scenarios which require estimation by management.	Reviewed and challenged reports from management on the basis of the calculation of the impairment loss provisions and the management judgements and estimates applied. Received reports from management on the ongoing performance of the models, noting any updates or recalibrations required. Considered management's proposed economic scenarios and weightings which had been approved by the Executive Committee. Noted the analysis provided by management in relation to the sensitivity of model outputs to changes in assumptions and reviewed the associated disclosures in the financial statements. Scrutinised the post model adjustments made by management to incorporate additional factors into provisions which are not covered by models. Considered the outcome of the detailed discussions and challenges to management by the Credit Committee. The Chair and other members of the Audit Committee attended Credit Committee discussions on impairment. Received benchmarking information in respect of the first full year of adoption of IFRS 9 and the impacts disclosed in other financial institutions' accounts. Considered and challenged management's response to thematic findings published by the PRA during the year. Considered whether overall movements in provisions were consistent with changes in economic conditions, in particular, whether management had sufficiently considered the potential impacts of the UK's departure from the EU and the uncertainty around those impacts.	Having considered management's reports and feedback from the external auditor, the committee concluded that our impairment models remain appropriate. The committee agreed that management's approach to deriving economic scenarios and probability weightings is reasonable. The committee also considered that the scenarios sufficiently incorporated the potential impacts of the UK's departure from the EU. Therefore, the committee agreed with the view of the Credit Committee that the level of impairment provisions at the date of the Statement of Financial Position, including post model adjustments, is reasonable.

Area of focus	Action taken by the Audit Committee	Conclusions
Fair value of the collateral loan which represents a pool of equity release mortgages The Society holds a collateral loan to a third party which represents a pool of equity release mortgages acquired from that third party for which some but not all of the risks were transferred to the Society. The nature of the loan means that under IFRS 9 it is classified as being held at fair value through profit or loss. Since open market prices are not readily available, the fair value of this loan is calculated using a model which requires a combination of market data and unobservable inputs.	Requested an in depth review from management setting out the economic and accounting risks arising from this asset, the approach to managing these risks and the key factors considered in determining the accounting value of the loan. Reviewed and challenged management's conclusions as to the application of the classification and measurement criteria of IFRS 9. Discussed the model proposed by management for valuing the loan to understand the basis for calculation; challenged the appropriateness of the modelling choices made. Considered the outcome of the independent model review and approval by the Models and Rating System Committee as part of our governance process for material models. Also considered the outcome of the external auditor's detailed review of the model and management's responses to the challenges raised by the auditor. Noted management's explanation of the key model inputs and challenged the unobservable inputs used by management in calculating the fair value of the collateral loan, requesting additional supporting evidence from management where required. Significant challenge to management was also provided by the external auditor, particularly in respect of the discount rate used in the model. Considered the analysis presented by management showing the sensitivity of the modelled fair value to movements in inputs. Reviewed the sensitivity disclosures in the financial statements. Sought explanation from management to understand the reported movements in fair values during the year.	The committee approved management's approach to the valuation of the collateral loan using a model, noting this would be subject to robust internal governance. The committee noted that open market data in relation to the fair value of the collateral loan is not available, so the valuation is determined based on a number of unobservable and judgemental inputs. As such, there is a wide range of valuations which could be considered reasonable. Taking into consideration management's justification of the model and assumptions, the external auditor's views and considering the sensitivity analysis provided by management, the committee concluded that the fair value recorded in the financial statements for the collateral loan and associated derivatives were within a reasonable range. We therefore considered the value in the financial statements to be appropriate.

Continued

Area of focus	Action taken by the Audit Committee	Conclusions
Hedge accounting and valuation of derivatives The Society holds derivative financial instruments, in order to mitigate various business risks, including interest rate and foreign exchange risks. Derivatives are measured at fair value through profit or loss, so changes in the value of these instruments are recognised in the Income Statement immediately. However, if strict accounting criteria are met, the volatility which would arise from the recognition of these fair value movements can be largely offset by changes in the fair value of the underlying items being hedged by them.	Requested that management provide the committee with an in depth review of their processes, controls and activity in valuing derivatives and applying the hedge accounting rules of IAS 39. Reviewed reports from management on the volume and value of derivatives held, the hedge accounting methodologies applied and effectiveness testing results. Sought additional information from management on the Income Statement impacts and Statement of Financial Position balances in respect of derivative valuations and hedge accounting. Noted the hedge effectiveness testing results presented by management. A review of hedge accounting controls was performed by Internal Audit during the year with the results presented to the committee. No high priority actions were noted. Noted the results of the external auditor's detailed substantive testing and re-performance of hedge effectiveness testing.	The committee has satisfied itself that the hedge accounting requirements of IAS 39 have been appropriately applied. Noting the results of the external auditor's testing, the committee agreed that management's hedge effectiveness testing performed throughout the year was materially appropriate. The committee concluded that amounts recognised by management in the financial statements are fairly stated and that appropriate disclosures have been made.
Interest income recognised on an effective interest rate basis For financial assets measured at amortised cost, interest income is recorded on an effective interest rate basis. For mortgages, this means that certain discounts, fees and costs are spread over the expected life of the mortgage.	Reviewed management's proposals for the calculation of effective interest rate adjustments to income, including which discounts, fees and costs are included in the calculation. Challenged management's explanation of changes to expected lives recorded in the year. Noted the external auditor's challenge to management over the appropriate items to include in the effective interest rate calculation.	Having considered management's report, including their response to the external auditor's challenge, the committee is satisfied that the application of the effective interest rate basis for interest recognition is materially appropriate.
Provisions for liabilities and charges The Society has set aside provisions for liabilities and charges including for the potential cost of customer redress. Although as far as possible the level of these provisions is evidence based, there is a degree of management judgement and estimation required to determine the appropriate level of provisions.	Reviewed and challenged reports from management, which set out the basis of the provisions. Noted the impacts recorded by management of the claims deadline, in respect of Mortgage Payment Protection Insurance. 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 was appropriate.

Area of focus	Action taken by the Audit Committee	Conclusions
Retirement benefit surplus The Society has a defined benefit pension scheme, which was closed to new entrants in January 2000 and 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 the scheme's actuary, KPMG. Noted confirmation from management that these assumptions, together with the disclosures in the Annual Report and Accounts, were consistent with IAS 19. Questioned management as to the movement in the value of the surplus during the year.	The committee noted that the assumptions adopted by management were consistent with the actuary's report and confirmed by the external auditor. It is satisfied with the position reported within the Annual Report and Accounts and the recognition on the balance sheet of the pension scheme surplus.
Recognition and measurement of intangible assets The Society continues to invest in its technological capabilities through purchasing of software licences and IT development services, alongside internal development activity. Judgement is required in assessing whether the expenditure meets the requirements of IAS 38 in order to be capitalised as an intangible asset, or whether it should be accounted for as an expense. In addition, capitalised amounts should be regularly assessed for impairment to determine whether they remain supportable in light of the future benefits to be realised which also requires the exercise of judgement by management.	Received management's report setting out the costs which were proposed for capitalisation and the rationale supporting this conclusion. Reviewed and challenged management's judgements and assumptions used in the assessments of impairment. Considered management's assessment of impairment in light of other information provided to the committee and other meetings attended by committee members.	The committee agreed that certain development costs, including internal staff costs, had been appropriately recognised within intangible assets. The committee also concluded that, in respect of previously capitalised amounts, the balance sheet carrying value remained appropriate.
Going concern assessment and Viability Statement The directors are required to prepare the financial statements on a going concern basis, unless they consider that it is inappropriate to presume that the Society will continue in business for the next 12 months. The Board has delegated this assessment to the Audit Committee. The Board is also required to provide a statement on the longer term viability of the Society and has also delegated this assessment to the Audit Committee.	Reviewed and challenged the detailed reports prepared by management which covered our business performance, profitability, capital and liquidity forecasts. Considered the review of principal and emerging risks undertaken by the Board Risk Committee to provide comfort on the Viability Statement, including reverse stress testing of those risks. Discussed whether we have taken reasonable steps to manage and mitigate the impact of risk events such that the Viability Statement was appropriate. Considered whether the going concern assessment and the Viability Statement were consistent with other internal information, such as the corporate plan, strategic reviews of the business model and the detailed stress testing undertaken as part of the annual liquidity and capital adequacy assessments.	After reviewing the report and the additional information, the committee concluded that the adoption of the going concern assumption to prepare the 2019 Annual Report and Accounts remained appropriate. The committee was satisfied that the Viability Statement was appropriate.

Continued

Area of focus	Action taken by the Audit Committee	Conclusions
Fair, balanced and understandable The Board is required to present a fair, balanced and understandable view of the Society's position and prospects in our Annual Report and Accounts. The Board has delegated this assessment to the Audit Committee.	Considered whether there was a robust process for review and challenge throughout the preparation of the Annual Report and Accounts and other external reporting to ensure balance and consistency. This included: • guidance issued to those involved in drafting or reviewing the Annual Report and Accounts; • a thorough internal verification process of the factual content of the reports; and • a range of reviews of drafts of the Annual Report and Accounts to ensure consistency of disclosures and an appropriate level of balance. The committee also considered consistency with other internal information, including a review of our 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.

Effectiveness of internal controls and risk management systems

The Board recognises the importance of effective 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 ERMF encourages a culture of sound risk management and internal control. This 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 ERMF can be found on pages 78 to 83. The principal risks faced by the Society and the controls in place to mitigate these risks are detailed on pages 32 to 37.

We continue to leverage the benefits of our risk management software which enables a consistent approach to risk and control monitoring and reporting across the Society, supporting improved aggregated risk and control reporting across all three lines of defence. The second line Risk function continues to monitor and oversee management's control effectiveness assessments, while Internal Audit performs more focused testing on a risk based approach.

A focus during 2019 has been a reassessment of the population of critical controls. Improvements have been made to introduce more prescriptive tests and thresholds for the assessment of these in order to provide greater focus and accountability and inform prioritisation of remediation activity. Opportunities to mature this process further have been identified for progression in 2020.

During the year, the Audit Committee sought and received controls assurance from first line business attestations, second line aggregate reporting, Internal Audit reports and feedback from the external auditor.

First line: management

First line management undertake a self-assessment of the design and effectiveness of key controls every six months through the Risk Control Self-Assessment (RCSA) process. Critical controls are tested on a regular scheduled basis with test results reviewed by second line. Any material deficiencies when compared to key risks are recorded in the risk register and remediation activities are identified and recorded by management, then tracked to completion. Ongoing risk based monitoring of the completeness and accuracy of risk registers and RCSA submissions is performed by the second and third lines.

Second line: Risk function

Second line provide reports on the outcome of the six monthly RCSA process to the committee, along with an integrated enterprise wide view of risks and controls. The reports showed that the Society's control environment and culture is substantially effective and proportionate to our operations, with a commitment to invest in continuous improvement. A general theme identified was the need to continue to embed the control environment in relation to operational resilience, following implementation of a new framework and policy suite in 2019.

Third line: Internal Audit function

Internal Audit's work is designed to provide an independent risk based assessment of the internal control environment. During the year, the committee received regular reports from the Chief Internal Auditor containing updates on progress against the agreed plan of work, as well as a summary of findings from each review undertaken and information on the resolution of recommended actions to improve controls. Internal Audit tracked and followed up recommendations made in its reviews, including reviewing high priority actions 12 months after implementation in order to check their continued operation.

Where Internal Audit identified underlying themes or recurring observations resulting in control issues, the committee requested that first line management reported to them directly as to how the identified issues were being resolved.

The committee also directed Internal Audit to undertake work on areas of particular importance and interest in addition to those identified through risk assessment, including requesting a cyclical programme of testing our critical controls, and additional follow up procedures on treasury operations key controls. Internal Audit undertook a review of Operational Resilience Board Management Information in response to a request from the PRA.

The Chief Internal Auditor's annual report to the committee in January 2020 summarised the 2019 audit findings and focused on the key themes, observations and root causes arising from Internal Audit's work.

The report also mapped audit reviews against the Society's principal risks, identified by management and recorded in the risk registers. This confirmed appropriate audit coverage. The 2019 Annual Report concluded that the Internal Audit function had not identified any issues that it considers would materially impact the accuracy and completeness of the financial statements.

External audit

In addition to comments on the financial reporting assumptions, estimates and judgements, the external auditor provided the committee with reports on an assessment of our 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 and IT controls.

Effectiveness and performance of the Internal Audit function

Internal Audit plays an important role in providing a reliable third line of defence and the Board has delegated to the Audit Committee the role of overseeing the effectiveness and performance of the Internal Audit function. The Chief Internal Auditor reports directly to the Chair of the Audit Committee.

The committee observed the continued progress of, and innovation from, Internal Audit, including the adoption of an 'Active Auditing' approach aimed at more closely engaging the business throughout the audit to avoid blockers and discuss and agree observations in real time.

In overseeing the Internal Audit Function, during the year the committee:

- received, assessed and approved Internal Audit's planning methodology and risk based audit plan;
- received and discussed regular updates on the progress of Internal Audit's work against this audit plan and the key themes arising from it;
- 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;
- agreed the metrics to be included in Internal Audit's balanced scorecard and received an update on these at each subsequent meeting;
- received the results of an annual self-assessment from the Chief Internal Auditor setting out the effectiveness of the Internal Audit function against the Institute of Internal Auditors' (IIA) International Professional Practices Framework (IPPF) and Financial Services Code;
- noted key innovations in the Internal Audit methodology, including agreement to pilot a change to action tracking whereby, from 2020, medium and lower priority observations will be handed over to management to prioritise within the context of their wider risk register;
- oversaw the ongoing development of skills, competencies and qualifications within the Internal Audit function;
- satisfied itself that, overall, Internal Audit had appropriate resources to deliver the annual audit plan; 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.

Continued

In addition to the regular self-assessments undertaken by Internal Audit, the Audit Committee is required to commission an external quality assessment of the Internal Audit function every three to five years. The most recent review was undertaken by KPMG LLP in 2018 and concluded that the Internal Audit function is fully compliant with all sections and subsections of the Chartered Institute of Internal Auditors' Standards and the Financial Services Code. Where areas for potential improvement were identified, an action plan was put in place. These actions were completed during 2019, including developing a new house reporting style to reduce the length and complexity of individual reports.

Based on work throughout the year and the results of the external quality assessment, the Audit Committee is pleased to note that the Internal Audit function is independent, effective and compliant with applicable standards. The committee concluded that the work completed by the Internal Audit function in 2019 has provided adequate coverage across the principal risks of the Society.

Independence, performance and objectivity of the external auditor

In 2019, to support its oversight of the relationship with the external auditor, the committee commissioned a review of the auditor's effectiveness from the Internal Audit function. The review was performed in accordance with guidance from the Institute of Chartered Accountants in England and Wales and the 'Big 4' accountancy firms. The work will continue on a cyclical basis in future years.

The review did not identify any significant concerns with the external auditor's execution of the audit or the level of challenge provided to management. In particular, it concluded that:

- external audit staff exhibit a good level of industry knowledge and technical skills;
- the external auditor's audit methodology is appropriately applied to the audit of the Society;
- a robust challenge is provided to management on key judgements;
- appropriate specialists are engaged to supplement the skills and knowledge in the core audit team;
- the dialogue between the external auditor, the Audit Committee and the Chair of the Audit Committee is open and transparent; and
- the external auditor has appropriately presented the results of its latest Financial Reporting Council (FRC) Audit Quality Review to the committee.

Other work performed by the committee in its role to assess the independence, performance and objectivity of the external auditor included:

- 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 assessment of significant judgements and risks and considered the effect of industry developments on the audit approach;
- monitored the external auditor's execution of 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 and of key members of the audit engagement team;
- reviewed and challenged the external auditor's response to the FRC's Audit Quality Review report on the firm for the 2018/2019 cycle, published in July 2019;
- discussed how the ongoing regulatory changes to the audit profession and wider market might impact our audit and the interactions between the committee and the external auditor; and
- held two private meetings to discuss any issues and concerns arising from the auditor's work.

Deloitte LLP's current tenure as external auditor is 15 years, having first been appointed in 2005. The current audit engagement partner, David Heaton, was appointed in 2015. The external auditor is appointed following a competitive tender process, with the last tender being undertaken in 2016.

The committee is responsible for the review and approval of the policy on non audit services, including the employment of former partners or staff of the external auditor. An update to the policy was approved during the year reflecting the changes to the Ethical and Auditing Standards published by the FRC in December 2019.

The external auditor undertook a number of non audit assignments during the year, including review of the Interim Financial Report and regular annual review work in connection with our 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 2019, non audit fees, including one-off items, represented 22% of the annual audit fee.

The committee therefore satisfied itself that the external auditor is effective and independent.

Other matters addressed by the committee

Changes to accounting standards

We adopted IFRS 16 – Leases with effect from 1 January 2019 and the impacts of adoption are disclosed in note 38 to the accounts. Ahead of adoption, the committee received reports from management regarding the key decisions made plus the anticipated impact. Further reports were received from the external auditor during the year detailing the results of their testing of the initial impacts of adoption. The committee is satisfied that the approach adopted by management is appropriate.

Speak Up policy

Following the 2018 changes to the Corporate Governance Code, the Society's whistleblowing policy is now a matter reserved for the Board. The Chair of the Audit Committee remains the Society's Whistleblowers' Champion.

The committee continues to review our whistleblowing policy, known internally as the Speak Up Policy and recommended this to the Board for approval. The committee also received, on behalf of the Board, an annual report from management on the number and nature of reports submitted and the extent of training and communication to colleagues. It also reviewed the culture of the Society in the context of whistleblowing and concluded that the Society has a positive culture, which creates an environment for colleagues to raise issues.

Other reporting matters

The committee reviewed and approved the Society's tax strategy, Tax Risk Management Policy and Financial Reporting and Disclosure Policy.

The committee reviewed the 2019 Pillar 3 disclosures and recommended the document for approval by the Board.

Maintaining Audit Committee effectiveness

The committee undertakes an annual self-assessment of its effectiveness. The review was performed via anonymous questionnaires to 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 (ToR) and no significant areas for remedial action were noted.

The ToR are reviewed annually and updated to align them to the latest governance requirements and best practice, although the latest review did not result in any fundamental changes to the committee's activities. The revised ToR were approved at the meeting in November 2019.

All committee members were required to undertake relevant training as part of their overall development during the year. As reported above, in 2019, formal training provided to the committee focused on two key aspects of financial reporting.

The year ahead

In 2020, the committee will continue to oversee the Society's external financial reporting and its internal control environment together with the performance and independence of the Internal Audit function and the external auditor.

In particular, the committee expects to receive further in depth review sessions from management regarding particular aspects of the financial statements.

We expect to see continued maturity in risk management across the Society, with further focus on the testing and remediation of critical internal controls and refinements to Internal Audit's methodology to drive greater efficiency.

The regulatory environment surrounding external audit continues to evolve and we are committed to ensuring that the auditor remains independent and effective.

Directors' Remuneration Report

Year ended
31 December 2019

Annual Statement

Dear member

As Chair of the Remuneration Committee, I am pleased to present the 2019 Directors' Remuneration Report.

The report is produced in compliance with the FCA Dual-Regulated Firms Remuneration Code.

The report is presented in two sections:

i. The Remuneration Policy (pages 96 to 101) explains how we pay executive directors, non executive directors and other Material Risk Takers.

ii. The Annual Report on Remuneration (pages 102 to 108) explains how we put our existing policy into practice in 2019 and how we intend to implement our policy in 2020.

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

The key focus of the committee is to set our Remuneration Policy including pay, variable remuneration and other benefits for executive directors and Material Risk Takers. It also has oversight of reward for the general colleague population.

The committee considers the Society's performance and the executive directors in detail. A breakdown of the outturn for 2019 of the corporate and personal objectives is provided on page 105.

Performance and awards

Earlier sections of the Annual Report and Accounts have explained we have again delivered a good financial performance in 2019 in our core savings and mortgage markets and have remained focused on sustainable growth by delivering value to our members and helping them save and have the home they want.

While profit levels are not as high as previous years, there has been a focus on efficiency and managing costs which contributed to a positive level of profit. There has also been a balance in performance this year across the corporate performance measures, with positive achievements in customer experience, colleague engagement and on new business performance.

As a result, annual bonuses of between 33% and 40% (2018: 42% and 45%) have been awarded to the executive directors, which represents between 66% and 78% (2018: 83% and 90%) of the maximum award available.

In arriving at the decision to award variable remuneration, a full risk assessment process is undertaken, during which the committee considers a range of factors and input from the Board Risk Committee. Very careful consideration was given to the risk and performance assessment processes.

The Remuneration Policy has operated as intended and there has been no Remuneration Committee discretion applied to the outcomes.

Executive director changes

As reported last year, Richard Fearon succeeded Peter Hill as Chief Executive Officer with effect from 27 February 2019.

Robin Litten, Chief Financial Officer, left the Society on 18 April 2019. Andrew Conroy joined the Society in July 2019 as Interim Chief Financial Officer and was appointed to the Board from 6 January 2020, subject to regulatory approval (an application for which has been submitted by the Society and is currently underway).

Karen Wint, Chief of Staff, retired from the Board on 31 December 2019. Karen has made a number of key contributions over many years to assuring the long term success of the Society.

2019 remuneration changes

As reported last year, the Remuneration Committee agreed a salary increase, for Richard Fearon to £450,000, in respect of his promotion to CEO.

An increase of 3.25% was awarded to the Chief Risk Officer in April 2019, in line with the colleague population, and an additional increase of 5% was awarded in May 2019, to reflect greater responsibilities.

The salaries of other executive directors increased by 2.25%, as did the Chairman's and non executive directors' fees, in line with the colleague population. The basic salary increase for colleagues ranged from 0% to 5%, with an average of 2.34%.

A small number of other colleagues, who are senior managers whose actions can have a material impact on the risk profile of the Society, are considered Material Risk Takers. The average salary increase for this group in April 2019 was 3%.

The committee was supportive of the executive directors' decision to voluntarily opt to move to the existing colleague pension scheme, from September 2019, without any compensation for the loss incurred.

Other matters considered by the Remuneration Committee

As well as myself as Chair, the committee consisted of two other non executive director members: David Fisher and Gareth Hoskin.

There were six meetings in 2019, dealing with the review of compliance with the Remuneration Code, the setting and review of performance against objectives, reviewing the variable remuneration schemes, considering the underlying measures of success for the annual schemes, Gender Pay Gap reporting and the oversight of reward for the general colleague population. The committee also reviewed the benchmarking of remuneration and received an update from PwC on remuneration trends.

The Remuneration Committee developed and approved our Fair Pay Charter in 2019, which commits us to:

- executive directors' pension contributions aligned to those of colleagues;
- providing sufficient information for colleagues to understand how they are rewarded, including clear performance standards and feedback;
- listening to our colleagues in remuneration decision making, through appropriate dialogue with our Colleague Association; and
- providing a competitive total reward package to attract, motivate and retain colleagues, including a range of benefit options to support health and wellbeing.

In my first year as non executive director responsible for representing colleague views at the Board, I have sought the views of colleagues by attending regular meetings with our Colleague Association, met colleagues around the business and had oversight of the engagement survey 'Your Voice' results. Throughout the year, I have provided regular updates to the Board, which have demonstrated the strong people culture in the organisation and highlighted areas to take into our future people strategy.

Looking ahead

Looking ahead to 2020, the committee's focus will continue to ensure we have the right reward structures in place, to support our future priorities to attract and retain the talent we will need to deliver our objectives.

Summary

I trust you will find this report helpful and informative. The Remuneration Committee recommends that members vote in favour of the 2019 Directors' Remuneration Report at the AGM.

Lynn McManus
Chair of the Remuneration Committee

25 February 2020

Directors' Remuneration Report

Year ended
31 December 2019

Continued

Directors' Remuneration Policy

The Remuneration Policy is designed to support members by:

- being clearly linked to business objectives;
- driving behaviours consistent with our purpose, culture, values and strategy; and
- being structured to attract and retain appropriately skilled colleagues to support the Society's long term interests.

Remuneration principles

In delivering this policy, the following principles are observed:

- objectives are clearly linked to our business strategy, values and the long term interests and security of the Society and our members;
- 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 are set at a competitive level to attract, retain and motivate colleagues of the required calibre; and
- remuneration arrangements meet regulatory requirements, including the FCA Dual-Regulated Firms Remuneration Code, PRA Rulebook and good corporate governance practice.

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 takes sufficient account of risk considerations.

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 2018 AGM.

Annual General Meeting 2019 results

Resolution	% votes for	% votes against
Directors' Remuneration Report	90.59%	9.41%

Annual General Meeting 2018 results

Resolution	% votes for	% votes against
Directors' Remuneration Policy	88.99%	11.01%

Components of remuneration

The following table summarises the principal components of the executive directors' total remuneration and the way they operate. Details which are commercially sensitive have not been provided.

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. Basic 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 basic 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; and (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.	Challenging performance objectives are aligned with our strategy, 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, with measures for the Chief Risk Officer assessed by an independent senior manager.	The 50% maximum is split between: Financial – 17% Performance – 17% Personal – 16%. The financial measure is based on profit. Performance measures are set at the start of each year and include sustainable growth, delivering outstanding service to all our members 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 the executive director in a control function is based on a range of personal objectives only.	Maximum of 50% of basic salary payable. For executive directors designated as 'Senior Managers' under the Senior Manager Regime and over the de-minimis[1], 60% of the bonus will be deferred, over a period of seven years with no vesting until three years after the award is made. 50% of variable remuneration will be delivered in a share-like instrument[2]. For executive directors designated as 'Senior Managers' under the Senior Manager Regime and below the de-minimis, 40% of the bonus will be deferred over three years. Should the de-minimis requirements be exceeded in year, the relevant additional deferral and use of the share-like instrument will be applied. Minimum is 0% of basic salary.
Operation of malus and clawback[3]	A deferred element exists 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 100% of the deferred bonus awards are subject to malus. Clawback will be applied as required by regulation.

Year ended
31 December 2019 **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.	Executive directors, appointed before 1 April 2019 receive a range of relevant employer contributions, in line with the colleague population, with a maximum contribution of 20% of basic salary, based on age and pensionable service. Executive directors, appointed on or after 1 April 2019, will receive a maximum contribution in line with the colleague population, of 10% of basic salary. Cash allowance is in lieu of employer contributions, up to the maximum contribution rate applicable to the executive director.
Benefits	Provides market competitive remuneration.	The principal benefits executive directors receive are: • life assurance • private medical insurance • long term health insurance • health screening • 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.

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

(2) Where remuneration exceeds the de-minimis, 50% of the variable remuneration award will be paid in an instrument and 50% will be paid in cash. As a mutual organisation, this means that 50% of the award payable in each year will be held and retained for a further 12 months and which can be written down in value if agreed capital levels are not maintained. The instrument cannot increase in value or attract interest payments during the deferral and retention periods.

(3) 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.

Policy for non executive directors

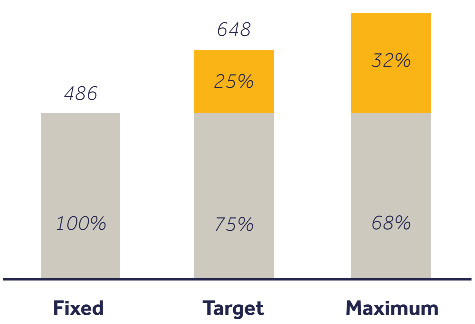
Element of pay	Link to strategy	Operation	Performance measures	Minimum and maximum payable
Fees	Reflects level of responsibilities and time commitment required for Board and Board subcommittee meetings.	Fees are reviewed annually with recommendations made to the Board by executive directors. The Chair's fee is reviewed by the Remuneration Committee. 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 the Chair are reviewed by the Remuneration Committee and 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.			

Element of pay	Link to strategy	Operation	Performance measures	Minimum and maximum payable
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.		

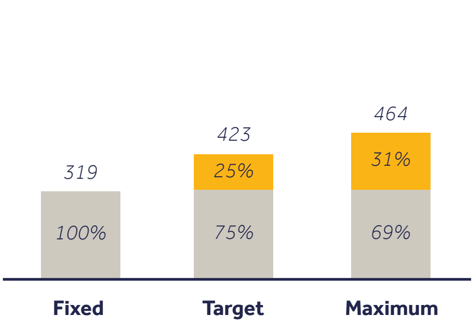
Awards under different scenarios

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

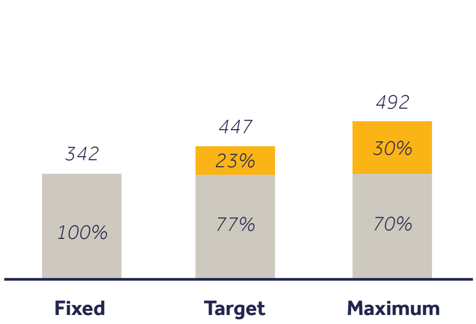
Chief Executive Officer £'000



Chief Financial Officer £'000



Chief Risk Officer £'000



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

Fixed

Consists of basic salary and pension (£'000)
Basic salary is as at 6 January 2020

Executive director	Basic salary	Pension	Total fixed
Chief Executive Officer	450	36	486
Chief Risk Officer	300	42	342
Chief Financial Officer	290	29	319

Target

Based on what an executive director would receive if the target level of performance was achieved: annual variable element pays out at 72% of the maximum available (70% for the Chief Risk Officer).

Maximum

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

Approach to recruitment remuneration for executive directors

Component	Policy
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 10% of basic salary, in line with the colleague population.
Replacement awards	When replacement awards cannot be avoided, the committee will 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 twelve months. The standard contract is available to view at the Society's head office.

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

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

Policy on payment for loss of office

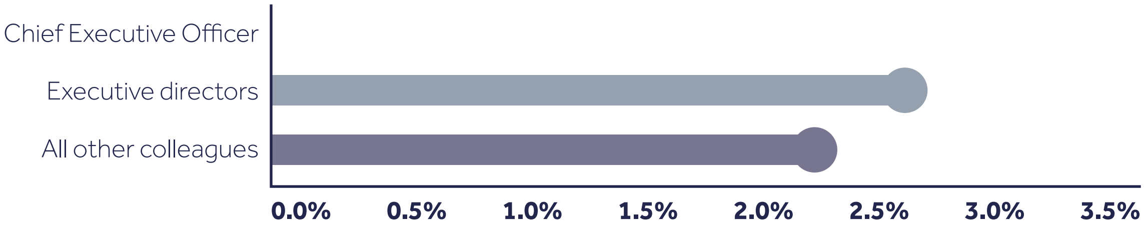
Component	Policy
General	When determining any loss of office payment for a departing individual, the committee will seek to minimise costs to the Society, whilst seeking to reflect the circumstances in place at the time. Accordingly, the committee retains overriding judgement to make loss of office payments 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 and pension contributions that the executive would have received if still in employment with the Society. Executive directors are expected to mitigate compensation for loss of office in appropriate circumstances.
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.

As reported last year, the Remuneration Committee agreed a salary increase to £450,000 for the CEO, from the date of his appointment, 27 February 2019. The salaries of the other executive directors increased by 2.25% or 3.25%.

The table below illustrates the comparison of average basic salary increases made in April 2019 to the Chief Executive Officer (no annual increase was awarded), executive directors and all other colleagues:



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 executive directors' salaries from 6 January 2020 are as follows, compared with 2019:

	6 January 2020	1 January 2019
R G Fearon	£450,000	£325,000
A J Greenwood	£300,426	£277,110
A P Conroy[1]	£290,000	N/A

An increase of 5% was awarded to Andrew Greenwood (Chief Risk Officer), in May 2019, to reflect his greater responsibilities.

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

	1 April 2020	Increase
R G Fearon	£459,000	2%
A J Greenwood	£306,450	2%
A P Conroy[1]	£290,000	No increase applied – appointed from 6 January 2020

Note:
[1] For further information refer to the executive director changes section on page 94.

Directors' Remuneration Report

Year ended
31 December 2019

Continued

Annual Report on Remuneration

Total remuneration summary

The total remuneration received by executive directors for 2019 is detailed below, compared with 2018. The total remuneration for executive directors equates to 2.8% of profit before tax (2018: 2.3%). This information has been audited and shows remuneration for the years ending 31 December 2018 and 31 December 2019, as required to be reported under the Building Societies (Accounts and Related Provisions) Regulations 1998. The awards made in respect of performance in 2019 are in line with the 2019 Remuneration Policy, with a maximum variable pay of 50% for executive directors.

The CEO is the Society's highest paid colleague and no colleague earns more than any executive director. As we are a mutual organisation, we have no share capital and, therefore, do not offer share based remuneration to executive directors or colleagues.

2019 audited

Executive directors	Salary	Annual bonus	Pension	Loss of office	Total fixed remuneration	Total variable remuneration	Total remuneration
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
R G Fearon	430	169	60[3]	–	490	169	659
P A Hill[1]	253	–	54[3]	–	307	–	307
R S P Litten[2]	99	30	23[3]	499[5]	621	30	651
K R Wint	270	90	62[3]	–	332	90	422
A J Greenwood	293	120	56[3]	–	349	120	469
Total remuneration[4]	**1,345**	**409**	**255**	**499**	**2,099**	**409**	**2,508**

2018 audited

Executive directors	Salary	Annual bonus	Pension	Loss of office	Total fixed remuneration	Total variable remuneration	Total remuneration
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
R G Fearon	292	146	50[3]	–	342	146	488
P A Hill	467	211	107[3]	–	574	211	785
R S P Litten	320	142	74[3]	–	394	142	536
K R Wint	264	112	63[3]	–	327	112	439
A J Greenwood	275	115	55[3]	–	330	115	445
Total remuneration[4]	**1,618**	**726**	**349**	**–**	**1,967**	**726**	**2,693**

Notes
(1) P A Hill retired on 30 June 2019.
(2) R S P Litten left the Society on 18 April 2019.
(3) These directors elected to receive part or all of the Society's pension contribution as a cash allowance.
(4) No director received other taxable benefits of £1,000 or above.
(5) Loss of office includes payments in lieu of notice in accordance with contractual terms and payments in line with the Remuneration Policy.

Chief Executive Officer (CEO) pay ratio

The Companies (Miscellaneous Reporting) Regulations 2018, came into force for accounting periods starting from 1 January 2019 and requires the publication of the ratio of the CEO's single figure total remuneration. We have chosen to use the Government's preferred methodology (option A), which determines the total full time equivalent total remuneration for all colleagues for the relevant financial year, and compares the median, 25th and 75th percentiles against the CEO single figure.

The ratios below are calculated as at 31 December 2019:

Year	Method	25th percentile	Median	75th percentile
2019	Option A	32:1	22:1	15:1

Remuneration element	25th percentile (£)	Median (£)	75th percentile (£)
Total pay and benefits	£20,453	£30,275	£45,116
Salary	£18,042	£24,105	£39,174

Unpaid deferred elements of the annual bonus scheme

Executive directors	Performance year	Due 2020 £'000	Due 2021 £'000	Due 2022 £'000	Due 2023 £'000	Due 2024 £'000	Due 2025 £'000	Due 2026 £'000	Due 2027 £'000	Due 2028 £'000	Total £'000
R G Fearon	2016	16	–	–	–	–	–	–	–	–	16
	2017	21	21	–	–	–	–	–	–	–	42
	2018	19	20	20	–	–	–	–	–	–	59
	2019	**34**	**34**	**–**	**10**	**20**	**20**	**20**	**20**	**11**	**169**
	Total	**90**	**75**	**20**	**10**	**20**	**20**	**20**	**20**	**11**	**286**
P A Hill	2016	33	–	–	–	–	–	–	–	–	33
	2017	35	36	–	–	–	–	–	–	–	71
	2018	42	–	13	25	25	25	25	14	–	169
	2019	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
	Total	**110**	**36**	**13**	**25**	**25**	**25**	**25**	**14**	**–**	**273**
R S P Litten	2016	23	–	–	–	–	–	–	–	–	23
	2017	23	24	–	–	–	–	–	–	–	47
	2018	23[(1)]	–	9	17	17	17	17	9	–	109
	2019	**6**	**6**	**–**	**2**	**3**	**3**	**4**	**4**	**2**	**30**
	Total	**75**	**30**	**9**	**19**	**20**	**20**	**21**	**13**	**2**	**209**
K R Wint	2016	18	–	–	–	–	–	–	–	–	18
	2017	20	20	–	–	–	–	–	–	–	40
	2018	15	15	15	–	–	–	–	–	–	45
	2019	**54**	**12**	**12**	**12**	**–**	**–**	**–**	**–**	**–**	**90**
	Total	**107**	**47**	**27**	**12**	**–**	**–**	**–**	**–**	**–**	**193**
A J Greenwood	2016	13	–	–	–	–	–	–	–	–	13
	2017	16	16	–	–	–	–	–	–	–	32
	2018	15	15	16	–	–	–	–	–	–	46
	2019	**72**	**16**	**16**	**16**	**–**	**–**	**–**	**–**	**–**	**120**
	Total	**116**	**47**	**32**	**16**	**–**	**–**	**–**	**–**	**–**	**211**
Total		**498**	**235**	**101**	**82**	**65**	**65**	**65**	**47**	**13**	**1,172**

Note
(1) Deferred award adjusted.

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

Directors' Remuneration Report

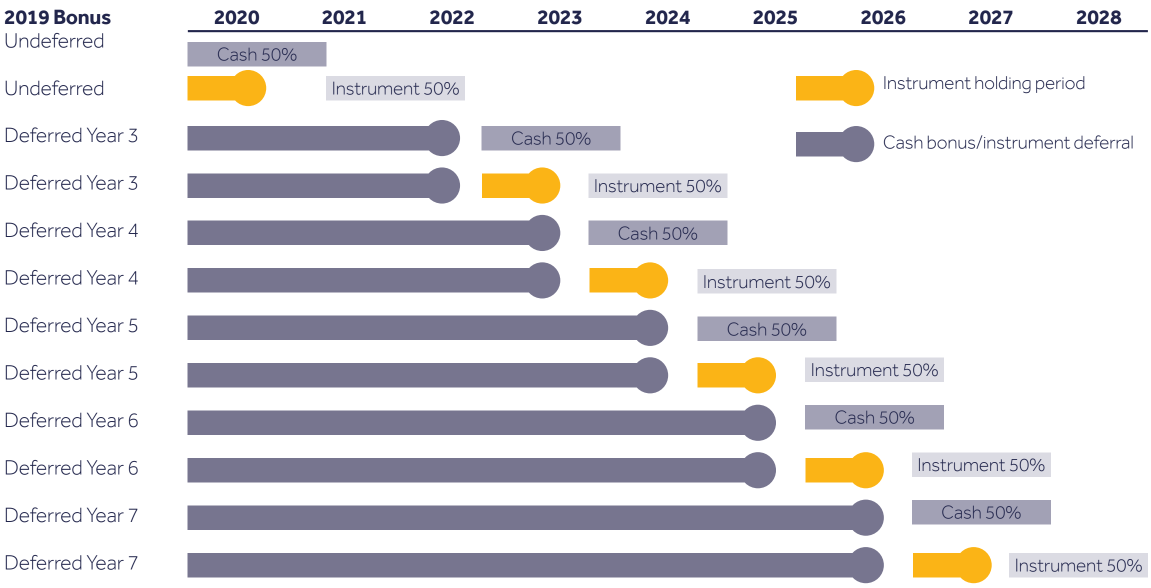
Year ended
31 December 2019

Continued

Bonus deferral and share-like instrument
For executive directors designated as 'Senior Managers' under the Senior Manager Regime and over the de-minimis limit, 60% of the bonus will be deferred, over a period of seven years with no vesting until three years after the award is made. 50% of variable remuneration will be delivered in a share-like instrument.

For executive directors designated as 'Senior Managers' under the Senior Manager Regime and below the de-minimis limit, 40% of the bonus will be deferred over three years. Should the de-minimis requirements be exceeded in year, the relevant additional deferral and use of the share-like instrument will be applied.

The table below illustrates how the 2019 bonus for the CEO and Chief Financial Officer will be delivered:



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 or risk adjustment is necessary to remuneration outcomes. The report is initially reviewed by the Board Risk Committee, which then highlights any specific areas for further consideration to the Remuneration Committee. In addition, the Risk function 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 our risk appetite, and general control and governance matters.

The Board Risk Committee considered the 2019 report in full and determined the Remuneration Committee should assess whether an adjustment was required. Following full consideration, no adjustment was applied.

Performance outcomes against targets for incentive awards

The 2019 scheme has generated awards of between 33% and 40% (2018: 42% and 45%) of salary for executive directors, reflecting between 66% and 80% (2018: 83% and 90%) of the maximum award available.

The 2019 scheme provides for:

- Financial performance measures (max. 17% opportunity, with 5% of this for superior performance);
- Corporate performance measures (max. 17% opportunity, with 5% of this for superior performance); and
- Personal performance measures (max. 16% opportunity, with 4% of this for superior performance).

For the executive director in a control function, the scheme provides for:

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

Annual incentive

For 2019, financial performance and corporate performance 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 9% to 40% (40% in respect of the CRO).

Vision: strategic pillar	**Corporate performance measure**	Weightings for maximum (as % of salary)	Target	Actual	Pay out %
Secure	Profit before tax	17%	Commercially sensitive(1)	£88.0m	9%
Secure	Net lending	4.25%	Commercially sensitive(1)	£1.0bn	4.25%
Customer centred	Broker NPS	4.25%	External broker NPS of 43	Our broker NPS was 54 with strong improvements across new lending & product transfer broker experience.	3.625%
	Customer experience	4.25%	Achieve sustained year on year equivalent Customer Experience Indicator (CEI) performance of 8.54.	We achieved sustained year-on-year equivalent CEI performance of 8.65.	4.25%
People	Colleague engagement	4.25%	Achieve sustained year on year equivalent colleague engagement index measured through an external survey of 83%.	We achieved an outturn of 82%, with over 90% of colleagues participating in the survey and the outturn ahead of the financial services benchmark.	3%

Notes:

(1) The committee consider the specific targets to be commercially sensitive. In these cases, disclosures will be made once it is deemed not to be sensitive.

The financial and corporate measures only apply to the CEO, Chief Financial Officer and the Chief of Staff. The Chief Risk Officer is responsible for a control function, and therefore, is remunerated on personal objectives only.

Continued

Remuneration for Material Risk Takers (MRTs)

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

The basic salary of MRTs 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. MRTs, other than non executive directors, are eligible for an annual bonus scheme. The bonus scheme for MRTs in control functions is based on the achievement of non financial objectives. In 2019, there were 31 MRTs during the year.

Aggregate remuneration for MRTs is reported in the table below.

Remuneration for Material Risk Takers

	Number of beneficiaries		Fixed pay (1)		Current year variable pay (2)		Total	
	2019	2018	2019 £'000	2018 £'000	2019 £'000	2018 £'000	2019 £'000	2018 £'000
Senior management	31	28	5,719	4,937	1,512	1,618	7,231	6,555
Other MRTs	–	–	–	–	–	–	–	–
Total	31	28	5,719	4,937	1,512	1,618	7,231	6,555

Notes:
(1) Fixed pay includes basic salary, benefits, pension, loss of office payments and fees for non executive directors.
(2) £826,680 of variable pay is deferred for one, three, or seven years (2018: £930,000).
(3) Material Risk Takers who left the Society during the calendar year are included in the table above.

Pensions and other benefits

A J Greenwood is a deferred member of the defined contribution section of the pension scheme and has opted for a cash allowance in lieu of the Society's pension contribution. K R Wint and R G Fearon 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.

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.

Executive directors may be entitled to receive compensation for loss of office. Such payments will be based on the monthly salary and pension contributions that the executive would have received if still in our employment.

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 £8,662 has been made in 2019 to K L Rebecchi, the former Distribution and Marketing Director, who left the business on 30 June 2015. A payment of £141,390 has been made in 2019 to P A Hill, the former Chief Executive Officer, who left the business on 30 June 2019. These payments are in respect of an incentive award which was subject to deferral and risk assessment. The committee determined that no risk adjustment was appropriate.

Payments for loss of office

On 18 April 2019, Robin Litten left his role of Chief Financial Officer. All payments made to Robin in respect of his service during 2019 are reported in the single figure in the remuneration table.

In line with the Remuneration Policy and the bonus scheme rules, the committee agreed to allow the deferred elements of Robin's variable pay award to remain in place. These payments will be subject to continued performance adjustment requirements and payments will be made on the normal dates. Regulatory requirements relating to risk adjustments, malus and clawback will continue to apply to all deferred bonus awards.

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

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 does not receive additional fees for roles carried out other than that of Chair of the Board.

Non executive directors	Basic fees (£'000)		Benefits[1] (£'000)		Committee chair fees (£'000)		Total (£'000)	
	2019	2018	2019	2018	2019	2018	2019	2018
R J Ashton (Chairman)[2]	150	147	3	5	–	–	153	152
G J Hoskin (current Vice Chairman)	50	48	5	6	23	17	78	71
L M Platts (previous Vice Chairman)[3]	–	65	–	4	–	–	–	69
A M Barnes[4]	46	–	3	-	–	–	49	–
P A Brown[5]	16	48	1	2	–	–	17	50
I C A Cornish[6]	50	–	1	–	–	–	51	–
D Fisher	50	48	–	–	17	17	67	65
J A Hunt	50	48	4	4	–	3	54	55
P A Jenks	50	48	–	–	–	–	50	48
L R McManus	50	48	4	3	11	–	65	51
Total	**512**	**500**	**21**	**24**	**51**	**37**	**584**	**561**

Notes

(1) In addition to the payment of fees, non executive directors are reimbursed for travel expenses for attending meetings and where tax liability arises, this will be covered by the Society.

(2) On 1 October 2019 Mr Ashton, the Chairman, inadvertently ceased to hold a shareholding with the Society of not less than £1,000, as required by the Society's Rules. This meant that technically Mr Ashton's directorship ceased with effect from that date. Mr Ashton was re-appointed as a director by the Society's Board on 13 January 2020. The Board is satisfied that during the period from 1 October 2019 to the date of his re-appointment to the Board, Mr Ashton continued to fully perform his role and responsibilities to the Society. The Remuneration Committee is therefore satisfied that the payment of fees and benefits remained appropriate for the relevant period.

(3) This director retired on 31 December 2018.

(4) This director was appointed on 1 February 2019.

(5) This director resigned on 30 April 2019.

(6) This director was appointed on 1 January 2019.

An increase of 2.25% was agreed for the Chairman to £150,959 with effect from 1 April 2019. The fee for the Vice Chairman was increased by 2.99% to £73,505 and the basic non executive director's fee was increased by 3.34% to £50,000. The committee chair fee was increased by 2.25%.

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 1 April 2020 will be as follows:

Non executive directors	Basic fees (£'000)	Committee chair fees (£'000)	Total fees (£'000)
	2020	2020	2020
R J Ashton (Chairman)	154	-	154
G J Hoskin (Vice Chairman)	51	24	75
A M Barnes	51	-	51
I C A Cornish	51	-	51
D Fisher	51	18	69
J A Hunt	51	-	51
P A Jenks	51	-	51
L R McManus	51	11	62
Total	**511**	**53**	**564**

Directors' loans, transactions and related business activity

The aggregate amount outstanding at 31 December 2019 in respect of loans from the Society or a subsidiary undertaking to directors of the Society or persons associated with directors was £1,026,177 (2018: £1,054,166), being four mortgages (2018: four) 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 our subsidiaries and any director of the Society during the year.

History of remuneration of the Chief Executive Officer

The table below shows the total remuneration of the CEO over the last five years, together with the performance pay awarded as a percentage of the maximum possible. R G Fearon was appointed CEO on 27 February 2019, the figures prior to 2019 relate to P A Hill, the former CEO.

	Total remuneration £'000	Performance pay as % of maximum
2019	659	75.0
2018	785	89.7
2017	765	87.0
2016	728	84.0
2015	649	86.0

Percentage change in salary for the Chief Executive Officer

The basic salary of the CEO increased by 38.46% during 2019, to reflect his appointment to the role on 27 February 2019. An average annual increase of 2.34% in fixed pay was awarded to all colleagues. The annual change of each individual executive director's pay compared to the annual change in average colleague pay, is detailed below:

	Promotion increase	Market adjustment	Annual increase
Chief Executive Officer	38.46%	–	–
Chief of Staff	–	–	2.25%
Chief Risk Officer	–	5.00%	3.25%
Chief Financial Officer	–	–	2.25%
Colleague average	–	–	2.34%

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 2019, compared to the previous year.

	2019	2018	Percentage change
Profit after tax	£66.2m	£89.2m	(26)%
Colleague remuneration costs	£47.5m	£49.0m	(3)%
Average headcount	1,408	1,423	(1)%

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 2019 were PwC LLP, who in 2019 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. PwC LLP does not have any conflict of interest in advising the Remuneration Committee.

Directors' Report

Year ended
31 December 2019

The directors have pleasure in presenting their Annual Report, together with the audited Annual Accounts and Annual Business Statement, for the year ended 31 December 2019.

Information on our vision, strategy and business performance, including key performance indicators, is provided in the Strategic Report on pages 2 to 51.

Profits and capital

Profit before tax for the year was £88.0 million (2018: £116.9 million). The profit after tax transferred to the general reserve was £66.2 million (2018: £89.2 million). Total equity attributable to members at 31 December 2019 was £1,086.1 million (2018: £1,026.5 million).

Gross capital at 31 December 2019 was £1,319.2 million (2018: £1,252.9 million) including £232.1 million (2018: £224.2 million) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings was 6.88% at 31 December 2019 (2018: 7.05%) and the free capital ratio was 6.45% (2018: 6.70%). Further explanation of these ratios is provided in the Annual Business Statement on page 188.

Mortgage arrears

At 31 December 2019, there were 152 (2018: 112) mortgage accounts 12 months or more in arrears. The total mortgage arrears, for these cases, was £2.0 million (2018: £1.5 million) and the total principal balance outstanding was £17.8 million (2018: £12.9 million).

Charitable and political donations

In 2019, the Group made a donation of £90,000 (2018: £90,000) to the Leeds Building Society Charitable Foundation. Our other donations to charities and good causes (including colleague fund matching) during the year amounted to £89,000 (2018: £85,000).

The Caring Saver Account and the Your Interest In Theirs scheme provided further donations of £15,250 (2018: £16,000) and £98,750 (2018: £100,000) respectively to specified charities.

Other charitable contributions from colleagues and members totalled £88,500 (2018: £80,000) taking total donations to charity and good causes to £381,500 (2018: £371,000).

No political donations were made during the year (2018: £nil).

Creditor payment policy

Our 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.

Creditor days stood at 22 days at 31 December 2019 (2018: 12 days).

Pillar 3 disclosures

The disclosures required under Pillar 3 of CRD IV are published on our website at www.leedsbuildingsociety.co.uk/press/financial-results/.

Principal risks and uncertainties

Our approach to managing risks is set out in the Board Risk Committee Report on pages 78 to 83. The principal risks and uncertainties we face are set out in the Strategic Report on pages 32 to 39. Further information relating to our financial risks and the approach to management of those risks is included in notes 31 to 34 of the accounts.

Colleagues

Information on key colleague policies and associated key performance indicators, including processes for communicating and consulting with colleagues, are included in the Strategic Report on pages 16 to 17 and the Corporate Governance Report on page 70.

We are committed to maintaining an inclusive workplace which provides all colleagues with equal access to development and opportunities, without barriers. We are a Disability Confident accredited employer and give full and fair consideration to applications for employment from disabled persons, having regard to their particular aptitudes and abilities. Where a colleague becomes disabled during the course of their employment, every effort is made to continue their employment, making reasonable and proportionate adjustments as necessary.

Business relationships

We are committed to developing strong business relationships, notably with brokers, suppliers and investors among others. Further details of how the Board has regard to the interests of these and other stakeholders can be found on pages 18 to 21.

Environmental policy

Our approach to the environment is summarised in the Corporate Responsibility section of the Strategic Report on pages 22 to 31.

Directors' Report

Year ended
31 December 2019

Continued

Corporate governance
Statements on corporate governance and directors' roles and responsibilities are set out in the Corporate Governance Report on pages 57 to 71.

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 statements on the respective responsibilities of directors and auditor on page 119.

For each financial year, the directors are required by the Building Societies Act 1986 (the Act) to prepare annual accounts which 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. Additionally, they must provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it. The Act states that references to IFRS accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing the 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 that they 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 an Annual Business Statement and a Directors' Report for each financial year. Each contains prescribed information relating to our business and subsidiary undertakings.

Directors' responsibilities for accounting records and internal control
The directors are responsible for ensuring that the Society and our 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 our assets 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 our website. Legislation in the United Kingdom, governing the preparation and dissemination of financial statements, may differ from legislation in other jurisdictions.

The directors who held office at the date of approval of this report confirm that, as far as they are aware, there is no relevant information of which our auditor is unaware and that each director has taken all steps necessary to make themselves aware of any relevant audit information and establish that the auditor is aware of that information.

Going concern
The directors are required to prepare financial statements on a going concern basis, unless it is inappropriate to presume that the Society and the Group will continue in business for the next 12 months.

The directors undertake regular rigorous assessments of whether the Society and the Group are a going concern, considering current economic and market conditions, as well as the potential impact of the principal and emerging risks set out on pages 32 to 39 of the Strategic Report. The directors have also reviewed the Society's and Group's position over a longer period than the 12 months required by the going concern assessment. This is explained in the Viability Statement on pages 40 to 41 of the Strategic Report.

The directors conclude that:

- The Group maintains an appropriate level of liquidity, sufficient to meet both the normal demands of the business and the requirements which might arise in modelled stressed circumstances. The availability and quality of liquid assets are structured so that funds are available to repay any maturing wholesale funds and cover exceptional demand from retail investors.
- The Group's other assets consist primarily of mortgages secured on residential property. The recoverability of all mortgage assets is reviewed regularly and provisions are made, where appropriate, so that the Group is not exposed to losses on these assets which would impact its decision to adopt the going concern basis.
- The Group's current capital resources are sufficient to meet regulatory requirements. Having reviewed future plans and forecasts, the directors consider plans for future capital generation are sufficient to maintain capital in excess of regulatory requirements, under both central and modelled stressed scenarios.

The directors have therefore concluded that it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

Directors

The names of the directors of the Society at 31 December 2019[1], their roles and membership of Board committees are detailed on pages 54 to 56. The following directors also served on the Board during the year and to the date of this report:

- Peter Hill (retired 26 February 2019)
- Philippa Brown (resigned 30 April 2019)
- Robin Litten (resigned 18 April 2019)

Andrew Conroy was appointed to the Board from January 2020, subject to regulatory approval (for which an application is underway).

In line with best practice, all executive and non executive directors offer themselves for election or re-election by the members at the AGM, apart from Robin Ashton, Phil Jenks and Karen Wint. Karen retired from the Board on 31 December 2019, while Phil will retire from the Board on 26 March 2020 and Robin will retire from the Board at the AGM.

None of the directors hold any beneficial interest in shares in, or debentures of, any subsidiary undertaking of the Society.

Auditor

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 AGM.

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 Legal, Compliance and Secretary

25 February 2020

1. On 1 October 2019 Mr Ashton, the Chairman, inadvertently ceased to hold a shareholding with the Society of not less than £1,000, as required by the Society's Rules. This meant that technically Mr Ashton's directorship ceased with effect from that date. As soon as possible, once this error was identified, Mr Ashton opened a new savings account with the Society on 2 January 2020 with the required balance and was re-appointed as a director by the Society's Board on 13 January 2020. The Board is satisfied that during the period from 1 October 2019 to the date of his re-appointment to the Board, Mr Ashton continued to fully perform his role and responsibilities to the Society.

Year ended
31 December 2019

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

Report on the audit of the financial statements

1. Opinion

In our opinion the financial statements of Leeds Building Society (the 'Society') and its subsidiaries (the 'Group'):

- **give a true and fair view of the state of the Group's and of the Society's affairs as at 31 December 2019 and of the Group's and the Society's income and expenditure for the year then ended;**
- **have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and**
- **have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.**

We have audited the financial statements which comprise:

- the Group and Society income statements;
- the Group and Society statements of comprehensive income;
- the Group and Society statements of financial position;
- the Group and Society statements of changes in member's interests;
- the 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.

2. Basis for opinion

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

We are independent of the Group and the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the Group and the Society for the year are disclosed in note 6 to the financial statements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • IFRS 9 Financial Instruments - Expected Credit Loss ("ECL") provisioning; • Hedge accounting; • Fair value of collateral loan; and • Fair value of complex financial instruments. Within this report, key audit matters are identified as follows: Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used for the Group financial statements was £6.5m which was determined on the basis of net assets.
Scoping	All material entities in the Group are within our audit scope and audited to a lower materiality for the purpose of individual entity reporting. Audit work to respond to the risks of material misstatement was performed directly by the Group audit engagement team.

Significant changes in our approach	Our risk assessment process has resulted in the key audit matters reported upon remaining broadly consistent with the previous year, with a controls reliance approach adopted for ECL provisioning for the first time. These continue to be areas in which significant judgement and complexity are inherent in the account balance. In the current year, materiality has been determined using net assets as the benchmark balance. In 2018 materiality was based on 5.2% of adjusted profit before tax. There has not been any change to our areas reported as key audit matters, however we note that in the prior year we reported the fair value of collateral loan and fair value of other complex financial instruments as one key audit matter whilst in the current year these have been split out to clearly differentiate the risk and our audit response which differ for each of these instruments.

4. Conclusions relating to going concern, principal risks and viability statement

4.1. Going concern

We have reviewed the directors' statement on page 110 about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and the Society's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

Going concern is the basis of preparation of the financial statements that assumes an entity will remain in operation for a period of at least 12 months from the date of approval of the financial statements.

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

4.2. Principal risks and viability statement

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

- the disclosures on pages 32 to 39 that describe the principal risks, procedures to identify emerging risks, and an explanation of how these are being managed or mitigated;
- the directors' confirmation on page 40 that they have carried out a robust assessment of the principal and emerging risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on pages 40 and 41 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.

Viability means the ability of the Group to continue over the time horizon considered appropriate by the directors.

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

Continued

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

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

5.1. IFRS 9 Financial Instruments – Expected Credit Loss provisioning

Key audit matter description

Under IFRS 9 provisions are required for the expected credit loss ('ECL') on loans measured at amortised cost. Estimating these expected losses requires judgement and estimation on assumptions relating to customer default rates, likelihood of repossession, future property values, forced sale discounts and indicators of significant increases in credit risk. These assumptions are informed using historical behaviour and experience as well as credit bureau data.

The Group held £33.2m of impairment provisions against such loans at year end in accordance with IFRS 9 (2018: £34.2m) against total loans and advances to customers of £17,008.0m (2018: £16,067.6m).

The Group applies four macro-economic scenarios when determining the ECL calculation; a central outlook, a downside and an alternative downside scenario and a growth scenario. The alternative downside scenario has been added in the current year to capture further downside risks. Probability weightings assigned to each scenario are determined by the Strategy team and approved by Executive Committee (Exco).

The selection and probability weighting of relevant macro-economic scenarios is judgemental and has a significant impact on the ECL calculation.

Our key audit matter has been identified as the selection and probability weighting of relevant macro economic scenarios and assumptions. There exists a risk of management bias in selecting the weightings and assumptions applied in the IFRS model, and also a potential lack of consistency in approach when determining the weightings period on period. As the downside scenarios are the most sensitive within the model, and have the largest impact on the overall ECL, there is a risk of Management bias in selecting the probability weightings of macroeconomic assumptions and the level of consistency in approach when determining the probability weightings for each scenario period on period.

We also considered the potential for fraud through possible manipulation of this balance.

The Group's loan loss provision balances are detailed within note 31. Management's associated accounting policies are detailed on pages 128 to 130 with detail about judgements in applying accounting policies and critical accounting estimates on pages 133 to 137. Management's consideration of the effect of the future economic environment is disclosed on pages 134 to 137. The audit committee's consideration of the matter is described on page 86.

How the scope of our audit responded to the key audit matter	We have tested the relevant controls over the loan impairment provisioning process. This included assessment of the level of challenge at key Management review forums that formed part of these controls. With the involvement of our credit risk and accounting specialists, we assessed the compliance of the modelling approach and methodology with the requirements of IFRS 9 – Financial instruments. With the involvement of our IT and credit risk specialists we assessed whether the documented modelled approach was implemented in practice. We challenged Management's consideration of the future economic environment by engaging our economic specialists to review Management's approach as well as comparing modelled assumptions to publically available data from the Office of National Statistics and comparable peer data. We challenged Management as to whether there was sufficient downside risk in the modelled approach given the heightened economic uncertainty, in particular relating to the economic impact of the UK's anticipated exit from the European Union, at the balance sheet date. We assessed, using publically available data, whether the combination of Management's modelled downside and alternative downside scenarios appropriately captured credit risk relating to the future economic environment. We reconciled each book to the general ledger and substantively tested a sample of loans to assess whether the data used in the provision calculation was complete and accurate.
Key observations	Based on the work performed, we concluded that the Group's ECL applied to the UK residential mortgage book was within a reasonable range. This conclusion is driven by the combined impact of the assumptions used and the probability weightings attributed to the scenarios. Management's modelling approach and methodology for determining the ECL is materially consistent with prior year and in line with IFRS 9.

5.2. Hedge accounting

Key audit matter description	The Group has designated a number of fair value macro hedges in order to minimise fair value volatility through the income statement. Over the life of the hedge, hedged items (mortgages and savings accounts) and instruments (derivatives) incept and de-designate from the hedge relationship. We have identified a key audit matter around the completeness of the identification of items which are designated and de-designated from the hedge relationship, as well as the accuracy of the amortisation adjustments posted against these items. The net fair value adjustment in the balance sheet at year end was an asset of £54.2m (2018: £2.3m). To address observations we raised in the prior period, Management has implemented enhancements to key controls and processes in relation to the designation and de-desgination of instruments within the macro hedge relationships. Management has taken the IFRS 9 accounting policy choice to continue to apply IAS 39 accounting with respect to all designated hedge relationships. Management's chosen accounting policies are detailed on page 129. The audit committee's consideration of this risk is included on page 88.

Independent Auditor's Report

Year ended
31 December 2019

Continued

How the scope of our audit responded to the key audit matter	We have tested the relevant controls over the hedge accounting process, including testing the operating effectiveness of the Group's controls over the identification and recording of the designation and de-designation adjustments. We have assessed whether the key areas for control and process improvement identified in the prior year in relation to the designation and de-designation process have been rectified by Management. We obtained Management's master document where the designation and de-designation adjustments are calculated on a monthly basis and reviewed Management's methodology for assessing items that have de-designated from the hedge relationship. We then tested the accuracy of the amortisation adjustments posted by Management through a full recalculation of the expected remaining amortisation as at 31 December 2019. We tested the valuation of the items which had been designated or de-designated from the macro hedge in the year through independent recalculation of the fair value of a sample of items as at their designation/de-designation date. We tested the completeness of the population of items within the master document through reperformance of Management's monthly designation and de-designation process.
Key observations	Based on the work peformed in relation to the designation and de-designation of items into macro hedge relationships we concluded that the overall treatment adopted, and subsequent amortisation of de-designated items, was appropriate.

5.3. Fair value of collateral loan

Key audit matter description	The Group holds a collateral loan to a third party secured on a portfolio of equity release mortgages. The collateral loan represents a complex financial instrument held at fair value and is classified within level 3 within the fair value hierarchy (see page 184 for a definition of level 3 measurements). The collateral loan had a carrying value at 31 December 2019 of £219.4m (2018: £229.5m). The fair value of the collateral loan is determined using a discounted cash flow model, and is reliant upon a number of unobservable and judgemental inputs. Our key audit matter has been pinpointed to the risk of Management bias in selecting the discount rate used with the fair value model, specifically the liquidity premium component of the discount rate assumption. We have also identified a key audit matter in relation to the accuracy of the model mechanics given the complexity of the model used to value the collateral loan. We also considered the potential for fraud through possible manipulation of this balance. The Group's disclosure of the collateral loan is detailed within note 31. Management's associated accounting policies are detailed on page128 with detail about judgements in applying accounting policies and critical accounting estimates on pages 133 and 137. The Audit Committee's consideration of the matter is described on page 87.
How the scope of our audit responded to the key audit matter	We obtained an understanding of the relevant controls over the fair valuation of collateral loan process. We challenged Management's valuation methodology for the equity release mortgage portfolio by: • involving our valuation specialists in the review of management's valuation approach; • testing the accuracy of the valuation model by involving our modelling specialists in the review of the model mechanics, which included an assessment of whether the model had been prepared in accordance with the loan contractual terms with the third party; • challenging the rate used to discount the future cash flows to present value, including the liquidity premium component, utilising both internal and external data and taking account of the repayment profiles and credit risks associated with the assets; and • testing the appropriateness of the other elements inherent in the valuation of the underlying loan assets, such as no negative equity guarantees provided by the Group to the originator of the underlying loans.

Key observations	Based on the work performed, we concluded that the Group's valuation of the collateral loan was within a reasonable range.

5.4. Fair value of complex financial instruments

Key audit matter description	In addition to the collateral loan detailed in the key audit matter above, there are a number of other complex financial instruments held at fair value by the Group which are classified as level 3 within the fair value hierarchy due to unobservable prepayment assumptions used within the calculation methodology. These financial instrument liabilities have a net carrying value of £54.8m (2018: £54.4m) and comprise the following: • the Retail Prices Index ("RPI") linked derivative hedging the equity release portfolio; and • the derivatives hedging the Residential Mortgage-Backed Securities ("RMBS") securitisation vehicles. The following are the unobservable inputs: • The RPI assumptions applied to the RPI linked derivative; and • The prepayment rate of mortgages within the RMBS securitisation vehicles. We also considered the potential for fraud through possible manipulation of this balance. The Group relies on counterparty valuations to determine the fair value of these instruments and we identified a key audit matter that these could be materially misstated. Management's chosen accounting policies are detailed on page 129 with details about valuation techniques and key inputs on page 185. The audit committee's consideration of this risk is included on page 88.
How the scope of our audit responded to the key audit matter	We obtained an understanding of the relevant controls over the fair valuation of complex financial instruments process. We selected a sample of complex derivatives for testing and, with the involvement of our pricing specialists, we valued these instruments using independently developed models. This included independently derived assumptions for RPI and other inputs that were not directly linked to client data. We tested the appropriateness of the prepayment rate used in the valuation of the RMBS derivatives by considering historical actual prepayment rates.
Key observations	Based on the work performed, we concluded that the Group's valuations of complex financial instruments were within a reasonable range.

6. Our application of materiality

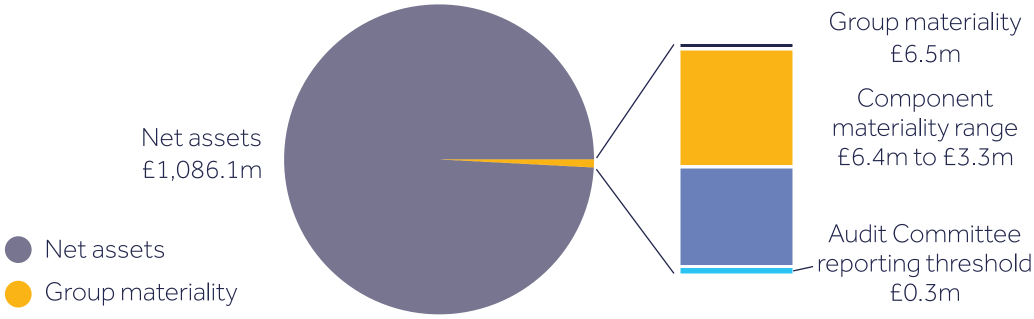
6.1. Materiality

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

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

	Group financial statements	Society financial statements
Materiality	£6.5m (2018: £6.4m)	£6.4m (2018: £6.2m)
Basis for determining materiality	0.6% of net assets (2018: 5.2% of adjusted profit before tax)	0.6% of net assets (2018: 5.2% of adjusted profit before tax) As the majority of the Group's operations are carried out by the Society and Society net assets are higher than Group, Society materiality was capped at 99% of Group materiality.
Rationale for the benchmark applied	The key reasons for the change in benchmark used are that the overall capital base is a key focus area for the Society's members and regulators and that the industry is experiencing lowered margins at the same time as the net assets of the Society are growing. Therefore, net assets has been considered a more appropriate base on which to determine materiality. This change in the benchmark has been communicated and agreed with the Audit Committee.	

Continued



6.2. Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Group performance materiality was set at 70% of Group materiality for the 2019 audit (2018: 70%). In determining performance materiality, we considered the following factors:

a. the quality of the control environment and whether we were able to rely on controls;

b. whether there were any significant changes in the business that might affect our ability to forecast misstatements; and

c. prior year uncorrected and corrected misstatements and the likelihood of errors occurring based on our previous experience.

6.3. Error reporting threshold

We agreed with the Audit Committee that we would report to the committee all audit differences in excess of £0.3m (2018: £0.3m), 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.

7. An overview of the scope of our audit

7.1. Identification and scoping of components

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 an audit of the Society and material subsidiaries. This provided 100% coverage of revenue, profit before tax and net assets of the Group, executed at levels of materiality applicable to each individual entity which were lower than Group materiality and in the range of £3.3m to £6.4m (2018: £0.03m to £6.2m).

We, as the Group auditor, were responsible for performing the audit of each subsidiary. At the Group level we also tested the consolidation process.

7.2. Our consideration of the control environment

Our approach in relation to the Group's business cycles

We relied on controls over the following business cycles for the Group:

- Residential mortgage lending
- Customer deposits
- Expected credit losses – UK portfolio
- Derivatives
- Hedge accounting

We obtained an understanding of the relevant controls of the above mentioned business cycles annually. We tested relevant controls over a three year cycle for the relevant controls that do not address a significant risk. We established the continuing relevance of that evidence by obtaining audit evidence about whether significant changes in these controls have occurred subsequent to the previous audit. Where there had been changes, the controls were tested in the current year. Relevant controls that address a significant risk, were tested annually.

Our approach in relation to the Group's IT systems

We relied on controls over the following IT systems as being key to the financial reporting processes in the Society:

- Core mortgage system
- Core savings system
- Treasury system
- Data reporting tool
- Expected credit loss platform
- Underlying servers and databases for the above systems where applicable
- Review of third party assurance report for key IT outsourced vendor

We obtained an understanding of the relevant IT controls associated with the above mentioned systems. We tested the relevant IT controls by selecting a representative sample based on the frequency of the operation of the control and assessing the effectiveness against supporting evidence. We tested key automated controls as identified during our walkthroughs of the business cycles described in the preceding section.

8. Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

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

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

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

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

- **Fair, balanced and understandable** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of these matters.

9. Responsibilities of directors

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

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

10. Auditor's responsibilities for the audit of the financial statements

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

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud and non-compliance with laws and regulations are set out below.

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

11. Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

11.1. Identifying and assessing potential risks related to irregularities
In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- The nature of the industry and sector, control environment and business performance including the design of the Group’s remuneration policies, key drivers for directors’ remuneration, bonus levels and performance targets.
- The results of our enquiries of management, internal audit and the Audit Committee about their own identification and assessment of the risks of irregularities.
- Any matters we identified having obtained and reviewed the Group’s documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations.
- The matters discussed among the audit engagement team and involving relevant internal specialists, including tax, financial instruments, pensions, IT, economic specialists and industry specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas: IFRS 9 Financial instruments – expected credit loss provisioning, fair value of collateral loan, fair value of complex financial instruments and hedge accounting. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory framework that the Group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the Building Societies Act 1986 for the Society and the UK Companies Act for the subsidiaries.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the Group’s ability to operate or to avoid a material penalty. These included the regulations set by the Prudential Regulation Authority relating to regulatory capital and liquidity requirements.

11.2. Audit response to risks identified
As a result of performing the above, we identified IFRS 9 Financial instruments – expected credit loss provisioning, fair value of collateral loan, fair value of complex financial instruments and hedge accounting as key audit matters related to the potential risk of fraud. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the Audit Committee and external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the Prudential Regulation Authority and the Financial Conduct Authority; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

12. Opinions on other matters prescribed by the Building Societies Act 1986

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

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

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

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

In our opinion the information given on page 191 for the financial year ended 31 December 2019 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by Country Reporting) Regulations 2013.

14. Matters on which we are required to report by exception

14.1. Adequacy of explanations received and accounting records

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

- adequate accounting records have not been kept by the Society; or
- the Society's financial statements are not in agreement with the accounting records and returns; 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.

15. Other matters

15.1. Auditor tenure

Following the recommendation of the audit committee, we were appointed by the Society at the Annual General Meeting on 15 June 2005 to audit the financial statements for the year ending 31 December 2005 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 15 years, covering the years ending 31 December 2005 to 31 December 2019.

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

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

16. Use of our report

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

David Heaton
(Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor

Leeds, United Kingdom
25 February 2020

Income Statements

For the year ended
31 December 2019

	Notes	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Interest receivable and similar income	3	**465.3**	457.0	**458.3**	450.5
Interest payable and similar charges	4	**(264.5)**	(238.9)	**(258.0)**	(232.3)
Net interest receivable		**200.8**	218.1	**200.3**	218.2
Fees and commissions receivable		**7.2**	8.6	**7.4**	8.6
Fees and commissions payable		**(0.9)**	(0.8)	**(0.6)**	(0.4)
Fair value losses from financial instruments	5	**(19.7)**	(5.7)	**(18.3)**	(11.0)
Income from investments in subsidiaries	15	**–**	–	**–**	2.8
Other operating income		**1.9**	0.7	**2.7**	0.5
Total income		**189.3**	220.9	**191.5**	218.7
Administrative expenses	6	**(93.8)**	(94.9)	**(93.8)**	(94.5)
Depreciation and amortisation	16,17	**(7.4)**	(4.0)	**(7.4)**	(4.0)
Impairment (losses) / gains on loans and advances to customers	8	**(2.8)**	1.2	**(2.8)**	1.2
Impairment losses on investments in subsidiary undertakings	15	**–**	–	**–**	(3.8)
Reversal of impairment losses on property, plant and equipment	17	**0.1**	–	**0.1**	–
Provisions release	22	**2.6**	0.2	**2.6**	0.2
Loss on sale of financial assets	13	**–**	(6.5)	**–**	(6.5)
Operating profit and profit before tax		**88.0**	116.9	**90.2**	111.3
Tax expense	9	**(21.8)**	(27.7)	**(21.8)**	(27.2)
Profit for the financial year		**66.2**	89.2	**68.4**	84.1

All amounts relate to continuing operations apart from those disclosed in note 13.

The notes on pages 122 to 187 form part of these accounts.

Statements of Comprehensive Income

For the year ended
31 December 2019

	Notes	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Profit for the financial year		**66.2**	89.2	**68.4**	84.1
Items that may subsequently be reclassified to profit and loss:					
Fair value gains / (losses) on investment securities measured at fair value through other comprehensive income		**1.8**	(5.3)	**1.8**	(5.3)
Gains on investment securities measured through other comprehensive income reclassified to profit or loss on disposal		**(0.5)**	(0.8)	**(0.5)**	(0.8)
Tax relating to items that may subsequently be reclassified	26	**0.1**	1.3	**0.1**	1.3
Items that may not subsequently be reclassified to profit and loss:					
Actuarial (loss) / gain on retirement benefit surplus	24	**(7.9)**	8.6	**(7.9)**	8.6
Revaluation loss on properties revalued	17	**(1.1)**	(1.0)	**(1.1)**	(1.0)
Tax relating to items that may not be reclassified	26	**1.0**	(4.8)	**2.2**	(4.8)
Total comprehensive income for the year		**59.6**	87.2	**63.0**	82.1

Statements of Financial Position

As at 31 December 2019

	Notes	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Assets					
Liquid assets					
Cash in hand and balances with the Bank of England	11	**1,451.7**	1,428.0	**1,451.7**	1,428.0
Loans and advances to credit institutions		**163.4**	169.7	**84.1**	71.3
Investment securities	12	**1,708.1**	1,229.1	**2,128.2**	1,552.9
Derivative financial instruments	35	**182.9**	273.4	**127.1**	182.8
Loans and advances to customers	13				
Loans fully secured on residential property		**16,739.8**	15,777.1	**16,739.8**	15,777.1
Other loans		**235.0**	256.3	**235.0**	256.3
Fair value adjustment for hedged risk on loans and advances to customers		**23.9**	18.0	**23.9**	18.0
Other assets, prepayments and accrued income	14	**210.1**	160.5	**276.9**	231.9
Deferred tax assets	25	**6.1**	6.4	**6.1**	6.4
Investments in subsidiary undertakings	15	**–**	–	**1.9**	46.6
Intangible assets	16	**19.6**	8.5	**19.6**	8.5
Property, plant and equipment	17	**64.2**	53.0	**64.2**	53.0
Retirement benefit surplus	24	**3.0**	10.1	**3.0**	10.1
Total assets		**20,807.8**	19,390.1	**21,161.5**	19,642.9
Liabilities					
Shares	18	**14,517.5**	13,909.5	**14,517.5**	13,909.5
Fair value adjustment for hedged risk on shares		**(30.3)**	15.7	**(30.3)**	15.7
Derivative financial instruments	35	**200.4**	133.2	**176.6**	132.9
Amounts owed to credit institutions		**1,439.5**	1,399.3	**1,439.5**	1,399.3
Amounts owed to other customers	19	**234.7**	211.0	**877.1**	584.7
Debt securities in issue	20	**2,972.5**	2,260.3	**2,706.9**	2,158.8
Other liabilities and accruals	21	**141.0**	188.7	**135.2**	165.7
Current tax liabilities		**9.4**	12.4	**9.3**	12.4
Deferred tax liabilities	25	**3.7**	4.3	**2.5**	3.8
Provisions for liabilities and charges	22	**1.2**	5.0	**1.2**	5.0
Subscribed capital	23	**232.1**	224.2	**232.1**	224.2
Total liabilities		**19,721.7**	18,363.6	**20,067.6**	18,612.0
Total equity attributable to members		**1,086.1**	1,026.5	**1,093.9**	1,030.9
Total liabilities and equity		**20,807.8**	19,390.1	**21,161.5**	19,642.9

The accounts on pages 122 to 187 were approved by the Board of Directors on 25 February 2020.
Signed on behalf of the Board of Directors by:

Robin Ashton
Chairman

Richard Fearon
Chief Executive Officer

Andrew Greenwood
Chief Risk Officer

Statements of Changes in Members' Interest

For the year ended
31 December 2019

Group 2019	**General reserve £M**	**Fair value reserve £M**	**Revaluation reserve £M**	**Other reserve £M**	**Total equity attributable to members £M**
At 1 January 2019	**1,006.3**	**(2.3)**	**8.2**	**14.3**	**1,026.5**
Comprehensive income for the year	**58.1**	**1.4**	**0.1**	**–**	**59.6**
Revaluation gains transferred on disposal of assets	**0.2**	**–**	**(0.2)**	**–**	**–**
At 31 December 2019	**1,064.6**	**(0.9)**	**8.1**	**14.3**	**1,086.1**

Group 2018	General reserve £M	Fair value reserve £M	Revaluation reserve £M	Other reserve £M	Total equity attributable to members £M
At 1 January 2018	931.3	2.3	11.1	14.3	959.0
Impact of adoption of IFRS9 at 1 January 2018	(26.4)	0.2	–	–	(26.2)
Tax relating to adoption of IFRS9 at 1 January 2018	6.5	–	–	–	6.5
At 1 January 2018 (Restated)	911.4	2.5	11.1	14.3	939.3
Comprehensive income for the year	93.9	(4.8)	(1.9)	–	87.2
Revaluation gains transferred on disposal of assets	1.0	–	(1.0)	–	–
At 31 December 2018	1,006.3	(2.3)	8.2	14.3	1,026.5

Society 2019	**General reserve £M**	**Fair value reserve £M**	**Revaluation reserve £M**	**Other reserve £M**	**Total equity attributable to members £M**
At 1 January 2019	**1,010.9**	**(2.3)**	**8.2**	**14.1**	**1,030.9**
Comprehensive income for the year	**61.5**	**1.4**	**0.1**	**–**	**63.0**
Revaluation gains transferred on disposal of assets	**0.2**	**–**	**(0.2)**	**–**	**–**
At 31 December 2019	**1,072.6**	**(0.9)**	**8.1**	**14.1**	**1,093.9**

Society 2018	General reserve £M	Fair value reserve £M	Revaluation reserve £M	Other reserve £M	Total equity attributable to members £M
At 1 January 2018	941.0	2.3	11.1	14.1	968.5
Impact of adoption of IFRS9 at 1 January 2018	(26.4)	0.2	–	–	(26.2)
Tax relating to adoption of IFRS9 at 1 January 2018	6.5	–	–	–	6.5
At 1 January 2018 (Restated)	921.1	2.5	11.1	14.1	948.8
Comprehensive income for the year	88.8	(4.8)	(1.9)	–	82.1
Revaluation gains transferred on disposal of assets	1.0	–	(1.0)	–	–
At 31 December 2018	1,010.9	(2.3)	8.2	14.1	1,030.9

Statements of Cash Flows

For the year ended
31 December 2019

	Notes	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Profit before tax		**88.0**	116.9	**90.2**	111.3
Adjusted for changes in:					
Impairment provision		**(1.0)**	(15.8)	**(1.0)**	(15.8)
Provisions for liabilities and charges		**(3.8)**	(1.4)	**(3.8)**	(1.4)
Depreciation and amortisation		**7.4**	4.0	**7.4**	4.0
Fair value of collateral loan which represents a pool of equity release mortgages		**8.5**	7.8	**8.5**	7.8
Loss on sale of financial assets		**–**	6.5	**–**	6.5
Non-cash and other items		**(7.4)**	(28.3)	**(40.3)**	(22.8)
Cash generated from operations		**91.7**	89.7	**61.0**	89.6
Changes in operating assets and liabilities:					
Derivative financial instruments		**12.2**	(43.6)	**33.9**	(36.1)
Loans and advances to customers		**(948.9)**	(813.6)	**(948.9)**	(813.6)
Other operating assets		**(49.6)**	40.1	**(97.9)**	63.5
Shares		**608.0**	838.0	**608.0**	838.0
Amounts owed to credit institutions and other customers		**63.9**	404.4	**332.6**	284.2
Other operating liabilities		**(63.0)**	34.1	**(45.1)**	21.5
Taxation paid		**(24.6)**	(31.2)	**(24.6)**	(31.2)
Net cash flows from operating activities		**(310.3)**	517.9	**(81.0)**	415.9
Cash flows from investing activities					
Purchase of investment securities		**(5,176.5)**	(1,995.1)	**(5,326.5)**	(1,995.1)
Proceeds from sale and redemption of investment securities		**4,699.4**	1,539.0	**4,753.1**	1,620.4
Change in loans to subsidiary undertakings		**–**	–	**44.7**	(9.3)
Purchase of intangible assets		**(11.9)**	(4.5)	**(11.9)**	(4.5)
Purchase of property, plant and equipment		**(5.9)**	(4.6)	**(5.9)**	(6.0)
Proceeds from sale of property, plant and equipment		**0.4**	2.2	**0.4**	2.2
Net cash flows from investing activities		**(494.5)**	(463.0)	**(546.1)**	(392.3)
Cash flows from financing activities	27				
Net proceeds from issue of debt securities		**1,609.4**	93.0	**1,359.4**	93.0
Repayments of debt securities in issue		**(787.2)**	(701.0)	**(695.8)**	(655.0)
Net proceeds from issue of subscribed capital		**–**	199.2	**–**	199.2
Net cash flows from financing activities		**822.2**	(408.8)	**663.6**	(362.8)
Net increase / (decrease) in cash and cash equivalents		**17.4**	(353.9)	**36.5**	(339.2)
Cash and cash equivalents at the beginning of the year		**1,597.7**	1,951.6	**1,499.3**	1,838.5
Cash and cash equivalents at the end of the year	28	**1,615.1**	1,597.7	**1,535.8**	1,499.3

Notes to the Accounts

Year ended
31 December 2019

1. Accounting policies

(a) Basis of preparation
These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) 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.

These financial statements are presented in sterling and, except where otherwise indicated, have been rounded to the nearest one hundred thousand pounds. The particular accounting policies adopted are described below and the policies, presentation and methods of computation are consistent with those applied by the Society in the prior year, except where otherwise indicated.

The following IFRS pronouncements, relevant to the Group, were adopted with effect from 1 January 2019:

- IFRS 16 – Leases
- IFRIC 23 – Uncertainty over Income Tax Treatments

The adoption of IFRS 16 has impacted the Statement of Financial Position of the Group and further information is provided in note 38. As permitted by the standard, the Group has chosen to apply the 'modified retrospective' approach to transition and therefore the cumulative effect of initially applying the standard is applied to the opening balance sheet at 1 January 2019 and comparative information has not been restated. The Group has also chosen to measure the right-of-use asset at an amount equal to the lease liability.

The adoption of IFRIC 23 has not resulted in any material changes to the accounting policies or financial statements of the Group.

The Group has also chosen to early adopt Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7) which was issued by the International Accounting Standards Board in September 2019 and is mandatorily effective from 1 January 2020. These amendments have modified certain hedge accounting requirements to allow continued designation for affected hedge relationships during the period of uncertainty as benchmark interest rates are amended or replaced.

These amendments affect the Society's hedge relationships in the following ways:

- The Society has issued sterling and euro fixed rate debt securities that are designated in fair value hedges using fixed to LIBOR and EURIBOR interest rate swaps respectively to mitigate interest rate risk. The amendments allow continued designation even though LIBOR and EURIBOR may no longer be separately identifiable. However, the amendment does not extend to removing the requirement for the interest rate risk to be reliably measured. Should it not be possible to reliably measure the interest rate risk the hedge relationship must be discontinued.
- The interest rate risk associated with the Society's fixed rate retail mortgages and investment securities is hedged using pay fixed, receive floating LIBOR interest rate swaps which are designated in a macro fair value hedge of the LIBOR risk. The amendments allow the Society to continue to designate these items and swaps in the macro fair value hedge even if LIBOR is no longer separately identifiable.
- Fixed rate deposits (savings) from customers and the interest rate risk associated with them is hedged using receive fixed, pay floating LIBOR interest rate swaps and included in a macro fair value hedge of the LIBOR risk component. This hedge will continue even if LIBOR is no longer separately identifiable.

The Society has chosen to early adopt the amendments for the period ending 31 December 2019 as adopting these amendments allows the Society to continue hedge accounting during the period of uncertainty arising during the benchmark rate reforms. Further information can be found in note 35c.

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:

- IFRS 17 – Insurance Contracts

IFRS 17, which is effective from 1 January 2022, is not expected to have a material impact on the Group since the Group does not issue insurance contracts. The Group holds a collateral loan which represents a pool of equity release mortgages purchased from a third party and is currently accounted for under IFRS 9 – Financial Instruments. The Group expects to continue to apply IFRS 9 to this loan following the adoption of IFRS 17, as permitted by the scope exclusion proposed in ED/2019/4 – Amendments to IFRS 17.

(b) Accounting convention
The Group prepares its accounts under the historical cost convention, except for the valuation of financial assets and liabilities held at fair value through other comprehensive income or fair value through profit or loss including all derivative financial instruments, and certain freehold and long leasehold properties.

1. Accounting policies continued

(c) Basis of consolidation
Leeds Building Society does not have a parent or controlling entity. 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 15. Uniform accounting policies are applied throughout the Group. Intercompany transactions are eliminated upon consolidation.

(d) Financial instruments

(i) Classification and measurement

Financial assets
In accordance with IFRS 9, the Group has classified its financial assets with reference to both the Group's business model for managing the assets and the contractual cash flow characteristics of the assets. The Group's financial assets have been classified into the following categories:

- At amortised cost
  These are assets for which the business model is to hold the asset and collect the contractual cash flows, and those cash flows are solely payments of principal and interest. This means that cash flows typically occur on pre-determined dates and that interest primarily reflects the time value of money, compensation for credit risk and a profit margin.

  The Group has classified the following assets as 'at amortised cost': cash in hand and balances with the Bank of England, loans and advances to credit institutions and loans and advances to customers, with the exception of a collateral loan which represents a pool of equity release mortgages purchased from a third party for which some but not all risks were transferred to the Group.

  Assets held at amortised cost are initially recorded at fair value (usually transaction price) plus any directly attributable costs. They are subsequently measured using the effective interest rate method less provisions for impairment.

- At fair value through other comprehensive income (FVOCI)
  These are categories of assets for which the business model is to hold the asset and collect the contractual cash flows or to sell the assets. The contractual cash flows must be solely payments of principal and interest. The Group holds investment securities in order to meet current and future liquidity requirements, and these are considered to meet the definition of the hold or sell business model. They are therefore classified as 'at FVOCI', apart from those assets for which the cash flows are not solely payments of principal and interest, as noted below.

  These assets are initially recognised at fair value plus any attributable costs. Subsequent changes in fair value are recognised in equity, except for impairment losses which are recognised in the Income Statement. Upon derecognition, any accumulated movements in fair value previously recognised in equity are reclassified to profit or loss in the Income Statement.

  Premia and discounts arising on the purchase of assets held at FVOCI are spread over the life of the asset using the effective interest rate method.

- At fair value through profit or loss (FVTPL)
  Assets for which the business model is neither to hold nor to hold or sell, or those for which contractual cash flows are not solely payments of principal and interest, are classified as 'at FVTPL'. The Group has classified the collateral loan which represents a pool of equity release mortgages as 'at FVTPL' since the underlying contract with the customer contains a 'no negative equity guarantee' that any shortfall arising on the sale of the property securing the mortgage will not be pursued.

  Certain investment securities are also classified as 'at FVTPL', either because interest can be foregone or because their credit risk is higher than the average credit risk of the underlying collateral. In addition, IFRS 9 has mandated that derivative financial instruments are classified as 'at FVTPL'.

  These assets are initially recognised at fair value and any subsequent changes in fair value are recognised immediately in the Income Statement.

  Purchases and sales of financial assets are recognised at settlement date.

Financial liabilities
All financial liabilities are classified as 'at amortised cost', with the exception of derivative financial instruments which under IFRS 9 are mandatorily classified as 'at FVTPL'.

Financial liabilities are initially recorded at their fair value, and those to be measured at amortised cost are subsequently measured using the effective interest rate method. 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. Those liabilities measured at FVTPL are initially recognised at fair value and any subsequent changes in fair value are recognised immediately in the Income Statement.

1. Accounting policies continued

(d) Financial instruments (continued)

(ii) 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.

(iii) 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. Assets and liabilities that have failed the derecognition test are recognised by the Society and its subsidiaries to reflect intra-group transfer of risks and rewards which are eliminated on consolidation.

(iv) Derivative financial instruments and hedge accounting
The Group continues to apply the IAS 39 hedge accounting standards, as permitted by IFRS 9.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently re-measured 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.

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 accounting 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 has not had any cash flow hedge relationships in place during the current or prior years or at the end of the current year.

(e) Impairment of financial assets
Impairment losses are calculated for all financial assets held at amortised cost or at FVOCI. Loss provisions are also held against undrawn loan commitments, where a loan offer has been issued to a customer and remains unexpired but the loan has not yet completed and so has not yet been recognised in the Statement of Financial Position.

Impairment losses are calculated on an expected credit loss (ECL) basis. Financial assets are classified individually into one of three stages, as follows:

- Stage 1 – assets are allocated to this stage on initial recognition and remain in this stage if there is no significant increase in credit risk since initial recognition. Impairment losses are recognised to cover 12 month ECL, being the proportion of lifetime ECL arising from default events expected within 12 months of the reporting date.
- Stage 2 – assets where it is determined that there has been a significant increase in credit risk since initial recognition, but where there is no objective evidence of impairment. Impairment losses are recognised to cover lifetime ECL.
- Stage 3 – assets where there is objective evidence of impairment, i.e. they are considered to be in default. Impairment losses are recognised to cover lifetime ECL.

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.

(i) Impairment of loans and advances to customers
The primary driver in determining whether an individual loan has had a significant increase in credit risk is a quantitative assessment of the increase in lifetime probability of default (PD). At each reporting date, lifetime PD is recalculated and compared to the lifetime PD calculated on initial recognition. The loan is allocated to Stage 2 if the lifetime PD has increased over a pre-determined threshold which is set using a test based approach and expressed as a percentage increase, segmented by product type and risk banding at the date of initial recognition.

1. Accounting policies continued

(e) Impairment of financial assets (continued)

(i) Impairment of loans and advances to customers (continued)
In addition to the above, a number of qualitative criteria have been set such that loans which are considered to have a significantly increased credit risk but would not be captured above are moved to Stage 2. These qualitative criteria include loans which have reached the end of their contractual term and loans where the customer has been identified as bankrupt but is not in arrears. A backstop is also in place such that all loans which are 30 days past due are moved to Stage 2.

Definition of default: Individual loans are considered to be in default and are allocated to Stage 3 if the loan is more than 90 days past due, is subject to certain forbearance activities, is in possession or if the customer has been identified as bankrupt and is in arrears by more than a nominal amount. A cure period is in place such that the loan would move back to Stage 2 if the loan remains not in default for 12 months or for loans subject to forbearance, if 12 consecutive full payments are made after the forbearance activity has completed.

ECL is calculated by multiplying loss given default (LGD), probability of default (PD) and exposure at default (EAD). Each element of the calculation is modelled at individual account level on a monthly basis over the remaining life of the loan, with the first 12 months totalled to obtain the 12 month ECL and the lifetime ECL obtained by totalling the above over the full life of the loan. Modelling assumptions are based on historical data analysis of the impact of economic variables on loan behaviour. These assumptions are then applied to the forecast economic scenarios to predict future loan behaviour.

The overall ECL recorded in the financial statements is calculated as the probability weighted ECL over a range of possible forecasted macroeconomic scenarios.

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. The implementation of a forbearance strategy does not give rise to the derecognition of the loan.

(ii) Impairment of liquid assets
The Group reviews the external credit ratings of its liquid assets (cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities) at each reporting date. Those assets which are of investment grade (external credit rating of Aaa to Baa3 or equivalent) are considered to have low credit risk and therefore are assumed to have not had a significant increase in credit risk since initial recognition, as allowed by IFRS 9. Liquid assets which are not of investment grade are not expected to be material, but would be assessed on an individual basis.

ECL is calculated by multiplying loss given default (LGD), probability of default (PD) and exposure at default (EAD). LGD is calculated based on publicly available data on historic recovery rates by product and PDs are similarly based on public information and analysis performed by third parties to derive PDs for similar products.

(f) Interest receivable and payable and similar income and charges
Interest income and expense on all financial instruments is recognised in interest receivable or payable in the Income Statement. Interest income and expense is calculated using the effective interest rate method for financial assets and liabilities held at amortised cost and at FVOCI.

The effective interest rate method is a method of allocating the interest income or interest expense to the carrying value 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. For investment securities, the effective interest rate method spreads any premia or discounts arising on the purchase of the asset over the period to the maturity date of the asset.

Interest received on the collateral loan and investment securities classified as 'at FVTPL' is recognised within 'Interest receivable and similar income'. Amounts accrued and settled in relation to coupon payments and receipts which are contractually due on derivative financial instruments are recognised within 'Interest receivable and similar income' for all derivatives which are economic hedges of financial assets, regardless of whether or not they are in an accounting hedge relationship, and within 'Interest payable and similar charges' for all derivatives which are economic hedges of financial liabilities. All other movements in the fair value of assets held 'at FVTPL' are recognised through 'Fair value gains less losses from financial instruments'.

1. Accounting policies continued

(g) Fees and commissions receivable
Fees and commissions are earned on referral of customers to third party service providers. The Group's performance obligation is satisfied at the point of referral and income is recognised at this point.

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.

(h) 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, certain IT development services and other internal costs, 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 for impairment at each Statement of Financial Position date or when there is an indication of impairment. Impairment occurs when the economic benefits arising from the asset are lower than its carrying amount. 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, calculated on the discounted cash flow method. Any impairment in the value of these assets is recognised immediately as an expense in the Income Statement.

(i) Property, plant and equipment
Freehold and long leasehold premises are revalued every three years by an independent firm of valuers. The fair value of the properties is determined from market based evidence either on a value in use basis for office property in long term use or open market value.

No provision is made for depreciation of freehold and long leasehold premises 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 their estimated useful lives as follows:

Short leasehold premises	Unexpired lease term
Improvements to premises	8 to 10 years
Office and computer equipment	3 to 5 years

Property, plant and equipment are reviewed annually for indications of impairment. Impairment losses are recognised immediately as an expense in the Income Statement.

(j) Leases
The adoption of IFRS 16 – Leases from 1 January 2019 has resulted in a new accounting policy in relation to the Society's leases as detailed below. Further information on the adoption of IFRS 16 can be found in note 38.

Accounting policy from 1 January 2019:
The Group classifies all contracts which give the right to control the use of an identified asset for a period of time in exchange for a consideration as leases. If the supplier of the asset has a substitution right then this is not classified as an asset and the contract is not classified as a lease.

(i) Lessee
At the commencement of a lease, the Group recognises a right-of-use asset within 'Property, plant and equipment' and a lease liability within 'Other liabilities and accruals' in the Statement of Financial Position. The lease liability is initially measured at the present value of all contractual payments that are not paid at the commencement date, discounted using the Group's cost of borrowing at the date of inception of the lease. The calculation of the lease liability reflects the Group's judgement as to whether it will exercise a purchase, extension or termination option. For leases of land and buildings, the Group has elected not to separate non-lease components and account for the lease and non-lease components as a single lease component.

Interest is charged on the lease liability at the Group's cost of borrowing at the date of inception of the lease and recorded in 'Interest payable and similar charges' within the Income Statement.

The lease liability is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Group's estimate of the amount expected to be payable under a residual value guarantee, or if the Group changes its assessment of whether it will exercise a purchase, extension or termination option. When the lease liability is remeasured in this way, a corresponding adjustment is made to the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

Year ended
31 December 2019 **Continued**

1. Accounting policies continued

(j) Leases (continued)

(i) Lessee (continued)
The right-of-use asset is initially measured at an amount equal to the lease liability. It is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term (or the end of the estimated useful life for the equivalent item of property, plant and equipment if shorter). Right-of-use assets are reviewed annually for indications of impairment. Impairment losses are recognised immediately as an expense in the Income Statement.

No right-of-use asset or lease liability is recognised for leases with a lease term of less than 12 months and leases of low value items. Lease payments associated with these leases are recognised within administrative expenses on a straight line basis over the lease term.

(ii) Lessor
All of the Group's leases where the Group acts as a lessor are classified as operating leases. The Group recognises lease payments received under operating leases in line with receipt of payments.

Accounting policy prior to 1 January 2019:
Rentals under operating leases are charged to administrative expenses on a straight line basis over the life of the lease.

(k) Retirement 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 surplus 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 obligation, 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.

(l) 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.

(m) Foreign currency
Assets and liabilities denominated in foreign currencies are translated into sterling at the appropriate rates of exchange prevailing at the Statement of Financial Position date 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.

(n) Segmental reporting
The Group's 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. The Group has determined that it has one reportable segment as the Chief Executive Officer reviews performance and makes decisions on the Group as a whole. Therefore, no separate segmental reporting note has been provided.

Year ended
31 December 2019 **Continued**

2. Critical accounting estimates and judgements

The preparation of these financial statements involves making judgements in the application of accounting policies which affect the amounts recognised in the financial statements. In addition, the Group makes estimates and assumptions which could affect the reported amounts of assets and liabilities in the next financial year and beyond.

The Group reviews all critical judgements and estimates on a regular basis, including approval by the Audit Committee as explained on pages 85 to 90, to ensure that these remain appropriate. The critical judgements and estimates which have a significant impact on the financial statements of the Group are described below.

(a) Critical judgements

(i) Classification of financial assets
Management judgement is applied in the classification of financial assets in determining the business model for managing the assets and in determining whether the contractual cash flows are solely payments of principal and interest. In particular, for retail mortgages, it has been determined that term extensions and forbearance activity are not contractual so do not impact on the assessment and such assets remain held at amortised cost.

In the case of the collateral loan which represents a pool of equity release mortgages, the existence of the no negative equity guarantee which means that certain receipts would be foregone in the event of a shortfall on sale, is judged not to be consistent with payments being solely principal and interest. The collateral loan is therefore classified as 'at FVTPL'.

(ii) Impairment of loans and advances to customers

- Significant increase in credit risk
  As described in note 1e(i), a test based approach is used to determine the thresholds, expressed as a percentage increase, over which an increase in lifetime PD compared to the lifetime PD calculated on initial recognition represents a significant increase in credit risk.

  Management judgement is applied to determine the appropriate tests and results required to derive the thresholds. The tests, which have been applied consistently with the previous year, aim to ensure that loans move through the stages in a timely manner, so that loans move to Stage 2 in advance of falling into arrears and to Stage 3 in advance of default, thus minimising the reliance on the 30 days past due and 90 days past due backstops respectively.

  If these thresholds moved such that all loans were assessed as having experienced a significant increase in credit risk, such that provisions were recognised to cover lifetime ECL, impairment loss provisions at 31 December 2019 would increase by £7.8m (2018: £5.1m).

- Definition of default
  The definition of default is given in note 1e(i). Management have judged that the definition of default for impairment loss calculations should align as closely as possible to the IRB regulatory definition of default, with the main difference being the application of the 90 days past due backstop in the IFRS 9 definition. Further it is management's judgement that 12 months is the appropriate cure period for recovery from default.

- Post model adjustments
  Management judgement is applied in the application of post model adjustments (PMAs) to increase the level of impairment loss provisions above the levels calculated by the detailed models used to calculate ECL. PMAs may be identified by any department in the Society, though they would be expected to originate from Finance or Credit Risk. All PMAs are subject to approval by Credit Committee and must be reviewed and reapproved at least annually.

  At 31 December 2019, PMAs were applied to cover the potential losses on interest only loans which are not repaid at term expiry and for specific individual loans where management had concerns over recoverability, such as potential fraud cases. The total of these PMAs at 31 December 2019 was £5.1m (2018: £6.0m).

(iii) Intangible assets
The Group applies judgement as to whether purchased software or IT development services qualify for recognition as intangible assets. For an asset to be recognised under IAS 38 it must be probable that future economic benefits will flow from the asset and the cost of the asset must be able to be measured reliably. For each significant project undertaken by the Group, an assessment is performed by the relevant business area of whether a separately identifiable asset is being developed and the level of future benefits flowing from the asset.

Intangible assets are reviewed annually for indications of impairment, which includes the application of judgement as to whether it is probable that future economic benefits will be realised from the asset, and whether the value in use of the asset is in excess of the carrying value (see note 16 for further information).

2. Critical accounting estimates and judgements continued

(a) Critical judgements (continued)

(iv) Leases

The application of the requirements of IFRS 16 for leased assets requires the application of judgement as to whether a contract contains a lease. In particular, the Group has a multi-year service contract with a third party for the provision and maintenance of its IT infrastructure. It is management's judgement that this contract does not provide the Group with the right to control the use of an identified asset and therefore does not meet the definition of a lease under IFRS 16.

(b) Significant accounting estimates and assumptions

(i) Impairment losses on loans and advances to customers

Wherever possible, the calculation of impairment loss provisions for loans and advances to customers has been performed using statistical modelling rather than management judgements or estimates. For the UK residential mortgage portfolio, probability of default (PD) is modelled based on analysis of how macroeconomic variables have impacted the performance of loans with similar credit risk characteristics historically.

The significant estimates required for the calculation of impairment loss provisions are forecast UK macroeconomic variables and the probability weightings of the macroeconomic scenarios used.

The Group has used four macroeconomic scenarios (2018: three), which are considered to represent a range of possible outcomes over a normal economic cycle, in determining impairment loss provisions:

- a central scenario aligned to the Group's Corporate Plan;
- a downside scenario as modelled in the Group's risk management process;
- an alternative downside scenario representing a more severe downturn than in the downside scenario; and
- an upside scenario representing the impact of modest improvements to assumptions used in the central scenario.

The fourth scenario, the alternative downside, was added in 2019 to increase the range of potential outcomes covered by the modelled scenarios.

Scenarios are developed based on the Group's analysis of third party published economic data and forecasts. The central scenario represents the Group's current view of the most likely economic outturn. The relative weighting of the macroeconomic scenarios is estimated by comparing recent movements in economic variables to historic data and trends to ascertain similarities with the periods preceding previous downturns or periods of growth and derive a range of probabilities for such scenarios occurring. This analysis is then considered alongside management's view of the current economic and political climate to determine final weightings, which are shown in the table below:

	2019	2018
Central	**55%**	52%
Downside	**30%**	46%
Alternative Downside	**10%**	N/A
Growth	**5%**	2%

2. Critical accounting estimates and judgements continued

(b) Significant accounting estimates and assumptions (continued)

(i) Impairment losses on loans and advances to customers (continued)
The table below shows the macroeconomic assumptions used in each scenario. Beyond the five year period shown below, assumptions move towards historic long run averages over the following four years and then remain constant at these rates thereafter. The variables with the most significant impact on the calculated impairment loss provisions are house price inflation and unemployment rate.

		31 December 2019				
		2020	2021	2022	2023	2024
House price inflation	Central	1.5%	2.0%	2.0%	2.0%	2.0%
	Downside	(10.6)%	(3.1)%	(2.0)%	0.0%	0.0%
	Alternative Downside	(10.8)%	(7.0)%	(4.0)%	0.0%	2.0%
	Growth	2.5%	3.0%	3.0%	3.5%	3.5%
	Weighted *	(3.3)%	(0.4)%	0.3%	1.3%	1.5%
Unemployment rate	Central	4.1%	4.0%	4.0%	4.0%	4.0%
	Downside	5.7%	6.3%	7.0%	6.5%	6.5%
	Alternative Downside	6.5%	7.5%	7.5%	7.0%	6.7%
	Growth	4.1%	4.0%	3.9%	3.8%	3.8%
	Weighted *	4.8%	5.0%	5.2%	5.0%	5.0%
Gross Domestic Product growth	Central	1.5%	1.7%	1.7%	1.8%	2.0%
	Downside	(2.0)%	(1.0)%	2.0%	1.5%	1.5%
	Alternative Downside	(3.0)%	(2.0)%	0.5%	1.0%	1.0%
	Growth	2.2%	2.0%	2.0%	2.0%	2.0%
	Weighted *	0.0%	0.5%	1.7%	1.6%	1.8%
Inflation (CPI)	Central	1.9%	1.9%	2.0%	2.0%	2.0%
	Downside	3.5%	3.0%	3.0%	2.5%	2.5%
	Alternative Downside	4.0%	3.0%	2.5%	2.0%	2.0%
	Growth	1.3%	1.3%	1.4%	1.3%	1.3%
	Weighted *	2.6%	2.3%	2.3%	2.1%	2.1%
Bank Base Rate (31 December)	Central	0.5%	0.5%	0.5%	0.5%	0.8%
	Downside	0.3%	0.3%	0.3%	0.5%	0.5%
	Alternative Downside	1.5%	2.0%	2.0%	2.0%	2.0%
	Growth	1.0%	1.3%	1.5%	1.8%	1.8%
	Weighted *	0.6%	0.6%	0.6%	0.7%	0.9%

Year ended
31 December 2019 **Continued**

2. Critical accounting estimates and judgements continued

(b) Significant accounting estimates and assumptions (continued)

(i) Impairment losses on loans and advances to customers (continued)

		31 December 2018				
		2019	2020	2021	2022	2023
House price inflation	Central	1.0%	1.8%	2.0%	2.1%	2.3%
	Downside	(10.6)%	(3.1)%	(2.0)%	0.0%	1.0%
	Alternative Downside	N/A	N/A	N/A	N/A	N/A
	Growth	2.5%	3.0%	3.0%	3.5%	3.9%
	Weighted *	(4.3)%	(0.4)%	0.2%	1.2%	1.7%
Unemployment rate	Central	4.1%	4.3%	4.3%	4.3%	4.3%
	Downside	5.9%	6.5%	7.5%	7.0%	6.8%
	Alternative Downside	N/A	N/A	N/A	N/A	N/A
	Growth	4.1%	4.0%	3.9%	3.8%	3.7%
	Weighted *	4.9%	5.3%	5.8%	5.5%	5.4%
Gross Domestic Product growth	Central	1.6%	1.7%	1.7%	1.7%	1.8%
	Downside	(2.0)%	(1.0)%	2.0%	1.5%	1.7%
	Alternative Downside	N/A	N/A	N/A	N/A	N/A
	Growth	2.2%	2.0%	2.0%	2.0%	2.0%
	Weighted *	0.0%	0.5%	1.8%	1.6%	1.8%
Inflation (CPI)	Central	2.1%	2.0%	2.0%	2.0%	2.0%
	Downside	6.2%	5.8%	3.3%	2.6%	2.4%
	Alternative Downside	N/A	N/A	N/A	N/A	N/A
	Growth	1.3%	1.3%	1.4%	1.3%	1.3%
	Weighted *	4.0%	3.7%	2.6%	2.3%	2.2%
Bank Base Rate (31 December)	Central	1.0%	1.3%	1.5%	1.5%	1.5%
	Downside	0.5%	0.3%	0.3%	0.3%	0.5%
	Alternative Downside	N/A	N/A	N/A	N/A	N/A
	Growth	1.0%	1.3%	1.5%	1.8%	1.8%
	Weighted *	0.8%	0.8%	0.9%	0.9%	1.0%

* Note that ECLs are calculated for each loan in each scenario and then probability weighted, so the weighted figure shown here is for illustrative purposes only.

The sensitivity of calculated impairment loss provisions at 31 December 2019 to changes in key individual macroeconomic variables, with all other assumptions held constant is illustrated below. Note that due to the interaction between different economic variables within the impairment loss provision models, the impacts of such single variable sensitivities may be distorted and are not representatative of realistic alternative scenarios.

The impact of changing the assumption for annual house price inflation is shown below. The sensitivity has been applied to each year of the forecast and, as such, has a cumulative impact over the forecast period. The table therefore also shows the total house price inflation across the first three years of the forecast period implied by applying this sensitivity annually, on a weighted scenario basis.

Movement in annual house price inflation assumption (percentage points)	-5	-2	0	+2	+5
Implied weighted scenario 2020-2022 cumulative increase / (decrease)	(17.3)%	(9.1)%	(3.4)%	2.6%	12.0%
Increase / (decrease) in impairment loss provisions (£M)	43.0	7.3	–	(3.8)	(7.3)

The impact of changing the assumption for the unemployment rate in each year of the forecast period is as follows:

Movement in unemployment rate assumption (percentage points)	-2	-1	0	+1	+2
Implied weighted scenario 2020-2022 peak rate	3.2%	4.2%	5.2%	6.2%	7.2%
Increase / (decrease) in impairment loss provisions (£M)	(2.9)	(1.6)	–	7.2	30.3

2. Critical accounting estimates and judgements continued

(b) Significant accounting estimates and assumptions (continued)

(i) Impairment losses on loans and advances to customers (continued)
In practice the above variables are unlikely to move in isolation. The combined impact of movements in a number of variables can be illustrated by the sensitivity of calculated provisions to scenario weightings. The table below shows the movement in impairment loss provisions if each of the scenarios were weighted 100%:

	2019 £M	2018 £M
(Decrease) / increase in impairment loss provisions if scenarios are weighted 100%:		
Central	**(9.8)**	(9.8)
Downside	**12.4**	14.1
Alternative Downside	**51.9**	N/A
Growth	**(9.8)**	(10.5)

The total impairment loss provisions if the Central scenario was 100% weighted would be £18.9m. For the non-UK residential portfolio, key variables in the calculation of impairment loss provisions (PD and LGD) are estimated based on analysis of historic loss experience, although volumes are limited.

Changes to macroeconomic assumptions, as expectations change over time, are expected to lead to volatility in impairment loss provisions, and may lead to pro-cyclicality in the recognition of impairment losses.

(ii) Fair value of the collateral loan
The Group measures the collateral loan which represents a pool of equity release mortgages at FVTPL. The fair value of this loan is calculated using a model which uses a combination of observable market data (such as interest rate curves and RPI swap prices) and unobservable inputs which require estimation. The model projects the future cash flows anticipated from the loan based on the contractual terms with the third party from which the mortgages were acquired, with the timing of those cash flows determined with reference to mortality tables (which are subject to estimation uncertainty). The model also calculates a value for the 'no negative equity guarantee' provided to the customer using a stochastic methodology applying a variant of the Black-Scholes formula.

The key estimates used in the model and the basis of estimation are summarised below:

Assumption	Basis of estimation
Discount rate	Benchmarking the portfolio against current market rates for equity release loans
Property price volatility	Analysis of historic property price volatility and third party research, with judgemental overlay giving estimate of 10%
Sales discount (dilapidations)	Average actual discounts observed on the portfolio in the previous three years

At 31 December 2019 the book value of the collateral loan was £219.4m (2018: £229.5m). The sensitivity of this value to the estimates shown above is as follows:

Assumption	Change to current assumption	(Decrease) / increase in fair value of collateral loan (£M)
Discount rate	+ / - 0.5 percentage points	(11.2) / 12.1
Property price volatility	+ 3 / - 5 percentage points	(6.3) / 7.5
Sales discount (dilapidations)	+ / - 5 percentage points	(5.5) / 4.9

The sensitivities shown reflect a range of alternative assumptions based on observed historic data and regulatory guidance.

(iii) Retirement benefit surplus
The Income Statement charge and Statement of Financial Position surplus of the defined benefit pension scheme are calculated in accordance with the advice of a qualified actuary. Calculations are based on a number of assumptions about the future which will impact the level of scheme liabilities and the performance of scheme assets. The most significant assumptions used are detailed in note 24.

Changes to any of the assumptions could have an impact on the level of actuarial gains and losses recognised in the Statements of Comprehensive Income and the Statement of Financial Position balance. The most significant impacts arise from the rate used to discount scheme liabilities and the rate of inflation, with the impact of changes to those assumptions detailed in note 24.

Year ended
31 December 2019 **Continued**

3. Interest receivable and similar income

	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Interest receivable calculated using the effective interest rate method:				
On loans fully secured on residential property	**453.0**	442.2	**453.0**	442.2
On other loans and advances to customers	**0.9**	2.4	**0.9**	2.4
On investment securities	**14.5**	10.2	**18.9**	14.6
On other liquid assets	**12.7**	12.8	**12.7**	12.5
Total interest receivable calculated using the effective interest rate method	**481.1**	467.6	**485.5**	471.7
Similar income on instruments held at fair value through profit or loss:				
On other loans and advances to customers	**11.2**	13.0	**11.2**	13.0
On investment securities	**–**	0.2	**–**	1.0
Net expense on derivatives which hedge financial assets and are designated in accounting hedge relationships	**(15.8)**	(18.7)	**(15.8)**	(18.7)
Net expense on derivatives which hedge financial assets and are not designated in accounting hedge relationships	**(11.2)**	(5.1)	**(22.6)**	(16.5)
Total similar income on instruments held at fair value through profit or loss	**(15.8)**	(10.6)	**(27.2)**	(21.2)
Total interest receivable and similar income	**465.3**	457.0	**458.3**	450.5
Included in the above is:				
Interest receivable on impaired financial assets	**7.2**	7.6	**7.2**	7.6

4. Interest payable and similar charges

	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Interest payable on instruments held at amortised cost				
On shares held by individuals	**194.9**	175.7	**194.9**	175.7
On subscribed capital	**10.8**	8.5	**10.8**	8.5
On deposits and other borrowings:				
Wholesale and other funding	**67.5**	69.1	**60.8**	62.4
Lease liabilities	**0.4**	–	**0.4**	–
Total interest payable on instruments held at amortised cost	**273.6**	253.3	**266.9**	246.6
Similar charges on instruments held at fair value through profit or loss				
On shares held by individuals	**–**	0.3	**–**	0.3
Net income on derivatives which hedge financial liabilities and are designated in accounting hedge relationships	**(16.1)**	(7.9)	**(8.7)**	(7.9)
Net expense / (income) on derivatives which hedge financial liabilities and are not designated in accounting hedge relationships	**7.0**	(6.8)	**(0.2)**	(6.7)
Total similar charges on instruments held at fair value through profit or loss	**(9.1)**	(14.4)	**(8.9)**	(14.3)
Total interest payable and similar charges	**264.5**	238.9	**258.0**	232.3

Year ended
31 December 2019 **Continued**

5. Fair value losses from financial instruments

	Group 2019 £M	Group 2018 £M	**Society 2019 £M**	Society 2018 £M
Fair value hedge relationships				
Derivatives designated in fair value hedge relationships	**(57.6)**	12.4	**(62.1)**	18.6
Fair value adjustment for hedged risk of hedged items	**53.1**	(12.6)	**58.0**	(18.4)
Derivatives not designated in fair value hedge relationships				
Equity release swaps	**(0.5)**	0.8	**(0.5)**	0.8
Cross currency swaps net of retranslation on matched Euro liabilities	**(3.1)**	4.2	**(1.0)**	(1.0)
Other derivatives	**(3.1)**	(2.7)	**(4.2)**	(3.2)
Other financial instruments measured at FVTPL				
Collateral loan which represents a pool of equity release mortgages	**(8.5)**	(7.8)	**(8.5)**	(7.8)
Total fair value losses from financial instruments	**(19.7)**	(5.7)	**(18.3)**	(11.0)
The net position on the cross currency swaps and options includes:				
Movement in fair value gain on cross currency swaps	**(2.9)**	1.3	**(17.0)**	5.5
Movement in exchange loss on retranslation of cross currency swaps	**(101.3)**	42.2	**(21.2)**	25.0
Movement in exchange rate on retranslation of matched Euro liabilities	**101.1**	(39.3)	**37.2**	(31.5)

The fair value accounting volatility loss arises due to accounting ineffectiveness on designated hedges, or because hedge accounting could not be applied to certain items. Volatility also arises from the collateral loan which represents a pool of equity release mortgages, which is measured at FVTPL. For further information refer to notes 35 and 36.

The cross currency swaps were entered into to reduce the exchange rate risk from funding in foreign currency; however they are not in accounting hedge relationships.

6. Administrative expenses

	Group 2019 £M	Group 2018 £M	**Society 2019 £M**	Society 2018 £M
Staff costs				
Wages and salaries	**47.5**	49.0	**47.5**	49.0
Social security costs	**5.2**	4.9	**5.2**	4.9
Pension costs	**6.3**	6.5	**6.3**	6.5
Other staff costs	**1.8**	1.0	**1.8**	1.0
Remuneration of auditor (see below)	**0.6**	0.6	**0.6**	0.6
Other administrative expenses				
Technology	**11.0**	10.3	**11.0**	10.3
Property	**5.0**	6.6	**5.0**	6.3
Marketing	**3.6**	3.1	**3.6**	3.1
Other	**12.8**	12.9	**12.8**	12.8
Total administrative expenses	**93.8**	94.9	**93.8**	94.5

There are 31 directors, senior management and members of staff whose actions have a material impact on the risk profile of the Group, with fixed remuneration of £5.7m and variable remuneration of £1.5m (2018: 28 individuals, £4.9m and £1.6m).

Further details of directors' remuneration can be found on page 102 of the Directors' Remuneration Report.

6. Administrative expenses continued

The analysis of auditor's remuneration is as follows:

	Group & Society 2019 £000	Group & Society 2018 £000
Fee payable to the Society's auditor for the audit of the Society's annual accounts	**436.5**	396.2
Fees payable to the Society's auditor for the audit of the Society's subsidiaries	**13.5**	39.5
Total audit fees	**450.0**	435.7
Assurance services	**99.3**	143.6
Total non audit fees	**99.3**	143.6
Fees payable to the Society's auditor and its associates in respect of associated pension schemes	**12.0**	10.0

The above figures relating to auditor's remuneration exclude value added tax.

7. Staff numbers

The average number of persons employed during the year was as follows:

	Group & Society 2019 Number	Group & Society 2018 Number
Central administration	**1,093**	1,113
Branches	**315**	310
Total monthly average number of persons employed	**1,408**	1,423

At 31 December 2019 the total number of persons employed by the Group and the Society was 1,434 (2018: 1,401). During 2019 the monthly average number of full time equivalent employees of the Group and the Society was 1,303 (2018: 1,308).

8. Impairment on loans and advances to customers

Group & Society 2019	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2019	27.7	4.0	2.5	34.2
Charge / (release) for the year	5.5	(2.0)	–	3.5
Amount written off during the year	(4.0)	–	–	(4.0)
Movement in foreign exchange rate	(0.5)	–	–	(0.5)
At 31 December 2019	28.7	2.0	2.5	33.2
Income Statement				
Charge / (release) for the year	5.5	(2.0)	–	3.5
Recoveries of amounts previously written off	(0.5)	(0.2)	–	(0.7)
Total income statement losses / (gains)	5.0	(2.2)	–	2.8

8. Impairment on loans and advances to customers continued

Group & Society 2018	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2018	50.2	17.2	2.5	69.9
Charge / (release) for the year	3.0	(3.6)	–	(0.6)
Amount written off during the year	(4.2)	(9.6)	–	(13.8)
Release of provision held against loans sold during the year (see note 13)	(21.3)	–	–	(21.3)
At 31 December 2018	27.7	4.0	2.5	34.2
Income Statement				
Charge / (release) for the year	3.0	(3.6)	–	(0.6)
Recoveries of amounts previously written off	(0.6)	–	–	(0.6)
Total income statement losses / (gains)	2.4	(3.6)	–	(1.2)

9. Tax expense

	Group 2019 £M	Group 2018 £M	**Society 2019 £M**	Society 2018 £M
Analysis of charge in the year				
Current tax				
UK corporation tax on profits for the year	**21.5**	29.3	**21.5**	29.3
Adjustments in respect of previous years	**0.7**	(0.6)	**0.7**	(0.6)
Total current tax	**22.2**	28.7	**22.2**	28.7
Deferred tax				
Origination and reversal of timing differences	**(0.1)**	(0.8)	**(0.1)**	(1.3)
Adjustments in respect of previous years	**(0.2)**	0.2	**(0.2)**	0.2
Adjustments for changes in tax rates	**(0.1)**	(0.4)	**(0.1)**	(0.4)
Total deferred tax	**(0.4)**	(1.0)	**(0.4)**	(1.5)
Tax on profit on ordinary activities	**21.8**	27.7	**21.8**	27.2
Factors affecting current tax charge for the year:				
Profit on ordinary activities before tax	**88.0**	116.9	**90.2**	111.3
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 19% (2018: 19%)	**16.7**	22.2	**17.1**	21.2
Effects of:				
Banking surcharge	**4.8**	7.1	**4.8**	7.1
Adjustment in respect of prior years	**0.5**	(0.5)	**0.5**	(0.5)
Expenses not deductible for tax purposes	**–**	0.8	**–**	0.8
Income not taxable	**(0.1)**	(0.6)	**(0.1)**	(0.6)
Tax rate changes	**0.1**	0.1	**0.1**	0.1
Other differences	**(0.2)**	(1.4)	**(0.6)**	(0.9)
	21.8	27.7	**21.8**	27.2

The standard rate of corporation tax applicable to the Group for the year ended 31 December 2019 was 19% (2018: 19%). A reduction in the UK corporation tax rate from 19% to 18% (effective 1 April 2020) was substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. The Finance (No. 2) Act 2015 introduced an additional surcharge of 8% on banking profits above a £25m threshold (including those of building societies) from 1 January 2016.

The deferred tax balances have been calculated at a rate of 25% (inclusive of the 8% banking levy), as it is expected that these balances will mostly reverse after 1 April 2020.

Year ended
31 December 2019 **Continued**

10. Classification of financial assets and liabilities

The following table summarises the classification of the carrying value of the Group and Society's financial assets and liabilities:

Group 2019	**Amortised cost £M**	**FVOCI £M**	**FVTPL £M**	**Total £M**
Financial assets:				
Cash in hand and balances with the Bank of England	**1,451.7**	**–**	**–**	**1,451.7**
Loans and advances to credit institutions	**163.4**	**–**	**–**	**163.4**
Investment securities	**–**	**1,708.1**	**–**	**1,708.1**
Derivative financial instruments	**–**	**–**	**182.9**	**182.9**
Loans and advances to customers:				
Loans fully secured on residential property	**16,739.8**	**–**	**–**	**16,739.8**
Other loans	**15.6**	**–**	**219.4**	**235.0**
Fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**23.9**	**23.9**
Total financial assets	**18,370.5**	**1,708.1**	**426.2**	**20,504.8**
Financial liabilities:				
Shares	**14,517.5**	**–**	**–**	**14,517.5**
Fair value adjustment for hedged risk on shares	**–**	**–**	**(30.3)**	**(30.3)**
Derivative financial instruments	**–**	**–**	**200.4**	**200.4**
Amounts owed to credit institutions	**1,439.5**	**–**	**–**	**1,439.5**
Amounts owed to other customers	**234.7**	**–**	**–**	**234.7**
Debt securities in issue	**2,972.5**	**–**	**–**	**2,972.5**
Subscribed capital	**232.1**	**–**	**–**	**232.1**
Total financial liabilities	**19,396.3**	**–**	**170.1**	**19,566.4**

Group 2018	Amortised cost £M	FVOCI £M	FVTPL £M	Total £M
Financial assets:				
Cash in hand and balances with the Bank of England	1,428.0	–	–	1,428.0
Loans and advances to credit institutions	169.7	–	–	169.7
Investment securities	–	1,229.1	–	1,229.1
Derivative financial instruments	–	–	273.4	273.4
Loans and advances to customers:				
Loans fully secured on residential property	15,777.1	–	–	15,777.1
Other loans	26.8	–	229.5	256.3
Fair value adjustment for hedged risk on loans and advances to customers	–	–	18.0	18.0
Total financial assets	17,401.6	1,229.1	520.9	19,151.6
Financial liabilities:				
Shares	13,909.5	–	–	13,909.5
Fair value adjustment for hedged risk on shares	–	–	15.7	15.7
Derivative financial instruments	–	–	133.2	133.2
Amounts owed to credit institutions	1,399.3	–	–	1,399.3
Amounts owed to other customers	211.0	–	–	211.0
Debt securities in issue	2,260.3	–	–	2,260.3
Subscribed capital	224.2	–	–	224.2
Total financial liabilities	18,004.3	–	148.9	18,153.2

10. Classification of financial assets and liabilities continued

Society 2019	**Amortised cost £M**	**FVOCI £M**	**FVTPL £M**	**Total £M**
Financial assets:				
Cash in hand and balances with the Bank of England	**1,451.7**	**–**	**–**	**1,451.7**
Loans and advances to credit institutions	**84.1**	**–**	**–**	**84.1**
Investment securities	**–**	**2,128.2**	**–**	**2,128.2**
Derivative financial instruments	**–**	**–**	**127.1**	**127.1**
Loans and advances to customers:				
Loans fully secured on residential property	**16,739.8**	**–**	**–**	**16,739.8**
Other loans	**15.6**	**–**	**219.4**	**235.0**
Fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**23.9**	**23.9**
Total financial assets	**18,291.2**	**2,128.2**	**370.4**	**20,789.8**
Financial liabilities:				
Shares	**14,517.5**	**–**	**–**	**14,517.5**
Fair value adjustment for hedged risk on shares	**–**	**–**	**(30.3)**	**(30.3)**
Derivative financial instruments	**–**	**–**	**176.6**	**176.6**
Amounts owed to credit institutions	**1,439.5**	**–**	**–**	**1,439.5**
Amounts owed to other customers	**877.1**	**–**	**–**	**877.1**
Debt securities in issue	**2,706.9**	**–**	**–**	**2,706.9**
Subscribed capital	**232.1**	**–**	**–**	**232.1**
Total financial liabilities	**19,773.1**	**–**	**146.3**	**19,919.4**

Society 2018	Amortised cost £M	FVOCI £M	FVTPL £M	Total £M
Financial assets:				
Cash in hand and balances with the Bank of England	1,428.0	–	–	1,428.0
Loans and advances to credit institutions	71.3	–	–	71.3
Investment securities	–	1,552.9	–	1,552.9
Derivative financial instruments	–	–	182.8	182.8
Loans and advances to customers:				
Loans fully secured on residential property	15,777.1	–	–	15,777.1
Other loans	26.8	–	229.5	256.3
Fair value adjustment for hedged risk on loans and advances to customers	–	–	18.0	18.0
Total financial assets	17,303.2	1,552.9	430.3	19,286.4
Financial liabilities:				
Shares	13,909.5	–	–	13,909.5
Fair value adjustment for hedged risk on shares	–	–	15.7	15.7
Derivative financial instruments	–	–	132.9	132.9
Amounts owed to credit institutions	1,399.3	–	–	1,399.3
Amounts owed to other customers	584.7	–	–	584.7
Debt securities in issue	2,158.8	–	–	2,158.8
Subscribed capital	224.2	–	–	224.2
Total financial liabilities	18,276.5	–	148.6	18,425.1

Year ended
31 December 2019 **Continued**

11. Cash in hand and balances with the Bank of England

	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Cash in hand	**2.1**	1.9	**2.1**	1.9
Balances with the Bank of England	**1,449.6**	1,426.1	**1,449.6**	1,426.1
Included in cash and cash equivalents (see note 28)	**1,451.7**	1,428.0	**1,451.7**	1,428.0

Balances with the Bank of England do not include mandatory reserve deposits of £46.8m (2018: £40.2m) 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.

12. Investment securities

	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Debt securities				
Listed	**1,708.1**	1,229.1	**2,128.2**	1,552.9

In addition to those securities held by the Group, the Society has purchased investment securities issued by other Group entities. Investment securities held by the Group and the Society are measured at fair value. The tables below show the changes in fair value during the year. All of the Group's and Society's investment securities at 31 December 2019 are of investment grade. No impairment loss provision is held against these assets since calculated ECL is immaterial (2018: no provision).

Group 2019	FVOCI £M	FVTPL £M	Total £M
At 1 January 2019	**1,229.1**	**–**	**1,229.1**
Additions	**5,176.5**	**–**	**5,176.5**
Disposals (sale and redemption)	**(4,699.4)**	**–**	**(4,699.4)**
Movement in fair value	**1.9**	**–**	**1.9**
At 31 December 2019	**1,708.1**	**–**	**1,708.1**

Group 2018	FVOCI £M	FVTPL £M	Total £M
At 1 January 2018	777.2	1.7	778.9
Additions	1,995.0	0.1	1,995.1
Disposals (sale and redemption)	(1,537.2)	(1.8)	(1,539.0)
Movement in fair value	(5.9)	–	(5.9)
At 31 December 2018	1,229.1	–	1,229.1

Society 2019	FVOCI £M	FVTPL £M	Total £M
At 1 January 2019	**1,552.9**	**–**	**1,552.9**
Additions	**5,326.5**	**–**	**5,326.5**
Disposals (sale and redemption)	**(4,753.1)**	**–**	**(4,753.1)**
Movement in fair value	**1.9**	**–**	**1.9**
At 31 December 2019	**2,128.2**	**–**	**2,128.2**

Year ended
31 December 2019 **Continued**

12. Investment securities continued

Society 2018	FVOCI £M	FVTPL £M	Total £M
At 1 January 2018	1,166.3	140.1	1,306.4
Additions	1,995.0	0.1	1,995.1
Disposals (sale and redemption)	(1,602.5)	(17.9)	(1,620.4)
Movement in fair value	(5.9)	–	(5.9)
Change in presentation (see below)	–	(122.3)	(122.3)
At 31 December 2018	1,552.9	–	1,552.9

In 2018 the presentation of unlisted Z-notes issued by other Group entities and retained by the Society was changed and these are now netted off amounts owed to subsidiary undertakings (see note 19) to more accurately reflect the nature of the transaction.

At 31 December 2019, no investment securities were pledged as collateral under sale and repurchase agreements (2018: none).

13. Loans and advances to customers

Group & Society 2019	**Gross balance £M**	**Impairment loss provision £M**	**Total £M**
Loans fully secured on residential property	**16,768.5**	**(28.7)**	**16,739.8**
Loans fully secured on land	**17.6**	**(2.0)**	**15.6**
Other loans	**221.9**	**(2.5)**	**219.4**
Total loans and advances to customers	**17,008.0**	**(33.2)**	**16,974.8**

Group & Society 2018	Gross balance £M	Impairment loss provision £M	Total £M
Loans fully secured on residential property	15,804.8	(27.7)	15,777.1
Loans fully secured on land	30.8	(4.0)	26.8
Other loans	232.0	(2.5)	229.5
Total loans and advances to customers	16,067.6	(34.2)	16,033.4

The Group has previously acquired a pool of equity release mortgages from a third party. The Group assumed certain, but not all, risks arising from these loans with the remainder retained by the third party, which also retained a proportion of the income from the underlying equity release mortgages. As a consequence these mortgages have been recognised as a collateral loan to the third party within other loans in the table above. This loan is measured at fair value through profit or loss. The net fair value movement on loans and advances to customers at fair value through profit or loss was a loss of £8.5m (2018: £7.8m loss) for both the Group and Society.

Loans and advances to customers, for both the Group and Society, include £3,942.9m (2018: £2,315.3m) of loans which have been ringfenced from the Society for its associated secured funding vehicles.

The following transfers have been made:

2019	**Covered Bonds LLP £M**	**Albion No. 3 plc £M**	**Albion No. 4 plc £M**	**Guildford No.1 plc £M**	**Total £M**
Loans and advances transferred from the Society to securitisation vehicles	**3,201.8**	**–**	**417.4**	**323.6**	**3,942.8**
Loan notes issued by securitisation vehicles	**1,689.0**	**–**	**443.8**	**335.9**	**2,468.7**

2018	Covered Bonds LLP £M	Albion No. 3 plc £M	Albion No. 4 plc £M	Guildford No.1 plc £M	Total £M
Loans and advances transferred from the Society to securitisation vehicles	1,815.3	126.0	–	374.0	2,315.3
Loan notes issued by securitisation vehicles	1,108.3	136.8	–	400.6	1,645.7

13. Loans and advances to customers continued

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.

Sale of a portfolio of loans and advances to customers in the prior year
On 28 June 2018 the Board gave approval to proceed with the sale of a portfolio of loans and advances to customers secured on residential property in the Republic of Ireland. A contract for the sale of the assets was signed on 18 July 2018 and final completion and transfer of legal title occurred on 16 November 2018. The purchaser also acquired cash flows arising from the portfolio since 28 February 2018.

The assets were initially reclassified as held for sale on the date of Board approval and the sale was subsequently recognised on the date the contract was signed.

At completion, the gross value of assets sold (excluding impairment loss provision and fair value adjustments) was £163.6m, including cash flows of £5.2m. The loss on sale of £6.5m was recognised in the 2018 Income Statement, together with interest receivable of £0.3m arising from the sold portfolio.

14. Other assets, prepayments and accrued income

	Group 2019 £M	Group 2018 £M	**Society 2019 £M**	Society 2018 £M
Collateral	**199.1**	142.4	**199.1**	142.4
Prepayments	**5.3**	4.4	**5.3**	4.4
Other assets	**5.7**	13.7	**72.5**	85.1
Total other assets, prepayments and accrued income	**210.1**	160.5	**276.9**	231.9

In the above table, collateral represents amounts owed by credit institutions on cash collateralisation of derivatives.

15. Investments in subsidiary undertakings

	Society 2019 £M	Society 2018 £M
(a) Shares held in subsidiary undertakings		
Cost		
At 1 January	**–**	3.8
Impairment of investment in Ravenstone Limited	**–**	(3.8)
At 31 December	**–**	–
(b) Loans to subsidiary undertakings		
Cost		
At 1 January	**46.6**	55.9
Net movement during the year	**(44.7)**	(9.3)
At 31 December	**1.9**	46.6
Total investments in subsidiary undertakings	**1.9**	46.6

15. Investments in subsidiary undertakings continued

(c) Interest in subsidiary undertakings

The Society holds the following interests in subsidiary undertakings at 31 December 2019, all of which are incorporated in the United Kingdom and registered in England, except where noted below.

Name	Major Activities	Class of Shares held	Interest of Society	Address
Leeds Financial Services Limited	Non-trading	Ordinary £1 shares	100%	105 Albion Street, Leeds, LS1 5AS
Leeds Mortgage Funding Limited	Non-trading	Ordinary £1 shares	100%	105 Albion Street, Leeds, LS1 5AS
Leeds Building Society Covered Bonds LLP	Provision of mortgage assets and guarantor of covered bonds	*	*	105 Albion Street, Leeds, LS1 5AS
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 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. 3 plc	Provision of residential mortgage backed securities (ceased operating)	*	*	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
Albion No. 4 plc	Provision of residential mortgage backed securities	*	*	11th Floor, 200 Aldersgate Street, London, EC1A 4HD
Albion No. 4 Holdings Limited	Holding company to Albion No. 4 plc	*	*	11th Floor, 200 Aldersgate Street, London, EC1A 4HD
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 plc	*	*	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 them, 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.

On 17 November 2019 the debt securities issued by Albion No.3 plc were repaid in full and the loans assigned to the company were returned.

The Society received a dividend of £nil from Leeds Mortgage Funding Ltd (2018: £10,850).

Notes to the Accounts

Year ended
31 December 2019 **Continued**

16. Intangible assets

Group & Society 2019	**Purchased software £M**	**Development costs £M**	**Total £M**
Cost			
At 1 January 2019	**2.2**	**9.2**	**11.4**
Additions	**–**	**11.9**	**11.9**
Reclassification	**–**	**1.7**	**1.7**
At 31 December 2019	**2.2**	**22.8**	**25.0**
Amortisation and impairment			
At 1 January 2019	**1.6**	**1.3**	**2.9**
Amortisation charged in the year	**0.4**	**2.1**	**2.5**
At 31 December 2019	**2.0**	**3.4**	**5.4**
Net book value			
At 31 December 2019	**0.2**	**19.4**	**19.6**

Group & Society 2018	Purchased software £M	Development costs £M	Total £M
Cost			
At 1 January 2018	2.2	10.3	12.5
Additions	–	4.5	4.5
Write off of previously impaired assets	–	(5.6)	(5.6)
At 31 December 2018	2.2	9.2	11.4
Amortisation and impairment			
At 1 January 2018	1.2	6.1	7.3
Amortisation charged in the year	0.4	0.8	1.2
Write off of previously impaired assets	–	(5.6)	(5.6)
At 31 December 2018	1.6	1.3	2.9
Net book value			
At 31 December 2018	0.6	7.9	8.5

During 2019 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. This review includes an assessment of whether it is probable that future economic benefits will be realised from the asset, and whether the value in use of the asset is in excess of the carrying value. In 2019 impairment of £nil (2018: £nil) was recognised in the Income Statement.

Year ended
31 December 2019 **Continued**

17. Property, plant and equipment

Group & Society 2019	**Freehold premises £M**	**Long leasehold premises £M**	**Short leasehold premises £M**	**Office and computer equipment £M**	**Right-of-use assets £M**	**Total £M**
Cost or valuation						
At 1 January 2019 (*)	**41.4**	**0.3**	**1.0**	**35.6**	**13.4**	**91.7**
Additions	**4.2**	**–**	**–**	**1.7**	**1.7**	**7.6**
Reclassification	**–**	**–**	**–**	**(1.7)**	**–**	**(1.7)**
Disposals	**(0.4)**	**–**	**–**	**(0.1)**	**(1.9)**	**(2.4)**
Decrease in value reported in Other Comprehensive Income	**(1.0)**	**(0.1)**	**–**	**-**	**–**	**(1.1)**
At 31 December 2019	**44.2**	**0.2**	**1.0**	**35.5**	**13.2**	**94.1**
Depreciation and impairment						
At 1 January 2019	**1.1**	**–**	**1.0**	**23.2**	**–**	**25.3**
Disposals	**–**	**–**	**–**	**–**	**(0.1)**	**(0.1)**
Depreciation charged in the year	**–**	**–**	**–**	**3.1**	**1.7**	**4.8**
Impairment charged in the year	**(0.1)**	**–**	**–**	**–**	**–**	**(0.1)**
At 31 December 2019	**1.0**	**–**	**1.0**	**26.3**	**1.6**	**29.9**
Net book value						
At 31 December 2019	**43.2**	**0.2**	**–**	**9.2**	**11.6**	**64.2**

Group & Society 2018	Freehold premises £M	Long leasehold premises £M	Short leasehold premises £M	Office and computer equipment £M	Right-of-use assets £M	Total £M
Cost or valuation						
At 1 January 2018	44.2	0.3	1.4	31.7	–	77.6
Additions	0.3	–	–	4.3	–	4.6
Disposals	(2.1)	–	(0.4)	(0.4)	–	(2.9)
Decrease in value reported in Other Comprehensive Income	(1.0)	–	–	–	–	(1.0)
At 31 December 2018	41.4	0.3	1.0	35.6	–	78.3
Depreciation and impairment						
At 1 January 2018	1.1	–	1.3	20.8	–	23.2
Disposals	–	–	(0.3)	(0.4)	–	(0.7)
Depreciation charged in the year	–	–	–	2.8	–	2.8
Impairment charged in the year	–	–	–	–	–	–
At 31 December 2018	1.1	–	1.0	23.2	–	25.3
Net book value						
At 31 December 2018	40.3	0.3	–	12.4	–	53.0

(*) The Group adopted IFRS16 – Leases with effect from 1 January 2019. The impact of adoption is disclosed in note 38.

The average remaining lease term of right-of-use assets is 6.8 years.

The Group's accounting policy is for all freehold and long leasehold premises to be revalued every three years, with an updated valuation undertaken as at 31 December 2019 by Knight Frank. In the periods between formal valuations, an assessment is made to ascertain whether there are indications of material changes in property values.

Where portions of freehold premises are leased out, these properties do not meet the definition of investment property under IAS 40 as the leased out portions could not be sold separately and the Group retains the use of a significant portion of the property.

Year ended
31 December 2019 **Continued**

17. Property, plant and equipment continued

	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £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	33.0	31.9	33.0	31.9
Long leasehold premises	0.1	0.1	0.1	0.1
Net book value	33.1	32.0	33.1	32.0
Land and buildings occupied by the Group and Society for its own activities				
Net book value	11.8	12.5	11.8	12.5

18. Shares

	Group & Society 2019 £M	Group & Society 2018 £M
Held by individuals	14,510.2	13,901.5
Other shares	7.3	8.0
Total shares	14,517.5	13,909.5

19. Amounts owed to other customers

	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Amounts owed to subsidiary undertakings	–	–	642.4	373.7
Other deposits	234.7	211.0	234.7	211.0
Total amounts owed to other customers	234.7	211.0	877.1	584.7

20. Debt securities in issue

	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Certificates of deposit	144.0	60.0	144.0	60.0
Senior unsecured debt	865.2	933.2	865.2	933.2
Covered bonds	1,712.3	1,175.4	1,697.7	1,165.6
Residential mortgage backed securities	251.0	91.7	–	–
Total debt securities in issue	2,972.5	2,260.3	2,706.9	2,158.8

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 13 for further detail).

Year ended
31 December 2019 **Continued**

21. Other liabilities and accruals

	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Accruals	**25.8**	24.0	**24.9**	23.2
Lease liabilities (*)				
Current	**1.7**	N/A	**1.7**	N/A
Non current	**10.1**	N/A	**10.1**	N/A
Other payables	**103.4**	164.7	**98.5**	142.5
Total other liabilities and accruals	**141.0**	188.7	**135.2**	165.7

(*) The Group applied the 'modified retrospective' approach to the adoption of IFRS 16 – Leases so comparative information has not been restated. Further information can be found in note 38.

Other payables within Group includes £98.6m (2018: £161.4m) owed to credit institutions on cash collateralisation of derivatives, Society £94.8m (2018: £139.4m).

Lease liabilities

Maturity analysis – contractual undiscounted cash flows	Group & Society 2019 £M
Less than one year	**2.0**
One to five years	**5.9**
More than five years	**5.5**
Total undiscounted cash flows at 31 December	**13.4**

At 31 December 2019, the Group and Society had no commitments under short term leases. Total lease commitments for low value assets were less than £0.1m.

Amounts recognised in Income Statement in respect of leases

	Group & Society 2019 £M
Interest payable on lease liabilities	**0.4**
Depreciation on right-of-use assets	**1.7**
Expenses relating to short term leases	**0.2**
Expenses relating to leases of low value assets, excluding short term leases of low value assets	**0.1**
Total amounts recognised in Income Statement	**2.4**

Amounts recognised in the Statement of Cash Flows in respect of leases

	Group & Society 2019 £M
Total cash outflow for leases	**2.4**

22. Provisions for liabilities and charges

Group & Society 2019	FSCS levy £M	Customer redress and related provisions £M	Commission clawback £M	Property related £M	Other provisions £M	Total £M
At 1 January 2019	0.3	3.9	0.3	0.2	0.3	5.0
Amounts paid during the year	(0.3)	(0.8)	–	–	(0.1)	(1.2)
Provision (release) / charge in the year	–	(2.6)	(0.1)	0.1	–	(2.6)
At 31 December 2019	–	0.5	0.2	0.3	0.2	1.2

Group & Society 2018	FSCS levy £M	Customer redress and related provisions £M	Commission clawback £M	Property related £M	Other provisions £M	Total £M
At 1 January 2018	1.0	4.9	0.3	0.2	–	6.4
Amounts paid during the year	(0.4)	(0.8)	–	–	–	(1.2)
Provision (release) / charge in the year	(0.3)	(0.2)	–	–	0.3	(0.2)
At 31 December 2018	0.3	3.9	0.3	0.2	0.3	5.0

Financial Services Compensation Scheme (FSCS) levy

The Group has a contingent liability in respect of FSCS levies (see note 29). All amounts payable at 1 January 2019 were paid during the year.

Customer redress and related provisions

This provision is made in respect of redress payments to customers. This previously included potential claims on payment protection insurance (PPI) sold by the Group, the deadline for which passed in August 2019, and other fees and premia charged. During 2019 all PPI claims were paid out and no further liability exists. All other provisions were released which were no longer considered to be required.

Commission clawback

This provision has been made for the potential clawback of commission on assurance policies sold.

Property related provisions

A provision was made for potential dilapidations on leased premises following the acquisition of a new head office property by the Group in 2017 which will result in leased property being vacated.

23. Subscribed capital

	Group & Society 2019 £M	Group & Society 2018 £M
13 3/8% permanent interest bearing shares	25.0	25.0
3 3/4% tier 2 capital	207.1	199.2
Total	232.1	224.2

The permanent interest bearing shares (PIBS), which are denominated in sterling, were issued for an indeterminate period and are only repayable in the event of the winding up of the Society. The PIBS have a fixed rate of interest of 13 ⅜ % payable semi-annually for an indeterminate period.

In April 2018 the Society issued £200m of tier 2 capital with a maturity date of 2029 to allow it to meet its projected Minimum Requirement for Own Funds and Eligible Liabilities (MREL). This requirement ensures that institutions have a minimum amount of liabilities that can bear losses before and in resolution, allowing the resolution authority to use these financial resources to absorb losses and recapitalise the continuing business.

Year ended
31 December 2019 **Continued**

24. Retirement benefit surplus

(a) Overview of the Society's pension arrangements
The Group operates both defined benefit and defined contribution schemes. In addition, the Group has, for one individual (2018: 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 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 2019 there were 305 deferred defined benefit members (2018: 319). The Society's unfunded liability remains at £0.8m (2018: £0.8m) and is detailed below.

The defined benefit scheme operates under UK trust law and the trust is a separate legal entity from the Society. The scheme is governed by a Trustee company, Leeds Building Society Staff Pension Scheme Limited. Directors of the Trustee company are required by law to act in the best interests of scheme members and are responsible for setting certain policies, such as investment and funding, together with the Society. Trustees are appointed in line with UK law and the Trustee Deed and Rules

The scheme's adopted and agreed funding target is 100% of its technical provisions. The trustees make annual checks on the funding position of the scheme, to confirm whether or not the scheme is still on track to meet this objective by the end of the set recovery period. Since the last actuarial valuation was undertaken at 31 December 2017, the Society and the trustees have implemented a lower risk investment strategy. This comprises a variety of credit assets, such as corporate bonds and gilts, and aims to eliminate risks to the scheme associated with equity investments and the inherent volatility this entails, and move towards a self-sufficient position.

The average duration of the benefit obligation is estimated to be 20 years (2018: 20 years).

The scheme is funded by the Society. Funding of the scheme is based on a separate actuarial valuation for funding purposes for which the assumptions may differ from the assumptions below. Funding requirements are formally set out in the Statement of Funding Principles, Schedule of Contributions and Recovery Plan agreed between the trustees and the Society. The Society expects to contribute £0.4m to the defined benefit scheme in the next financial year.

The defined benefit obligation at 31 December 2019 can be approximately attributed to the scheme members as follows:

- Deferred members: 51% (2018: 51%)
- Pensioner members: 49% (2018: 49%)

(b) Actuarial risks
The defined benefit scheme exposes the Group to actuarial risks, as detailed below:

Risk	Impact
Interest rate risk	A decrease in corporate bond yields results in an increase in the present value of the scheme liabilities
Inflation risk	An increase in inflation results in higher benefit increases for scheme members, increasing the scheme's liabilities
Longevity risk	An increase in life expectancies results in a longer benefit payment period which in turn increases the scheme liabilities
Investment market risk	A fall in equity markets would result in a decrease in the scheme's overall assets due to the return-seeking element of the investment strategy

Actuarial gains and losses are recognised immediately in full through the Statements of Comprehensive Income.

Year ended
31 December 2019 **Continued**

24. Retirement benefit surplus continued

(c) Valuation assumptions

Principal actuarial assumptions at the balance sheet date (expressed as weighted averages):

	2019	2018
Discount rate	**2.00%**	2.80%
Price inflation		
RPI	**3.15%**	3.15%
CPI	**2.15%**	2.15%
Future salary increases	**N/A**	N/A
Future pension increases		
RPI max 5%	**3.10%**	3.05%
RPI min 3% max 5%	**3.60%**	3.65%
Cash commutation	**75% of members assumed to take 75% of maximum tax free cash**	75% of members assumed to take 75% of maximum tax free cash
Mortality – current pensioners		
Actuarial tables used	**S2PXA, YoB CMI_2018 1.25% pa long-term trend and a smoothing factor of 7.0**	S2PXA, YoB CMI_2017 1.25% pa long-term trend and a smoothing factor of 7.5
Male life expectancy at age 63	**23.3 years**	23.7 years
Female life expectancy at age 63	**25.2 years**	25.7 years
Mortality – future pensioners		
Actuarial tables used	**S2PXA, YoB CMI_2018 1.25% pa long-term trend and a smoothing factor of 7.0**	S2PXA, YoB CMI_2017 1.25% pa long-term trend and a smoothing factor of 7.5
Male life expectancy at age 63 (currently aged 43)	**24.7 years**	25.2 years
Female life expectancy at age 63 (currently aged 43)	**26.8 years**	27.3 years

The table above includes 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.

(d) Reconciliation of funded statement

	Group & Society 2019 £M	Group & Society 2018 £M
Present value of funded obligations	**(115.5)**	(101.7)
Present value of unfunded obligations	**(0.8)**	(0.8)
Assets at fair value	**119.3**	112.6
Surplus	**3.0**	10.1

Changes in the present value of the scheme's liabilities are as follows:

	2019 £M	2018 £M
At 1 January	**102.5**	114.2
Interest cost	**2.8**	2.7
Actuarial losses / (gains) arising from changes in demographic assumptions	**(1.8)**	(0.7)
Actuarial losses / (gains) arising from changes in financial assumptions	**16.4**	(7.1)
Experience losses / (gains) on liabilities	**0.2**	(2.5)
Benefits paid	**(3.8)**	(5.1)
Past service cost	**–**	1.0
At 31 December	**116.3**	102.5

Year ended
31 December 2019 **Continued**

24. Retirement benefit surplus continued

(d) Reconciliation of funded statement (continued)
Changes in the present value of the scheme's assets are as follows:

	2019 £M	2018 £M
At 1 January	112.6	115.2
Interest income	3.1	2.7
Actuarial gains / (losses)	6.9	(1.7)
Contribution by employer	0.9	2.0
Contribution by scheme members	–	–
Administration expenses	(0.4)	(0.5)
Benefits paid	(3.8)	(5.1)
At 31 December	**119.3**	112.6

(e) Scheme assets
The major categories of scheme assets are as follows:

	2019		2018	
	Quoted market price in active market £M	No quoted price in active market £M	Quoted market price in active market £M	No quoted price in active market £M
Corporate bonds	52.9	–	–	–
Fixed-interest government bonds	1.9	–	40.5	–
Index-linked government bonds	25.8	–	20.9	–
Absolute return bonds	19.2	–	15.1	–
Property	–	–	–	0.1
Liability driven investments	14.7	–	22.7	–
Cash and cash equivalents	4.8	–	13.3	–
Total assets	**119.3**	–	112.5	0.1

The pension scheme assets include no assets from the Society's own financial instruments (unchanged from 2018). The pension scheme assets include no property occupied by, or other assets used by the Society (unchanged from 2018). The change in mix of assets compared to 2018 reflects a new investment strategy (see note 24a).

(f) Amounts recognised in the Income Statements

	Group & Society 2019 £M	Group & Society 2018 £M
Past service cost	–	1.0
Administration expenses	0.4	0.5
Net interest on the defined benefit (asset) / liability	(0.1)	–
Total cost – defined benefit scheme	**0.3**	1.5

Year ended
31 December 2019 **Continued**

24. Retirement benefit surplus continued

(g) Amounts recognised in the Statements of Comprehensive Income (SOCI)

	Group & Society 2019 £M	Group & Society 2018 £M
Experience (losses) / gains on liabilities	**(0.2)**	2.5
Actuarial (losses) / gains arising from changes in demographic assumptions	**1.8**	0.7
Actuarial (losses) / gains arising from changes in financial assumptions	**(16.4)**	7.1
Percentage of scheme liabilities (%)	***(12.7)%***	*10.0%*
Return on scheme assets excluding interest income	**6.9**	(1.7)
Percentage of scheme assets (%)	***5.8%***	*(1.5)%*
Total (loss) / gain recognised in SOCI during the year	**(7.9)**	8.6

The cumulative amount of actuarial gains and losses recognised in the Statements of Other Comprehensive Income since the date of transition to IFRS is a net loss of £22.0m (2018: £14.1m loss).

(h) Sensitivity to changes in key assumptions

The table below gives a broad indication of the impact on the pension surplus to changes in assumptions and experience. All figures are before allowing for deferred tax.

Group & Society	**Approximate impact on current surplus £M**	**Approximate impact on projected pension cost £M**
Reduce discount rate by 0.25%	**-5.7**	**+0.1**
Increase inflation assumption by 0.25%	**-4.4**	**+0.1**
Change long-term trend of increases in mortality improvement from 1.25% per annum to 1.50% per annum	**-1.1**	**+0.0**

(h) Estimated contributions for 2020 financial year

Group & Society	**£M**
Estimated employer normal contributions in financial year 2020	**0.4**

Annual agreed contributions will remain at this level until they are reviewed following the next actuarial valuation at 31 December 2020.

25. Deferred tax

	Group 2019 £M	Group 2018 £M	**Society 2019 £M**	Society 2018 £M
Deferred tax				
At 1 January	**2.1**	(1.3)	**2.6**	(1.1)
Adjustment relating to the adoption of IFRS9 at 1 January 2018	**–**	6.5	**–**	6.5
Adjustment in respect of prior years	**(1.2)**	(0.6)	**(1.7)**	(0.8)
Amount recognised directly in equity	**1.1**	(3.5)	**2.3**	(3.5)
Income and expenditure movement during the year	**0.4**	1.0	**0.4**	1.5
At 31 December	**2.4**	2.1	**3.6**	2.6

	Group 2019 £M	Group 2018 £M	**Society 2019 £M**	Society 2018 £M
Deferred tax assets				
IFRS9 transitional adjustments	**5.4**	6.0	**5.4**	6.0
Other provisions	**0.7**	0.4	**0.7**	0.4
Total deferred tax assets	**6.1**	6.4	**6.1**	6.4

Year ended
31 December 2019 **Continued**

25. Deferred tax continued

	Group 2019 £M	Group 2018 £M	Society 2019 £M	Society 2018 £M
Deferred tax liabilities				
Gain on revaluation	**2.7**	2.2	**2.7**	2.2
Temporary trading differences	**(0.6)**	(0.6)	**(0.6)**	(0.6)
Pensions	**0.8**	2.5	**0.8**	2.5
Fair value reserve	**(0.3)**	(0.3)	**(0.3)**	(0.3)
Other temporary differences	**1.1**	0.5	**(0.1)**	–
Total deferred tax liabilities	**3.7**	4.3	**2.5**	3.8

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

	Group 2019 Before tax amount £M	Group 2019 Tax benefit/ (expense) £M	Group 2019 Net of tax amount £M	Society 2019 Before tax amount £M	Society 2019 Tax benefit/ (expense) £M	Society 2019 Net of tax amount £M
Investment securities at FVOCI	**1.3**	**0.1**	**1.4**	**1.3**	**0.1**	**1.4**
Revaluation loss on properties revalued	**(1.1)**	**0.1**	**(1.0)**	**(1.1)**	**0.1**	**(1.0)**
Actuarial gains / (losses) on retirement benefit obligations	**(7.9)**	**1.8**	**(6.1)**	**(7.9)**	**1.8**	**(6.1)**
IFRS9 transitional adjustment	**–**	**(0.5)**	**(0.5)**	**–**	**(0.5)**	**(0.5)**
Adjustment to tax in relation to prior periods	**–**	**(0.4)**	**(0.4)**	**–**	**0.8**	**0.8**
Other comprehensive income	**(7.7)**	**1.1**	**(6.6)**	**(7.7)**	**2.3**	**(5.4)**

	Group 2018 Before tax amount £M	Group 2018 Tax benefit/ (expense) £M	Group 2018 Net of tax amount £M	Society 2018 Before tax amount £M	Society 2018 Tax benefit/ (expense) £M	Society 2018 Net of tax amount £M
Investment securities at FVOCI	(6.1)	1.3	(4.8)	(6.1)	1.3	(4.8)
Revaluation loss on properties revalued	(1.0)	0.2	(0.8)	(1.0)	0.2	(0.8)
Actuarial gains / (losses) on retirement benefit obligations	8.6	(2.3)	6.3	8.6	(2.3)	6.3
IFRS9 transitional adjustment	–	(0.5)	(0.5)	–	(0.5)	(0.5)
Adjustment to tax in relation to prior periods	–	(2.2)	(2.2)	–	(2.2)	(2.2)
Other comprehensive income	1.5	(3.5)	(2.0)	1.5	(3.5)	(2.0)

Year ended
31 December 2019 **Continued**

27. Cash flows from financing activities

For the purposes of the Statements of Cash Flows, debt securities in issue and subscribed capital are classified as liabilities arising from financing activities. The table below provides a reconciliation of movements in liabilities arising from financing activities:

	Group 2019 £M	Group 2018 £M	**Society 2019 £M**	Society 2018 £M
At 1 January	**2,484.5**	2,880.7	**2,383.0**	2,727.8
Cash flows:				
Net proceeds from issue of debt securities	**1,609.4**	93.0	**1,359.4**	93.0
Net proceeds from issue of subscribed capital	**–**	199.2	**–**	199.2
Repayments of debt securities in issue	**(787.2)**	(701.0)	**(695.8)**	(655.0)
Non cash flows:				
Amortisation of discount on issue	**2.1**	0.6	**2.5**	0.6
Accrued interest movements	**4.0**	–	**3.1**	–
Foreign exchange movements	**(108.5)**	21.1	**(108.5)**	21.1
Movement in fair value	**0.3**	(9.1)	**(4.7)**	(3.7)
At 31 December	**3,204.6**	2,484.5	**2,939.0**	2,383.0

28. Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

	Group 2019 £M	Group 2018 £M	**Society 2019 £M**	Society 2018 £M
Cash in hand and balances with the Bank of England (note 11)	**1,451.7**	1,428.0	**1,451.7**	1,428.0
Loans and advances to credit institutions	**163.4**	169.7	**84.1**	71.3
Total cash and cash equivalents	**1,615.1**	1,597.7	**1,535.8**	1,499.3

The Group's loans and advances to credit institutions includes £79.3m (2018: £76.3m) of balances belonging to the Society's securitisation programmes which are not available for general use by the Society.

29. 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.

(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 capital commitments contracted for but not accrued for under executory contracts of £6.2m (2018: £1.5m) relating to technology investment programmes (intangible assets) and £11.8m (2018: £nil) relating to the refurbishment of the Society's new head office (property, plant and equipment). This amount is inclusive of value added tax.

(d) Other commitments

The Group is committed to a multi-year service contract for the provision and maintenance of its IT infrastructure. The remaining commitment at 31 December 2019 is £28.2m (2018: £34.3m). This service contract does not meet the definition of a lease under IFRS 16 – Leases since it does not give the Group the right to control the assets used to provide the service.

Year ended
31 December 2019 **Continued**

30. Related party transactions

Group
Key management personnel comprise 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 15. 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.

On 12 July 2018, the Society acquired a freehold office property and sundry other assets from its wholly-owned subsidiary Ravenstone Limited (Ravenstone). Ravenstone had been acquired by the Society in December 2017 in order to obtain control of the property which will become the new head office for the Society.

Total consideration for the purchase was £23.8m, in line with the fair value of the property in the accounts of Ravenstone and the Group. Ravenstone subsequently settled its intragroup loan of £21.0m payable to the Society and declared a dividend of £2.8m. Ravenstone was liquidated during 2019.

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	
	2019 £M	2018 £M	**2019 £M**	2018 £M
Loans payable to the Society				
Loans outstanding at 1 January	**46.6**	55.9	**1.1**	1.1
Net movement during the year	**(44.7)**	(9.3)	**(0.1)**	–
Loans outstanding at 31 December	**1.9**	46.6	**1.0**	1.1
Deposits payable by the Society				
Deposits outstanding at 1 January	**373.7**	616.2	**0.7**	1.3
Net movement during the year	**269.2**	(120.2)	**(0.1)**	(0.6)
Change in presentation (see note 12)	**–**	(122.3)	**–**	–
Deposits outstanding at 31 December	**642.9**	373.7	**0.6**	0.7

	2019 £M	2018 £M
Directors' emoluments		
Total remuneration	**3.1**	3.3

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 94 to 108. No directors are active members of the defined benefit section of the Leeds Building Society Pension Scheme (2018: none). Two directors were active members of the defined contribution section of the Leeds Building Society Pension Scheme during 2019 (2018: two).

31. Credit risk on loans and advances to customers

(a) Credit risk management
Credit risk is defined as the current or prospective loss to earnings and impact to capital (expected and unexpected loss) arising from lending, as a result of borrowers defaulting on their credit obligations as they fall due.

Credit risk identification, measurement and management is integrated into a Board approved framework that covers all strategic risks. Credit risk is measured using a range of appropriate key performance indicators, largely underpinned by modelling techniques that are themselves developed and maintained in line with the model risk policy. Key performance indicators are assessed across both new lending and stock and include: risk-weighted assets, impairment charge ratio, expected credit losses (ECL), loan to value (LTV), Probability of Default (PD), in addition to a broad range of concentration limits that cover a number of dimensions.

Year ended
31 December 2019 **Continued**

31. Credit risk on loans and advances to customers continued

(a) Credit risk management (continued)

The Group employs a three 'lines of defence' (LoD) credit risk management approach which includes a dedicated credit risk function that is independent from the areas responsible for originating or renewing exposures. The Group uses a range of approaches to support credit risk management which include the use of through the cycle principles and regular stress testing to understand the impacts of credit volatility. Oversight of first line activity is provided to support credit risk mitigation and a broad range of quantitative and qualitative benchmarking is undertaken. This is supplemented with external independent assurance where required.

Comprehensive management insight and information enable the prevailing, future and stressed levels of credit risk within the Group's credit portfolios to be understood and any adverse trends to be identified before impacting on performance.

The Group's exposure to credit risk on loans and advances to customers can be broken down as below:

	Group & Society 2019 £M	Group & Society 2018 £M
Retail mortgages	**16,768.5**	15,804.8
Commercial lending	**17.6**	30.8
Other loans	**168.3**	170.0
Total gross exposure (contractual amounts)	**16,954.4**	16,005.6
Impairment loss provisions	**(33.2)**	(34.2)
Fair value adjustments	**53.6**	62.0
Total net exposure	**16,974.8**	16,033.4

The Group's commercial lending balances are not past due. The overall indexed loan to value of commercial lending is 57% (2018: 60%).

Other loans includes a collateral loan which represents a pool of equity release mortgages of £165.8m (contractual amount) (2018: £167.5m) and an other loan of £2.5m (2018: £2.5m). The collateral loan is measured at FVTPL and is neither past due nor impaired. The risk relating to this balance arises due to the presence of a guarantee to the equity release mortgage customer whereby any shortfall in the value of the property on redemption of the loan is not pursued. The expected impact of this guarantee is reflected in the calculated fair value of the loan. The overall indexed loan to value of the collateral loan is 36% (2018: 34%) with the value of property on which the equity release mortgages are secured totalling £518m (2018: £551m).

The other loan is not past due but is impaired and is fully provided for.

In addition to the above exposures which are recorded in the Statement of Financial Position, the analysis below also considers undrawn loan commitments where a loan offer has been issued to a customer and remains unexpired but the loan has not yet completed and so has not yet been recognised in the Statement of Financial Position.

(b) Retail credit risk

The Group is firmly committed to the management of credit risk at all stages of the lending cycle. The Group maintains appropriate policies which set out acceptable lending and debt management activities. The Group originates first charge, prime residential mortgage assets in the UK. Bespoke scorecards and affordability assessments are applied alongside appropriate underwriting and fraud detection techniques to manage losses. It also takes a proactive approach to the control of bad and doubtful debts 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 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 use of distributional new lending and portfolio policy limits provides additional resilience to stress and prevents an over concentration of marginal risk exposures.

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(i) Credit quality

The following table sets out information about the credit quality of the Group's retail mortgages, which are all fully secured on residential property and are measured at amortised cost, and loan commitments where the amounts in the table represent the amounts committed. Classification into low, medium or high is based on internal rating grades which approximately translate into the IRB probabilities of default (PD) shown in the table. Explanation of the classification of loans into Stages 1 to 3 can be found on page 129.

Retail mortgages Group & Society 2019		**Stage 1 £M**	**Stage 2 £M**	**Stage 3 £M**	**Total £M**
Low	IRB PD < 2.02%	**14,396.2**	**682.2**	**2.3**	**15,080.7**
Medium	IRB PD ≥ 2.02% and < 25.97%	**651.5**	**722.6**	**9.9**	**1,384.0**
High	IRB PD ≥ 25.97%	**0.4**	**143.5**	**159.9**	**303.8**
Total gross exposure		**15,048.1**	**1,548.3**	**172.1**	**16,768.5**
Impairment loss provision		**(3.7)**	**(9.9)**	**(15.1)**	**(28.7)**
Net exposure		**15,044.4**	**1,538.4**	**157.0**	**16,739.8**

Loan commitments Group & Society 2019		**Stage 1 £M**	**Stage 2 £M**	**Stage 3 £M**	**Total £M**
Low	IRB PD < 2.02%	**428.6**	**–**	**–**	**428.6**
Medium	IRB PD ≥ 2.02% and < 25.97%	**38.7**	**–**	**–**	**38.7**
High	IRB PD ≥ 25.97%	**–**	**–**	**–**	**–**
Total gross exposure		**467.3**	**–**	**–**	**467.3**
Impairment loss provision		**–**	**–**	**–**	**–**
Net exposure		**467.3**	**–**	**–**	**467.3**

Retail mortgages Group & Society 2018		Stage 1 £M	Stage 2 £M	Stage 3 £M	Total £M
Low	IRB PD < 2.02%	13,605.2	646.2	0.9	14,252.3
Medium	IRB PD ≥ 2.02% and < 25.97%	583.5	648.5	7.7	1,239.7
High	IRB PD ≥ 25.97%	0.3	148.2	164.3	312.8
Total gross exposure		14,189.0	1,442.9	172.9	15,804.8
Impairment loss provision		(3.9)	(9.8)	(14.0)	(27.7)
Net exposure		14,185.1	1,433.1	158.9	15,777.1

Loan commitments Group & Society 2018		Stage 1 £M	Stage 2 £M	Stage 3 £M	Total £M
Low	IRB PD < 2.02%	640.6	–	–	640.6
Medium	IRB PD ≥ 2.02% and < 25.97%	35.2	–	–	35.2
High	IRB PD ≥ 25.97%	–	–	–	–
Total gross exposure		675.8	–	–	675.8
Impairment loss provision		–	–	–	–
Net exposure		675.8	–	–	675.8

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(i) Credit quality (continued)

The table below provides further information on the Group's retail mortgages by payment due status as at 31 December 2019, excluding impairment losses. Of the loans and advances secured on residential property in Spain, £7.9m (2018: £11.7m) are past due and £0.6m (2018: £0.5m) are in possession.

	Group & Society 2019 £M	Group & Society 2019 %	Group & Society 2018 £M	Group & Society 2018 %
– Not past due	**16,501.0**	**98.5**	15,552.2	98.4
– Past due up to 3 months	**184.2**	**1.1**	190.8	1.2
– Past due 3 to 6 months	**41.1**	**0.2**	28.5	0.2
– Past due 6 to 12 months	**22.3**	**0.1**	18.4	0.1
– Past due over 12 months	**12.8**	**0.1**	9.5	0.1
– Possessions	**7.1**	**–**	5.4	–
Total gross exposure	**16,768.5**	**100.0**	15,804.8	100.0

(ii) Geographical analysis

The geographical distribution of retail mortgages is as follows:

	Group & Society 2019 %	Group & Society 2018 %
Scotland	**8.2**	7.9
North East	**3.9**	3.9
Yorkshire and Humberside	**9.0**	9.6
North West	**8.3**	8.4
Midlands	**15.2**	15.2
East of England	**4.9**	5.0
South West	**9.1**	8.7
Greater London	**16.2**	16.1
South East	**19.0**	18.9
Wales	**3.1**	3.1
Northern Ireland	**2.6**	2.6
Spain	**0.4**	0.5
Other	**0.1**	0.1
Total	**100.0**	100.0

The Group's retail lending exposures are predominantly in the UK, with some legacy exposure in Spain.

Year ended
31 December 2019 **Continued**

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(iii) Impairment loss provision
The Group's policy for calculating impairment of loans and advances to customers (including retail mortgages and loan commitments) is detailed in note 1. Details of the significant accounting estimates and judgements required in the calculation of impairment loss provisions, including the incorporation of forward looking information, are provided in note 2.

The table below summarises the Group's retail mortgage balances, loan commitments and associated impairment loss provisions:

	Group & Society 2019			Group & Society 2018		
	Gross exposure £M	Impairment loss provision £M	Provision coverage %	Gross exposure £M	Impairment loss provision £M	Provision coverage %
Retail mortgages						
Stage 1	**15,048.1**	**3.7**	**0.02**	14,189.0	3.9	0.03
Stage 2 and <30 days past due	**1,469.7**	**8.6**	**0.59**	1,369.0	8.4	0.62
Stage 2 and 30+ days past due	**78.6**	**1.3**	**1.65**	73.9	1.4	1.81
Stage 3	**172.1**	**15.1**	**8.77**	172.9	14.0	8.10
Total retail mortgages	**16,768.5**	**28.7**	**0.17**	15,804.8	27.7	0.18
Loan commitments						
Stage 1	**467.3**	**–**	**0.01**	675.8	–	0.01

The tables below provide information on movements in the gross retail mortgage exposures and associated impairment loss provisions during the year:

	Group & Society 2019			
	Stage 1 12m ECL £M	Stage 2 Lifetime ECL £M	Stage 3 Lifetime ECL £M	Total £M
Gross exposure at 1 January 2019	**14,189.0**	**1,442.9**	**172.9**	**15,804.8**
Transfers resulting in increased impairment loss provision:				
From Stage 1 to Stage 2	**(812.7)**	**812.7**	**–**	**–**
From Stage 1 to Stage 3	**(18.6)**	**–**	**18.6**	**–**
From Stage 2 to Stage 3	**–**	**(44.9)**	**44.9**	**–**
Transfers resulting in reduced impairment loss provision:				
From Stage 2 to Stage 1	**477.0**	**(477.0)**	**–**	**–**
From Stage 3 to Stage 1	**10.2**	**–**	**(10.2)**	**–**
From Stage 3 to Stage 2	**–**	**29.1**	**(29.1)**	**–**
New advances	**3,434.2**	**–**	**–**	**3,434.2**
Redemptions, repayments and disposals	**(2,231.0)**	**(214.5)**	**(25.0)**	**(2,470.5)**
Gross exposure at 31 December 2019	**15,048.1**	**1,548.3**	**172.1**	**16,768.5**

Year ended
31 December 2019 **Continued**

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(iii) Impairment loss provision (continued)

	Group & Society 2019 Stage 1 12m ECL £M	Stage 2 Lifetime ECL £M	Stage 3 Lifetime ECL £M	Total £M
Impairment loss provision at 1 January 2019	3.9	9.8	14.0	27.7
Transfers resulting in increased impairment loss provision:				
From Stage 1 to Stage 2	(0.1)	2.2	–	2.1
From Stage 1 to Stage 3	–	–	1.1	1.1
From Stage 2 to Stage 3	–	(0.5)	4.3	3.8
Transfers resulting in reduced impairment loss provision:				
From Stage 2 to Stage 1	0.1	(0.9)	–	(0.8)
From Stage 3 to Stage 1	–	–	(0.2)	(0.2)
From Stage 3 to Stage 2	–	0.3	(1.3)	(1.0)
Change in impairment loss provision resulting from loan modifications	1.2	(0.6)	(0.6)	–
Other remeasurement of impairment loss provision (no movement in stage)	(2.0)	(0.1)	1.0	(1.1)
New advances	0.9	–	–	0.9
Redemptions and repayments	(0.3)	(0.3)	0.8	0.2
Write offs	–	–	(4.0)	(4.0)
Impairment loss provision at 31 December 2019	**3.7**	**9.9**	**15.1**	**28.7**

	Group & Society 2018 Stage 1 12m ECL £M	Stage 2 Lifetime ECL £M	Stage 3 Lifetime ECL £M	Total £M
Gross exposure at 1 January 2018	13,350.5	1,352.4	229.1	14,932.0
Transfers resulting in increased impairment loss provision:				
From Stage 1 to Stage 2	(1,031.9)	1,031.9	–	–
From Stage 1 to Stage 3	(21.0)	–	21.0	–
From Stage 2 to Stage 3	–	(23.6)	23.6	–
Transfers resulting in reduced impairment loss provision:				
From Stage 2 to Stage 1	214.6	(214.6)	–	–
From Stage 3 to Stage 1	10.7	–	(10.7)	–
From Stage 3 to Stage 2	–	36.9	(36.9)	–
New advances	3,758.8	–	–	3,758.8
Redemptions, repayments and disposals	(2,092.7)	(740.1)	(53.2)	(2,886.0)
Gross exposure at 31 December 2018	14,189.0	1,442.9	172.9	15,804.8

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(iii) Impairment loss provision (continued)

Group & Society	Group & Society 2018 Stage 1 12m ECL £M	Stage 2 Lifetime ECL £M	Stage 3 Lifetime ECL £M	Total £M
Impairment loss provision at 1 January 2018	1.8	15.8	32.6	50.2
Transfers resulting in increased impairment loss provision:				
From Stage 1 to Stage 2	(0.1)	1.8	–	1.7
From Stage 1 to Stage 3	–	–	0.9	0.9
From Stage 2 to Stage 3	–	(0.3)	3.6	3.3
Transfers resulting in reduced impairment loss provision:				
From Stage 2 to Stage 1	0.2	(1.2)	–	(1.0)
From Stage 3 to Stage 1	–	–	(0.2)	(0.2)
From Stage 3 to Stage 2	–	0.4	(1.1)	(0.7)
Change in impairment loss provision resulting from loan modifications	–	–	(0.7)	(0.7)
Other remeasurement of impairment loss provision (no movement in stage)	1.2	1.5	(0.9)	1.8
New advances	0.9	–	–	0.9
Redemptions, repayments and disposals	(0.1)	(8.2)	(16.0)	(24.3)
Write offs	–	–	(4.2)	(4.2)
Impairment loss provision at 31 December 2018	3.9	9.8	14.0	27.7

(iv) Collateral

Retail mortgages are all fully secured on residential property. Collateral values are assessed at the point of origination and in line with the Group's lending policy. The Group requires collateral to be valued by an appropriately qualified source, independent of both the credit decisioning and the customer, at the time of borrowing. This includes the selected use of automated valuation models. These are developed on market data and usage is subject to accuracy and criteria thresholds.

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's lending policy permits owner occupier applications with a maximum LTV of 95% and buy to let mortgages with a maximum LTV of 80%. Higher LTV lending is subject to enhanced underwriting criteria, including higher scorecard cut-offs.

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 retail mortgage portfolio is as follows:

	Group & Society 2019 %	Group & Society 2018 %
<70%	**80.5**	79.1
70% to 80%	**11.2**	11.7
80% to 90%	**6.0**	7.0
>90%	**2.3**	2.2
Total	**100.0**	100.0

The overall weighted average loan to value of the retail mortgage portfolio is 53.8% (2018: 54.6%). The weighted average loan to value of new lending in 2019 was 59.9% (2018: 61.5%).

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(iv) Collateral (continued)
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 value of collateral capped at 100% of the individual loan amount:

	Group & Society 2019 £M	Group & Society 2018 £M
Not past due	**16,463.2**	15,510.9
Past due up to 3 months	**181.9**	187.9
Past due over 3 months	**77.7**	58.8
Possessions	**6.5**	4.5
Total collateral	**16,729.3**	15,762.1

(v) Forbearance
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. The Group has a wide range of forbearance options which can be offered to customers in financial distress. Forbearance is intended to support both the customer and the Group and the primary aim of a forbearance facility is to enable a complete recovery of the mortgage through the full repayment of arrears and minimise the risk of the customer losing their home. Forbearance typically consists of modifications to previous conditions of a contract or a total or partial refinancing of debt, either of which would not have been required had the customer not been experiencing financial difficulties.

The table below provides further information on loans existing at the 2019 reporting date which have had their terms renegotiated in the last 24 months, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

Group & Society 2019	**Capitalisation £M**	**Transfer to interest only £M**	**Term extension £M**	**Other payment arrangements £M**	**Total forbearance £M**
Not past due	**23.8**	**14.9**	**90.7**	**15.7**	**145.1**
Past due up to 3 months	**9.8**	**4.5**	**0.3**	**10.6**	**25.2**
Past due over 3 months	**9.7**	**4.3**	**–**	**13.2**	**27.2**
Total forbearance	**43.3**	**23.7**	**91.0**	**39.5**	**197.5**

Group & Society 2018	Capitalisation £M	Transfer to interest only £M	Term extension £M	Other payment arrangements £M	Total forbearance £M
Not past due	38.5	15.8	100.9	18.7	173.9
Past due up to 3 months	12.8	4.3	0.4	8.9	26.4
Past due over 3 months	8.9	5.2	–	7.2	21.3
Total forbearance	60.2	25.3	101.3	34.8	221.6

32. Wholesale credit risk

(a) Summary

The Group holds various investments in order to satisfy operational demand and to meet current and future liquidity 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 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.

Wholesale credit risk also arises on the Group's derivative portfolio, which is used for hedging market risk. This is mitigated through the exchange of collateral through clearing and other netting arrangements.

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.

(b) Credit quality analysis

Counterparty credit ratings are used to inform the Group's assessment of wholesale credit risk. The table below shows the Statement of Financial Position items impacted by wholesale credit risk and provides credit rating details for each exposure. The table shows exposures external to the Group only and does not include debt securities retained by the Society.

Group 2019	**Total £M**	**Aaa £M**	**Aa1-Aa3 £M**	**A1-A3 £M**	**Unrated £M**
Cash in hand and balances with the Bank of England	**1,451.7**	**–**	**1,451.7**	**–**	**–**
Loans and advances to credit instuitutions	**163.4**	**–**	**50.7**	**112.6**	**0.1**
Investment securities					
UK Government securities	**508.1**	**–**	**508.1**	**–**	**–**
Supranational bonds	**539.1**	**509.4**	**29.7**	**–**	**–**
Covered bonds	**432.2**	**432.2**	**–**	**–**	**–**
Residential mortgage backed securities	**140.2**	**137.5**	**2.7**	**–**	**–**
Certificate of deposit	**77.0**	**–**	**42.0**	**35.0**	**–**
Senior unsecured	**11.5**	**–**	**–**	**11.5**	**–**
Total wholesale exposures	**3,323.2**	**1,079.1**	**2,084.9**	**159.1**	**0.1**
Total	**100.0%**	**32.5%**	**62.7%**	**4.8%**	**–**

Group 2018	Total £M	Aaa £M	Aa1-Aa3 £M	A1-A3 £M	Unrated £M
Cash in hand and balances with the Bank of England	1,428.0	–	1,428.0	–	–
Loans and advances to credit institutions	169.7	–	89.8	79.7	0.2
Investment securities					
UK Government securities	457.1	–	457.1	–	–
Supranational bonds	255.6	237.5	18.1	–	–
Covered bonds	328.9	328.9	–	–	–
Residential mortgage backed securities	187.5	184.5	3.0	–	–
Total wholesale exposures	2,826.8	750.9	1,996.0	79.7	0.2
Total	100.0%	26.6%	70.6%	2.8%	–

All wholesale exposures are to financial institutions in major industrial countries. The largest exposure to a single institution other than the UK Government was £104.9m (2018: £99.0m).

At 31 December 2019 none of the Group's wholesale portfolio exposure was either past due or impaired (2018: none). There are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

The Group has implemented a policy that initial investments in wholesale assets must be grade A3 or above. At 31 December 2019 100% (2018: 100%) of the Group's wholesale investments are rated single A or better.

The Group's accounting policy for the calculation of impairment on wholesale (liquid) assets is detailed in note 1. All wholesale assets were classified as at Stage 1 at 31 December 2019 and throughout the year. No impairment loss provision is held against these assets at 31 December 2019 or throughout the year since calculated ECLs are immaterial.

32. Wholesale credit risk continued

(c) Concentration risk

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 2019, the Group had exposures to the following geographical regions:

	Group 2019 £M	Group 2019 %	Group 2018 £M	Group 2018 %
UK	**2,738.1**	**82.3**	2,548.3	90.2
Europe split into individual countries as follows:				
Germany	**199.1**	**6.0**	125.5	4.4
Ireland	**–**	**–**	1.0	–
Finland	**46.7**	**1.4**	–	–
Netherlands	**39.5**	**1.2**	18.1	0.6
European Supranational	**43.7**	**1.3**	44.6	1.6
North America	**74.9**	**2.3**	22.0	0.8
Global Supranational	**136.2**	**4.1**	67.3	2.4
Asia Supranational	**45.0**	**1.4**	–	–
Total wholesale exposures	**3,323.2**	**100.0**	2,826.8	100.0

(d) Collateral

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. The majority of the Group's derivatives are transacted through a central clearing house. 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 a 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.

33. Liquidity risk

(a) Summary

Liquidity risk is 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.

The development and implementation of liquidity policy is the responsibility of 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.

Year ended
31 December 2019 **Continued**

33. Liquidity risk continued

(b) Maturity profile of financial assets and liabilities

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 2019	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	1,451.7	–	–	–	–	1,451.7
Loans and advances to credit institutions	–	163.4	–	–	–	163.4
Investment securities	–	202.0	454.7	889.7	161.7	1,708.1
Derivative financial instruments	–	0.3	33.6	123.8	25.2	182.9
Loans and advances to customers						
Loans fully secured on residential property	5.4	6.8	39.7	550.9	16,137.0	16,739.8
Other loans	5.3	–	0.1	0.9	228.7	235.0
Fair value adjustment for hedged risk on loans and advances to customers	–	–	6.8	16.6	0.5	23.9
Total financial assets	1,462.4	372.5	534.9	1,581.9	16,553.1	20,504.8
Financial liabilities						
Shares	111.8	5,576.4	4,483.2	4,293.2	52.9	14,517.5
Fair value adjustment for hedged risk on shares	–	(3.2)	(19.0)	(8.1)	–	(30.3)
Derivative financial instruments	–	0.3	8.6	95.8	95.7	200.4
Amounts owed to credit institutions	–	359.6	403.7	676.2	–	1,439.5
Amounts owed to other customers	23.7	158.7	52.3	–	–	234.7
Debt securities in issue	–	133.0	690.9	1,897.7	250.9	2,972.5
Subscribed capital	–	–	–	–	232.1	232.1
Total financial liabilities	135.5	6,224.8	5,619.7	6,954.8	631.6	19,566.4

Group 2018	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	1,428.0	–	–	–	–	1,428.0
Loans and advances to credit institutions	–	169.7	–	–	–	169.7
Investment securities	–	26.3	517.8	507.5	177.5	1,229.1
Derivative financial instruments	–	0.5	4.7	231.9	36.3	273.4
Loans and advances to customers						
Loans fully secured on residential property	5.9	5.5	26.6	478.5	15,260.6	15,777.1
Other loans	4.7	7.5	3.7	0.3	240.1	256.3
Fair value adjustment for hedged risk on loans and advances to customers	–	–	3.9	13.5	0.6	18.0
Total financial assets	1,438.6	209.5	556.7	1,231.7	15,715.1	19,151.6
Financial liabilities						
Shares	88.7	5,491.9	3,782.6	4,415.2	131.1	13,909.5
Fair value adjustment for hedged risk on shares	–	0.3	7.3	7.7	0.4	15.7
Derivative financial instruments	–	0.2	5.2	22.9	104.9	133.2
Amounts owed to credit institutions	–	103.9	50.1	1,245.3	–	1,399.3
Amounts owed to other customers	36.8	100.1	73.7	–	0.4	211.0
Debt securities in issue	–	21.1	150.0	1,640.2	449.0	2,260.3
Subscribed capital	–	–	–	–	224.2	224.2
Total financial liabilities	125.5	5,717.5	4,068.9	7,331.3	910.0	18,153.2

Year ended
31 December 2019 **Continued**

33. Liquidity risk continued

(b) Maturity profile of financial assets and liabilities (continued)

Society 2019	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	1,451.7	–	–	–	–	1,451.7
Loans and advances to credit institutions	84.1	–	–	–	–	84.1
Investment securities	–	202.0	454.7	889.7	581.8	2,128.2
Derivative financial instruments	–	0.3	2.8	113.2	10.8	127.1
Loans and advances to customers						
Loans fully secured on residential property	5.4	6.8	39.7	550.9	16,137.0	16,739.8
Other loans	5.3	–	0.1	0.9	228.7	235.0
Fair value adjustment for hedged risk on loans and advances to customers	–	–	6.8	16.6	0.5	23.9
Total financial assets	1,546.5	209.1	504.1	1,571.3	16,958.8	20,789.8
Financial liabilities						
Shares	111.8	5,576.4	4,483.2	4,293.2	52.9	14,517.5
Fair value adjustment for hedged risk on shares	–	(3.2)	(19.0)	(8.1)	–	(30.3)
Derivative financial instruments	–	0.3	8.6	72.0	95.7	176.6
Amounts owed to credit institutions	–	359.6	403.7	676.2	–	1,439.5
Amounts owed to other customers	52.7	394.8	52.3	–	377.3	877.1
Debt securities in issue	–	133.0	676.0	1,897.9	–	2,706.9
Subscribed capital	–	–	–	–	232.1	232.1
Total financial liabilities	164.5	6,460.9	5,604.8	6,931.2	758.0	19,919.4

Society 2018	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	1,428.0	–	–	–	–	1,428.0
Loans and advances to credit institutions	71.3	–	–	–	–	71.3
Investment securities	–	26.3	517.8	507.5	501.3	1,552.9
Derivative financial instruments	–	0.5	4.7	172.7	4.9	182.8
Loans and advances to customers						
Loans fully secured on residential property	5.9	5.5	26.6	478.5	15,260.6	15,777.1
Other loans	4.7	7.5	3.7	0.3	240.1	256.3
Fair value adjustment for hedged risk on loans and advances to customers	–	–	3.9	13.5	0.6	18.0
Total financial assets	1,509.9	39.8	556.7	1,172.5	16,007.5	19,286.4
Financial liabilities						
Shares	88.7	5,491.9	3,782.6	4,415.2	131.1	13,909.5
Fair value adjustment for hedged risk on shares	–	0.3	7.3	7.7	0.4	15.7
Derivative financial instruments	–	0.2	5.2	22.8	104.7	132.9
Amounts owed to credit institutions	–	103.9	50.1	1,245.3	–	1,399.3
Amounts owed to other customers	36.8	115.1	202.2	–	230.6	584.7
Debt securities in issue	–	21.1	58.8	1,630.3	448.6	2,158.8
Subscribed capital	–	–	–	–	224.2	224.2
Total financial liabilities	125.5	5,732.5	4,106.2	7,321.3	1,139.6	18,425.1

33. Liquidity risk continued

(c) Gross contractual cash flows for financial liabilities

The following tables detail the Group's remaining undiscounted contractual cash flows for its non-derivative 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.

Group 2019	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
Shares	4,551.4	1,580.3	4,096.4	4,422.7	53.0	14,703.8
Amounts owed to credit institutions	–	159.4	608.0	685.6	–	1,453.0
Amounts owed to other customers	–	187.5	47.5	–	–	235.0
Debt securities in issue	–	133.1	691.3	1,928.5	–	2,752.9
Subscribed capital	–	–	–	–	386.7	386.7
Total financial liabilities	4,551.4	2,060.3	5,443.2	7,036.8	439.7	19,531.4

Group 2018	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
Shares	4,856.6	1,170.0	3,485.3	4,517.6	96.5	14,126.0
Amounts owed to credit institutions	–	265.2	50.2	1,237.3	–	1,552.7
Amounts owed to other customers	–	153.9	78.1	–	–	232.0
Debt securities in issue	–	21.1	54.6	1,651.6	461.5	2,188.8
Subscribed capital	–	–	–	–	303.8	303.8
Total financial liabilities	4,856.6	1,610.2	3,668.2	7,406.5	861.8	18,403.3

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 / (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.

Group 2019	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Swap contracts	45.1	32.6	38.1	127.3	243.1

Group 2018	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Swap contracts	8.3	15.7	79.5	79.6	183.1

(d) 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 institutional 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 2019 had £1,695.8m covered bonds in issue (2018: £1,168.4m). In addition, the Group had a further £nil (2018: £91.4m) of debt securities in issue through the Albion No. 3 securitisation programme and £250.0m (2018: £nil) of debt securities in issue through the Albion No. 4 securitisation programme.

The debt securities issued by Albion No. 3 were repaid in full on 17 November 2019. The Albion No. 4 programme was established during the year.

33. Liquidity risk continued

(d) Pledged assets (encumbrance) (continued)
The table below illustrates the external secured funding balances after redemptions in the mortgage pool:

	2019 Assets pledged £M	2019 Secured funding £M	2018 Assets pledged £M	2018 Secured funding £M
Secured against loans and advances to customers – LBS Covered Bonds LLP	**3,201.8**	**1,695.8**	1,815.3	1,168.4
Secured against loans and advances to customers – Albion No.3 plc	**–**	**–**	126.0	91.4
Secured against loans and advances to customers – Albion No.4 plc	**417.4**	**250.0**	–	–
Total	**3,619.2**	**1,945.8**	1,941.3	1,259.8

Pledged assets include those available to Leeds Building Society Covered Bonds LLP and Albion No.4 plc to provide collateral to support external funding transactions. The secured funding balances above show issuance external to the Group, and do not include debt securities retained by the Society.

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 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 effected 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 programmes operate under a Mortgage Sale Agreement, where there is an equitable assignment of the loans from the seller to the issuers, Albion No.4 plc and Guildford No.1 plc. Legal title remains with the Society and full transfer of title is not effected until the occurrence of certain 'perfection' events such as it being directed by a regulatory authority, the courts or the Society.

34. Market risk

(a) Summary
Market risk is the risk that market movements adversely impact the Group. It is the risk that the value of, or income arising from, the Group's assets and liabilities changes adversely due to movements in market variables, primarily 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 the Board-approved Market Risk Policy. 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 market risk.

(b) Interest rate risk
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.

Notes to the Accounts

Year ended
31 December 2019 **Continued**

34. Market risk continued

(b) Interest rate risk (continued)

The following table provides a summary of the interest rate re-pricing profile of the Group's assets and liabilities as at 31 December 2019. 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 the effect of which is to alter the interest basis of Group assets and liabilities. The non-interest bearing balances have been included in a separate column.

Group 2019	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	2,499.1	395.6	58.8	337.8	18.1	–	13.8	3,323.2
Loans and advances to customers	3,323.1	1,133.6	2,489.5	9,726.5	227.2	–	74.9	16,974.8
Total interest bearing assets	5,822.2	1,529.2	2,548.3	10,064.3	245.3	–	88.7	20,298.0
Total non-interest bearing assets	–	–	–	–	–	–	509.8	509.8
Total assets	5,822.2	1,529.2	2,548.3	10,064.3	245.3	–	598.5	20,807.8

	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	5,576.4	1,563.2	2,920.0	4,293.2	52.9	–	111.8	14,517.5
Amounts owed to credit institutions, other customers and debt securities in issue	2,599.0	470.0	269.0	1,268.6	–	–	40.1	4,646.7
Subscribed capital	–	–	–	–	200.0	32.1	–	232.1
Total interest bearing liabilities	8,175.4	2,033.2	3,189.0	5,561.8	252.9	32.1	151.9	19,396.3
Total non-interest bearing liabilities and equity	–	–	–	–	–	–	1,411.5	1,411.5
Total liabilities and equity	8,175.4	2,033.2	3,189.0	5,561.8	252.9	32.1	1,563.4	20,807.8
Effect of derivatives	2,608.0	1,177.5	(80.4)	(3,581.6)	(123.5)	–	–	–
Interest rate sensitivity gap	254.7	673.5	(721.1)	920.9	(131.1)	(32.1)	(964.8)	–

34. Market risk continued

(b) Interest rate risk (continued)

Group 2018	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	2,130.1	258.2	235.6	198.0	–	–	4.9	2,826.8
Loans and advances to customers	3,718.4	1,024.7	1,680.1	9,297.4	213.4	–	99.4	16,033.4
Total interest bearing assets	5,848.5	1,282.9	1,915.7	9,495.4	213.4	–	104.3	18,860.2
Total non-interest bearing assets	–	–	–	–	–	–	529.9	529.9
Total assets	5,848.5	1,282.9	1,915.7	9,495.4	213.4	–	634.2	19,390.1

	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	5,491.8	1,243.2	2,539.4	4,415.2	131.1	–	88.8	13,909.5
Amounts owed to credit institutions, other customers and debt securities in issue	1,663.9	76.5	36.0	1,598.5	449.5	–	46.2	3,870.6
Subscribed capital	–	–	–	–	199.2	25.0	–	224.2
Total interest bearing liabilities	7,155.7	1,319.7	2,575.4	6,013.7	779.8	25.0	135.0	18,004.3
Total non-interest bearing liabilities and equity	–	–	–	–	–	–	1,385.8	1,385.8
Total liabilities and equity	7,155.7	1,319.7	2,575.4	6,013.7	779.8	25.0	1,520.8	19,390.1
Effect of derivatives	2,274.3	549.5	465.4	(3,540.2)	251.0	–	–	–
Interest rate sensitivity gap	967.1	512.7	(194.3)	(58.5)	(315.4)	(25.0)	(886.6)	–

The Society's interest rate repricing profile is not materially different to the Group position.

Liquid assets comprise cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment 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 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 sensitivity of the Group's and Society's annual earnings 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	**+200bps 2019 £M**	+200bps 2018 £M	**-200bps 2019 £M**	-200bps 2018 £M
Impact	**31.4**	52.6	**(14.9)**	(27.5)

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.

34. Market risk continued

(b) Interest rate risk (continued)
The above interest rate risk represents the market value movement, calculated using a discounted cash flow basis, on all of the Group's financial assets and liabilities, resulting from an immediate 200 basis points parallel shift in interest rates.

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.

(c) Foreign 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 its debt issuance in foreign currencies, which give rise to exchange rate impacts. 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:

Group	**Assets 2019 £M**	Assets 2018 £M	**Liabilities 2019 £M**	Liabilities 2018 £M
Euro	**1,762.0**	1,863.3	**1,762.8**	1,861.2

At the year end the Group has hedges in place to match 100% of its foreign currency exposures, via the use of currency swaps which offset the impact of foreign exchange fluctuations. Therefore any movement in foreign currency through profit or loss and other equity will be minimised. At 31 December 2019, a 10% movement in the sterling : euro exchange rate would result in a movement of £0.2m (2018: £0.2m) in profit or loss or other equity.

(d) 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.

35. Derivative financial instruments and hedge accounting

(a) 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, foreign 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 only.

The main derivatives used by the Group are interest rate swaps 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 Statement of Financial Position.

Year ended
31 December 2019 **Continued**

35. Derivative financial instruments and hedge accounting continued

(a) Derivative financial instruments (continued)

Activity	Risk	Type of Derivative	Hedge Accounting
Fixed rate mortgage lending	Sensitivity to changes in interest rates	Pay fixed interest rate swaps	Fair value hedge
Fixed rate asset investments	Sensitivity to changes in interest rates	Pay fixed interest rate swaps	Fair value hedge
Fixed rate savings products	Sensitivity to changes in interest rates	Receive fixed interest rate swaps	Fair value hedge
Fixed rate wholesale funding	Sensitivity to changes in interest rates	Receive fixed interest rate swaps	Fair value hedge
Equity release mortgages	Sensitivity to changes in interest rates	Pay fixed 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	–
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 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 into 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 hedge accounting does not need to be applied. In these cases a natural offset may be achieved; these types of hedge are only entered into where a high degree of effectiveness can be achieved.

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.

The Group discounts its collateralised and un-collateralised positions based on overnight interest rate curves.

The table below shows the value of derivatives by type:

	Group 2019			Group 2018		
	Contract or underlying principal amount £M	**Positive fair value £M**	**Negative fair value £M**	Contract or underlying principal amount £M	Positive fair value £M	Negative fair value £M
Interest rate swaps available to designate in fair value accounting hedges	**19,664.7**	**79.7**	**(81.8)**	22,572.9	63.4	(34.2)
Derivatives not designated as accounting hedges:						
Equity release swaps	**76.6**	**–**	**(73.9)**	79.4	–	(72.8)
Interest rate swaps	**830.3**	**1.0**	**(1.0)**	685.3	14.9	(0.2)
Cross currency swaps	**1,799.2**	**102.2**	**(40.6)**	1,933.3	193.8	(24.6)
Floating swaps	**1,339.0**	**–**	**(3.1)**	1,339.0	1.3	(1.4)
Total derivatives held for hedging purposes	**23,709.8**	**182.9**	**(200.4)**	26,609.9	273.4	(133.2)

Notes to the Accounts

Year ended
31 December 2019 **Continued**

35. Derivative financial instruments and hedge accounting continued

(a) Derivative financial instruments (continued)

	Society 2019 Contract or underlying principal amount £M	Society 2019 Positive fair value £M	Society 2019 Negative fair value £M	Society 2018 Contract or underlying principal amount £M	Society 2018 Positive fair value £M	Society 2018 Negative fair value £M
Interest rate swaps available to designate in fair value accounting hedges	**18,569.0**	**61.9**	**(81.8)**	21,423.8	53.2	(34.2)
Derivatives not designated as accounting hedges:						
Equity release swaps	**76.6**	**–**	**(73.9)**	79.4	–	(72.7)
Interest rate swaps	**415.1**	**–**	**(1.0)**	567.4	14.9	–
Cross currency swaps	**855.2**	**65.2**	**(16.4)**	919.4	113.5	(24.6)
Floating swaps	**1,339.0**	**–**	**(3.5)**	1,339.0	1.3	(1.4)
Total derivatives held for hedging purposes	**21,254.9**	**127.1**	**(176.6)**	24,329.0	182.8	(132.9)

The following tables analyse derivatives by contractual and residual maturity:

	Group 2019 Notional principal amount £M	Group 2019 Replacement cost £M	Group 2018 Notional principal amount £M	Group 2018 Replacement cost £M
Under 1 year	**9,813.1**	**33.9**	5,974.8	5.1
Between 1 and 5 years inclusive	**12,070.1**	**123.8**	17,784.3	232.0
Over 5 years	**1,826.6**	**25.2**	2,850.8	36.3
Total derivatives	**23,709.8**	**182.9**	26,609.9	273.4

	Society 2019 Notional principal amount £M	Society 2019 Replacement cost £M	Society 2018 Notional principal amount £M	Society 2018 Replacement cost £M
Under 1 year	**8,717.3**	**3.1**	5,974.8	5.1
Between 1 and 5 years inclusive	**11,224.3**	**113.2**	16,635.2	172.8
Over 5 years	**1,313.3**	**10.8**	1,719.0	4.9
Total derivatives	**21,254.9**	**127.1**	24,329.0	182.8

(b) Hedge accounting

The Group holds a portfolio of fixed rate mortgages, savings and investments and is therefore exposed to changes in interest rate risk (see note 34). As shown in the table on page 176 the Group manages this risk by entering into interest rate swaps that either pay or receive a fixed rate.

By entering into these swaps the Group is hedging interest rate risk only (other risks, such as credit risk, are managed but not hedged). These risks are managed by entering into swap contracts with high quality counterparties, requiring the posting of collateral and clearing swaps through central counterparties.

The interest rate risk that arises from fixed rate mortgages and savings is managed by entering into swaps on a monthly basis. The exposure fluctuates due to new products being added, products maturing and early repayments in the case of mortgage products. Because of this the Group utilises a dynamic hedging strategy (also known as macro hedging) to manage the exposure created by entering into swap contracts this way.

35. Derivative financial instruments and hedge accounting continued

(b) Hedge accounting (continued)

The Group uses macro fair value hedges to recognise the changes in fair value of the hedged items (the mortgage and savings products) due to the changes in interest rates and therefore can reduce the impact on profit and loss that would arise if only the changes in fair value from the interest rate swaps was recognised. The main sources of volatility in profit and loss are:

- Differences in interest rates used to discount the cash flows of the swap and the hedged item; and
- Differences in the maturity dates of the swaps and hedged items.

In addition to the macro fair value hedges used to manage the interest rate risk of mortgages and savings the Group also uses one-to-one hedges, known as micro hedges, to manage the interest rate risk of fixed rate funding issuances. In this type of hedge a single swap is matched directly against a fixed rate bond and remains matched until maturity or a de-designation event (such as becoming ineffective). The changes in fair value are recognised in the same way as the macro hedge, with the change in the fair value of the bond and swap being offset to reduce volatility in the Income Statement. The main source of ineffectiveness in the micro fair value hedges is differences in the interest rates used to discount the cash flows of the swap and hedged item.

The notional value of interest rate swaps designated into hedge relationships is as follows, analysed by maturity date:

Group 2019	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M
Macro hedges of loans and advances to customers				
Swap notional	222.1	2,568.1	4,266.8	370.2
Average fixed rate	1.1	1.2	0.8	0.9
Macro hedges of shares				
Swap notional	508.0	3,537.9	1,745.0	–
Average fixed rate	0.9	0.8	1.0	–
Micro hedges of debt securities in issue denominated in Sterling				
Swap notional	–	250.0	–	200.0
Average fixed rate	–	4.9	–	3.8
Micro hedges of debt securities in issue denominated in Euros				
Swap notional	–	422.9	845.8	–
Average fixed rate	–	0.1	0.9	–

Group 2018	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M
Macro hedges of loans and advances to customers				
Swap notional	257.5	1,682.1	7,192.5	106.7
Average fixed rate	0.8	1.3	1.1	1.3
Macro hedges of shares				
Swap notional	212.0	2,728.5	3,399.6	28.1
Average fixed rate	1.2	1.0	1.1	2.2
Micro hedges of debt securities in issue denominated in Sterling				
Swap notional	–	–	250.0	200.0
Average fixed rate	–	–	4.9	3.8
Micro hedges of debt securities in issue denominated in Euros				
Swap notional	–	–	899.1	449.6
Average fixed rate	–	–	0.8	0.5

Year ended
31 December 2019 **Continued**

35. Derivative financial instruments and hedge accounting continued

(b) Hedge accounting (continued)

The tables below provide analysis of the impacts of hedge accounting on the Statement of Financial Position and the Income Statement:

Group 2019	Notional amount £M	Carrying Amount Assets £M	Carrying Amount Liabilities £M	Line item in the Statement of Financial Position that includes the hedging instrument	Change in fair value of the hedging instrument used for recognising ineffectiveness in the year £M	Total ineffectiveness recognised in Income Statement £M	Line item in Income Statement that includes hedge effectiveness
Interest rate swaps							
Hedge of loans and advances to customers	7,427.2	6.1	(27.6)	Derivative financial instruments	(38.5)	(5.8)	Fair value gains less losses from financial instruments
Hedge of shares	5,790.9	17.6	(2.1)	Derivative financial instruments	18.8	(9.3)	Fair value gains less losses from financial instruments
Hedge of debt securities in issue denominated in Sterling	450.0	13.6	–	Derivative financial instruments	3.3	0.8	Fair value gains less losses from financial instruments
Hedge of debt securities in issue denominated in Euros	1,268.7	18.6	–	Derivative financial instruments	(6.9)	(2.0)	Fair value gains less losses from financial instruments

Group 2019	Carrying Amount Assets £M	Carrying Amount Liabilities £M	Accumulated amount of fair value adjustments on the hedged item Assets £M	Accumulated amount of fair value adjustments on the hedged item Liabilities £M	Line item in the Statement of Financial Position that includes the hedged item	Change in value used to calculate hedge ineffectiveness £M	Accumulated amount of fair value adjustments remaining in the Statement of Financial Position due to items that have ceased to be adjusted for hedging gains or losses £M
Hedged items							
Loans and advances to customers	11,811.7	–	65.4	(5.7)	Fair value adjustment for hedged risk on loans and advances to customers	44.3	66.5
Shares	–	5,021.9	2.4	(9.6)	Fair value adjustment for hedged risk on shares	(9.5)	(22.1)
Debt securities in issue denominated in Sterling	–	452.9	14.2	–	Debt securities in issue	(4.1)	–
Debt securities in issue denominated in Euros	–	1,274.0	18.6	–	Debt securities in issue	8.9	(6.9)

Year ended
31 December 2019 **Continued**

35. Derivative financial instruments and hedge accounting continued

(b) Hedge accounting (continued)

The tables below provide analysis of the impacts of hedge accounting on the Statement of Financial Position and the Income Statement:

Group 2018	Notional amount £M	Carrying Amount Assets £M	Carrying Amount Liabilities £M	Line item in the Statement of Financial Position that includes the hedging instrument	Change in fair value of the hedging instrument used for recognising ineffectiveness in the year £M	Total ineffectiveness recognised in Income Statement £M	Line item in Income Statement that includes hedge effectiveness
Interest rate swaps							
Hedge of loans and advances to customers	9,238.8	29.2	(12.2)	Derivative financial instruments	31.7	(10.0)	Fair value gains less losses from financial instruments
Hedge of shares	6,368.2	6.1	(9.4)	Derivative financial instruments	(10.4)	6.6	Fair value gains less losses from financial instruments
Hedge of debt securities in issue denominated in Sterling	450.0	10.2	–	Derivative financial instruments	(10.9)	(0.3)	Fair value gains less losses from financial instruments
Hedge of debt securities in issue denominated in Euros	1,348.7	9.4	(0.1)	Derivative financial instruments	3.5	3.4	Fair value gains less losses from financial instruments

Group 2018	Carrying Amount Assets £M	Carrying Amount Liabilities £M	Accumulated amount of fair value adjustments on the hedged item Assets £M	Accumulated amount of fair value adjustments on the hedged item Liabilities £M	Line item in the Statement of Financial Position that includes the hedged item	Change in value used to calculate hedge ineffectiveness £M	Accumulated amount of fair value adjustments remaining in the Statement of Financial Position due to items that have ceased to be adjusted for hedging gains or losses £M
Hedged items							
Loans and advances to customers	7,801.1	–	23.7	(8.3)	Fair value adjustment for hedged risk on loans and advances to customers	(21.7)	7.2
Shares	–	6,103.1	6.8	(8.7)	Fair value adjustment for hedged risk on shares	3.8	(15.0)
Debt securities in issue denominated in Sterling	–	452.9	10.0	–	Debt securities in issue	11.2	(1.3)
Debt securities in issue denominated in Euros	–	1,354.3	11.0	(0.1)	Debt securities in issue	(6.9)	11.6

(c) IBOR reform

The Society is exposed to LIBOR and EURIBOR (IBOR) which are subject to the interest rate benchmark reform. Please refer to note 1 for detail on the hedged items affected by these reforms.

The Society is closely monitoring the announcements made by the market and regulators, such as the Financial Conduct Authority (FCA), regarding the move away from LIBOR to SONIA. LIBOR is expected to expire on 31 December 2021. EURIBOR was expected to expire on 31 December 2019, however amendments to the rate made by the European Money Markets Institute have allowed the rate to continue to be published beyond this date. It is unclear if EURIBOR will expire at a future date.

35. Derivative financial instruments and hedge accounting continued

(c) IBOR reform (continued)
To prepare for the cessation of IBORs, the Society has commenced a programme to manage the transition of the Society's IBOR exposures. The programme is overseen by the Chief Financial Officer.

Of the Society's IBOR linked contracts, none have sufficient provisions for the termination of the benchmark rates. The Society has engaged with a number of external parties to assist in the successful delivery of changes required to these contracts.

The International Swaps and Derivatives Association's (ISDA) fall back clauses were published at the end of 2019 and these will influence how the Society proceeds with transitioning derivative contracts. This work will extend in to 2020.

The Society has £138.4m of IBOR linked floating rate mortgages. The Society intends to treat customers fairly during the transition of these mortgages away from IBOR such that there is no customer detriment at the point of transfer and that customers are kept informed of the impact of the IBOR reforms on their contracts.

Below is a list of the hedging instruments and items affected by the IBOR reform.

Hedge	Instrument type	Maturing in	Nominal £M	Hedged item
Fair value macro hedges	Receive 3-month GBP LIBOR, pay sterling fixed interest rate swaps	2020	3,696.2	Fixed rate financial assets
		2021	1,677.9	
		2022	564.8	
		2023	2,150.8	
		2024+	1,376.6	
	Pay 3-month GBP LIBOR, receive sterling fixed interest rate swaps	2020	3,787.4	Fixed rate financial liabilities
		2021	392.0	
		2022	24.7	
		2023	314.4	
		2024+	380.2	
Fair value micro hedges	Pay 1-month GBP LIBOR, receive sterling fixed interest rate swap	2020	250.0	Fixed rate issued bond of the same maturity and nominal of the swap
	Pay 3-month GBP LIBOR, receive sterling fixed interest rate swap	2028	200.0	Fixed rate issued bond of the same maturity and nominal of the swap
	Pay 3-month EURIBOR, receive euro fixed rate interest rate swap	2020	422.9	Fixed rate issued bond of the same maturity and nominal of the swap
	Pay 3-month EURIBOR, receive euro fixed rate interest rate swap	2021	422.9	Fixed rate issued bond of the same maturity and nominal of the swap
	Pay 3-month EURIBOR, receive euro fixed rate interest rate swap	2022	422.9	Fixed rate issued bond of the same maturity and nominal of the swap
	Pay 3-month EURIBOR, receive euro fixed rate interest rate swap	2024	422.9	Fixed rate issued bond of the same maturity and nominal of the swap

The Society will continue to apply the amendments to IFRS 9/IAS39 until the uncertainty surrounding interest rate benchmark reform ends. This will be dependent on the completion of the transition programme undertaken by the Society.

Year ended
31 December 2019 **Continued**

36. Fair values

(a) Carrying value and fair value of financial instruments not carried at fair value
The classification and measurement categories of the Group's financial assets and liabilities are detailed in note 10.

The following tables summarise the carrying amounts and fair values of those financial assets and liabilities not carried at fair value in the Statement of Financial Position. 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.

		Fair Value Hierarchy Level	Group 2019 Carrying Value £M	Group 2019 Fair Value £M	Society 2019 Carrying Value £M	Society 2019 Fair Value £M
Financial assets:						
Cash in hand and balances with the Bank of England		Level 1	1,451.7	1,451.7	1,451.7	1,451.7
Loans and advances to credit institutions	i)	Level 2	163.4	163.4	84.1	84.1
Loans and advances to customers						
Loans fully secured on residential property	ii)	Level 3	16,739.8	17,866.7	16,739.8	17,866.7
Other loans	ii)	Level 2	15.6	15.6	15.6	15.6
Financial liabilities:						
Shares	ii)	Level 2	14,517.5	14,580.4	14,517.5	14,580.4
Amounts owed to credit institutions	iii)	Level 2	1,439.5	1,439.5	1,439.5	1,439.5
Amounts owed to other customers	ii)	Level 2	234.7	234.7	877.1	877.1
Debt securities in issue	iv)	Level 1	2,528.7	2,744.8	2,706.9	2,759.8
Debt securities in issue	iv)	Level 2	443.8	447.4	–	–
Subscribed capital	v)	Level 1	232.1	230.7	232.1	230.7

		Fair Value Hierarchy Level	Group 2018 Carrying Value £M	Group 2018 Fair Value £M	Society 2018 Carrying Value £M	Society 2018 Fair Value £M
Financial assets:						
Cash in hand and balances with the Bank of England		Level 1	1,428.0	1,428.0	1,428.0	1,428.0
Loans and advances to credit institutions	i)	Level 2	169.7	169.7	71.3	71.3
Loans and advances to customers						
Loans fully secured on residential property	ii)	Level 3	15,777.1	16,251.2	15,777.1	16,251.2
Other loans	ii)	Level 2	26.8	26.8	26.8	26.8
Financial liabilities:						
Shares	ii)	Level 2	13,909.5	13,922.6	13,909.5	13,922.6
Amounts owed to credit institutions	iii)	Level 2	1,399.3	1,399.3	1,399.3	1,399.3
Amounts owed to other customers	ii)	Level 2	211.0	211.0	584.7	584.7
Debt securities in issue	iv)	Level 1	2,123.5	2,318.1	2,158.8	2,328.5
Debt securities in issue	iv)	Level 2	136.8	136.9	–	–
Subscribed capital	v)	Level 1	224.2	272.1	224.2	272.1

Year ended
31 December 2019 **Continued**

36. Fair values continued

(a) Carrying value and fair value of financial instruments not carried at fair value (continued)
Fair value represents 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) 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.

iv) 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.

v) The fair value of subscribed capital is obtained from market prices.

(b) Fair value measurement basis for financial instruments carried at fair value
The table below classifies all assets and liabilities carried at fair value in the Statement of Financial Position according to the method used to establish their fair value.

Group 2019	**Level 1 £M**	**Level 2 £M**	**Level 3 £M**	**Total £M**
Assets:				
Investment securities	**508.1**	**1,200.0**	**–**	**1,708.1**
Derivative financial instruments	**–**	**168.6**	**14.3**	**182.9**
Loans and advances to customers	**–**	**–**	**219.4**	**219.4**
Fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**23.9**	**23.9**
	508.1	**1,368.6**	**257.6**	**2,134.3**
Liabilities				
Fair value adjustment for hedged risk on shares	**–**	**–**	**(30.3)**	**(30.3)**
Derivative financial instruments	**–**	**131.3**	**69.1**	**200.4**
	–	**131.3**	**38.8**	**170.1**

Group 2018	Level 1 £M	Level 2 £M	Level 3 £M	Total £M
Assets:				
Investment securities	457.0	772.1	–	1,229.1
Derivative financial instruments	–	248.5	24.9	273.4
Loans and advances to customers	–	–	229.5	229.5
Fair value adjustment for hedged risk on loans and advances to customers	–	–	18.0	18.0
	457.0	1,020.6	272.4	1,750.0
Liabilities:				
Fair value adjustment for hedged risk on shares	–	–	15.7	15.7
Derivative financial instruments	–	35.6	97.6	133.2
	–	35.6	113.3	148.9

Year ended
31 December 2019 **Continued**

36. Fair values continued

(b) Fair value measurement basis for financial instruments carried at fair value (continued)

Level 1: Relates to financial instruments where fair values are derived from quoted prices (unadjusted) in active markets 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 the 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.

(c) Reconciliation of level 3 fair value measurements of financial instruments

Group 2019	**Derivative financial instruments £M**	**Loans and advances to customers £M**	**Fair value adjustment for hedged risk £M**
At 1 January 2019	**(72.6)**	**229.5**	**2.3**
Total (losses) / gains in the Income Statement	**(1.2)**	**(8.5)**	**–**
Movement in fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**5.9**
Movement in fair value adjustment for hedged risk on shares	**–**	**–**	**46.0**
Reclassification of equity release swap from Level 3 to Level 2	**19.1**	**–**	**–**
Net repayment in the year	**–**	**(1.6)**	**–**
At 31 December 2019	**(54.8)**	**219.4**	**54.2**

Group 2018	Derivative financial instruments £M	Loans and advances to customers £M	Fair value adjustment for hedged risk £M
At 1 January 2018	(60.3)	247.7	18.3
Total (losses) / gains in the Income Statement	(12.3)	(7.8)	–
Movement in fair value adjustment for hedged risk on loans and advances to customers	–	–	5.5
Movement in fair value adjustment for hedged risk on shares	–	–	(21.5)
Net repayment in the year	–	(10.4)	–
At 31 December 2018	(72.6)	229.5	2.3

Total gains / (losses) for the year are included in fair value gains less losses from financial instruments in the Income Statement.

Year ended
31 December 2019 **Continued**

36. Fair values continued

(d) Recurring fair value measurements

Financial assets / financial liabilities	Fair value at 31 December 2019	Fair value at 31 December 2018	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 £508.1m	Assets £457.0m	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 £1,200.0m	Assets £772.1m	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. Derivative financial instruments (interest rate swaps)	Assets £79.7m and Liabilities £84.9m	Assets £79.4m and Liabilities £35.6m	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. Derivative financial instruments (cross currency swaps)	Assets £88.9m and Liabilities £27.3m	Assets £169.1m	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. Derivative financial instruments (equity release swaps)	Liabilities £19.1m Liabilities £54.8m	Nil Liabilities £72.7m	Level 2 Level 3	Discounted cash flow. 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 and early prepayment.	Assumptions on future life expectancy of customers based on best estimate mortality data. Assumptions on the level of early prepayment.	An increase in life expectancy or reduction in early prepayments will increase the value of the liability.
6. Derivative financial instruments (securitisation swaps)	Assets £14.3m and Liabilities £14.3m	Assets £24.9m and Liabilities £24.9m	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 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 prepayment.	Assumptions on future notional balances related to mortgage prepayment rates.	An increase in prepayment rates will increase the fair value of the swaps.
7. Loans and advances to customers (collateral loan)	Assets £219.4m	Assets £229.5m	Level 3	Discounted cash flow. The valuations are based on a discounted cash flow model which uses projections of interest rates, a discount rate and assumptions for future mortality and early prepayment. The no negative equity component of the loan is valued using a stochastic modelling technique.	Assumptions on future life expectancy of customers based on best estimate mortality data. Assumptions on the level of early repayment, house price volatility and the discount rate.	An increase in life expectancy or reduction in early repayment will increase the value of the asset. An increase in house price volatility or the discount rate will reduce the value of the asset.

36. Fair values continued

(e) Level 3 unobservable inputs

(i) Loans and advances to customers (collateral loan)

The collateral loan which represents a pool of equity release mortgages is valued using a discounted cash flow model which uses unobservable input assumptions for property price volatility, sales discount, mortality, early prepayment and the discount rate used to discount future cash flows. Wherever possible these input assumptions are calculated with reference to actual historic experience. The variables which are considered to have the largest impact on the value of the loan are property price volatility, sales discount and the discount rate. The sensitivities below reflect a range of alternative assumptions based on observed historic data and regulatory guidance.

At 31 December 2019, a 300 basis points increase in assumed property price volatility would reduce the value of the collateral loan by £6.3m and a 500 basis points decrease in assumed property price volatility would increase the value of the collateral loan by £7.5m. A 500 basis points increase in the sales discount would reduce the value of the collateral loan by £5.5m and a 500 basis points decrease in the sales discount would increase the value of the collateral loan by £4.9m. A 50 basis points increase in the discount rate would reduce the value of the collateral loan by £11.2m and a 50 basis points decrease in the discount rate would increase the value of the collateral loan by £12.1m.

(ii) Derivative financial instruments (securitisation swaps and equity release swaps)

The valuation of securitisation swaps is performed using models which utilise a combination of observable market interest rate data and unobservable assumptions about future mortgage prepayment. At 31 December 2019, a 20% proportionate increase in prepayments would lead to an increase in the fair value of the swaps of £0.1m. A 20% proportionate reduction in prepayments would decrease the fair value by £1.1m. These sensitivities reflect the variability in prepayment rates observed historically.

For equity release swaps, the valuation uses significant unobservable inputs which have not been developed by the Group. The Group is therefore not disclosing quantitative information regarding these inputs, in line with the permitted exemption under IFRS 13.

(iii) Fair value adjustment for hedged risk

The Group designates a portfolio of fixed rate mortgages into hedge relationships to mitigate interest rate risk and similarly for a portfolio of fixed rate savings. For the mortgage portfolio only, the calculation of the fair value uses observable market interest rate data and assumptions about projected prepayments. These prepayment assumptions are unobservable inputs that are calculated using historic data and reviewed periodically so that projections are broadly in line with actual data, with sensitivities calculated based on historic observed variability.

At 31 December 2019, a 20% proportionate increase in mortgage repayments would lead to a reduction in the fair value of the mortgages in the hedge relationship of £1.6m. A 20% proportionate decrease in mortgage repayments would lead to an increase in the fair value of the mortgages of £1.9m.

37. Events after the date of the Statement of Financial Position

There have been no subsequent events between 31 December 2019 and the date of approval of these Annual Report and Accounts by the Board which would have had a material impact on the financial position of the Group.

38. Impact of adoption of IFRS 16 – Leases

(a) Introduction

IFRS 16 – Leases was adopted by the Group from 1 January 2019. The standard replaces IAS 17 – Leases and specifies how an entity will recognise, measure, present and disclose leases. The objective of the new standard is to ensure that lessees and lessors provide information which fully represents the lease transactions in which the entity is involved.

The impact on the Group is to bring the majority of leases where the Group is a lessee on-balance sheet. Leased assets are recognised as 'right-of-use' assets within 'Property, plant and equipment' and a corresponding lease liability is recognised within 'Other liabilities and accruals' in the Statement of Financial Position. The right-of-use asset is depreciated while interest expense is charged on the lease liability. Previously operating lease costs were recorded within administrative expenses within the Income Statement.

The Group has chosen to apply the 'modified retrospective' approach to transition. The cumulative effect of initially applying the standard is applied to the opening balance sheet at 1 January 2019 and comparative information has not been restated. Further, for all leases, the Group has chosen to measure the right-of-use asset at an amount equal to the lease liability.

The Group has applied the practical expedient permitted to recognise all leases which end within 12 months of the date of adoption as short term leases, resulting in no right-of-use asset or lease liability being recognised for these leases.

The adoption of IFRS 16 has had no impact on how the Group accounts for leases where it is the lessor.

Year ended
31 December 2019 **Continued**

38. Impact of adoption of IFRS 16 – Leases continued

(b) Financial Impact

The Group has a number of short leasehold properties which are used as branches and office accommodation. Right-of-use assets totalling £13.4m have been recognised at 1 January 2019 in respect of these properties, with corresponding lease liabilities of £13.4m. The weighted average incremental borrowing rate used as the discount rate in the calculation of lease liabilities recognised in the Statement of Financial Position at 1 January 2019 was 2.88%.

As a result of the adoption of IFRS 16, administrative expenses recorded in the income statement for 2019 were £1.8 m lower than they would have been had IAS 17 still been applied, depreciation was £1.7m higher and interest payable was £0.4m higher. The overall impact on profit before tax in 2019 from the adoption of IFRS 16 was therefore a reduction of £0.3m.

The operating lease commitments at 31 December 2018 disclosed in note 29(d) of the 2018 Annual Report and Accounts are reconciled to the lease liability recognised on 1 January 2019 below:

	Group & Society £M
Operating lease and service contract commitments at 31 December 2018	**43.0**
Service contracts which do not meet the definition of a lease (note (i))	**(34.3)**
Operating leases recognised as short term leases on adoption of IFRS 16	**(0.1)**
Operating leases commencing after 1 January 2019 (note (ii))	**(0.9)**
Additional lease payments included in calculation of lease liability (note (iii))	**7.0**
Impact of discounting (note (iv))	**(1.3)**
Lease liability recognised on 1 January 2019	**13.4**

(i) The Group is committed to a multi-year service contract for the provision and maintenance of its IT infrastructure which is disclosed in note 29(d). This contract does not provide the Group with the right to control the use of an identified asset and therefore does not meet the definition of a lease under IFRS 16.

(ii) Leases signed before 31 December 2018 which were therefore included in operating lease commitments disclosed at 31 December 2018 but did not commence until after 1 January 2019 are excluded from the lease liability recognised at 1 January 2019.

(iii) Operating lease commitments disclosed at 31 December 2018 represented the minimum contractual commitments, assuming that termination options were exercised where this was possible at the discretion of the lessee. Under IFRS 16, the lease liability calculation takes into account the Group's expected behaviour in respect of future termination options.

(iv) Previously, undiscounted commitments were disclosed, whereas the lease liability represents the discounted value of future lease payments.

Annual Business Statement

Year ended
31 December 2019

1. Statutory percentages

	31 December 2019	Statutory Limit
Lending limit	**3.8%**	25%
Funding limit	**24.3%**	50%

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 and intangible fixed assets.

The funding limit measures the proportion of shares and borrowings (excluding fair value adjustment for hedged risk) not in the form of shares held by individuals.

2. Other percentages

	31 December 2019	31 December 2018
As a percentage of shares and borrowings:		
Gross capital	**6.88%**	7.05%
Free capital	**6.45%**	6.70%
Liquid assets	**17.34%**	15.90%
Profit for the financial year as a percentage of mean total assets	**0.33%**	0.47%
Management expenses as a percentage of mean total assets	**0.50%**	0.52%

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 less tangible and intangible fixed assets;
- '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;
- 'mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year; and
- 'management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

Year ended
31 December 2019 **Continued**

3. Information relating to the directors and other officers at 31 December 2019

Name	Occupation	Date of birth	Date first appointed
Chairman			
R J Ashton[1] Chairman from 26 March 2013	Chairman	19.01.58	26.04.11
Vice Chairman			
G J Hoskin Vice Chairman and Senior Independent Director from 1 January 2019	Non Executive Director	18.09.60	16.11.15
Chief Executive			
*R G Fearon Chief Executive from 27 February 2019	Chief Executive Officer	16.07.78	19.02.16
Directors			
A M Barnes	Non Executive Director	10.11.68	01.02.19
I C A Cornish	Non Executive Director	11.11.60	01.01.19
D Fisher	Non Executive Director	02.08.58	27.03.12
*A J Greenwood	Chief Risk Officer	11.12.69	08.01.15
J A Hunt	Non Executive Director	25.09.54	29.04.15
P A Jenks	Non Executive Director	03.01.51	27.03.12
L R McManus	Non Executive Director	17.06.68	01.09.17
*K R Wint	Chief Of Staff	02.05.65	01.12.12

(*executive directors)

The Society's executive director service contracts can be terminated on twelve months' notice by either the Society or the director.

Documents may be served on the above named directors at: c/o Deloitte LLP (Ref DH), 1 City Square, Leeds LS1 2AL.

1. On 1 October 2019 Mr Ashton inadvertently ceased to hold a shareholding with the Society of not less than £1,000, as required by the Society's Rules. This meant that technically Mr Ashton's directorship ceased with effect from that date. As soon as possible, once this error was identified, Mr Ashton opened a new savings account with the Society on 2 January 2020 with the required balance and was re-appointed as a director by the Society's Board on 13 January 2020. The Board is satisfied that during the period from 1 October 2019 to the date of his re-appointment to the Board, Mr Ashton continued to fully perform his role and responsibilities to the Society.

Year ended
31 December 2019 **Continued**

Details of directors' other directorships and appointments

R J Ashton	Shawbrook Bank Ltd Shawbrook Group plc Domestic & General Ltd
A M Barnes	Globaldata plc Old Mutual Wealth Ltd Old Mutual Wealth Life & Pensions Ltd
I C A Cornish	St James's Place plc St James's Place UK plc MacMillan Cancer Support
*R G Fearon	Member of the Business in the Community (BITC) (Yorkshire and Humber Advisory Board) Member of the UK Finance Ltd - Mortgage Product and Service Board Committee
D Fisher	Pollen Street Secured Lending plc
*A J Greenwood	None
G J Hoskin	The British Diabetic Association Diabetes UK Services Ltd Saga plc Acromas Insurance Company Ltd
J A Hunt	None
P A Jenks	Recognise Financial Services Ltd
L McManus	Doggy Day Care Academy Ltd Kane LMMG Ltd
*K R Wint	None

Executive Committee members

Name	Occupation	Directorships/Other Appointments
A P Conroy	Chief Financial Officer	Trustee of the Saltmine Trust
K J Green	Chief Customer Officer	Leeds Federated Housing Association
R Howse	Chief Operating Officer	None
N Marsh	Chief Digital Officer	Trustee of the Point of Care Foundation
A R A Moody	Chief Commercial Officer	None
N Young	Chief Transformation Officer	None

(*also Executive Committee members in 2019)

Country by Country Reporting

Year ended
31 December 2019

Leeds Building Society provides disclosures below in accordance with the Capital Requirements (Country by Country Reporting) Regulations 2013. The information below has been audited in accordance with the standards required by Directive 2006/43/EC.

Nature and location of the Group's activities
Leeds Building Society is the UK's fifth largest building society with 54 branches (2018: 55), total assets of £20.8bn (2018: £19.4bn) and 797,000 members (2018: 804,000).

The Society's subsidiary undertakings, their country of incorporation and their principal activities are detailed in note 15 on page 147. The Society and its subsidiaries are all tax resident in the United Kingdom.

The Society closed its branch in Gibraltar on 29 November 2019. This branch was controlled from the UK and formed part of the results of Leeds Building Society and was subject to taxation in the UK. Additionally, it was classified locally as a regulatory branch for which a corporate tax return was submitted and tax paid in Gibraltar. The Society has retained its Gibraltar mortgage book which is administered from the UK. Income from these mortgages is subject to taxation in the UK and also, under current arrangements between the two countries, in Gibraltar.

The Society also has mortgages with UK customers in Spain but has no physical presence or regulatory branch. The results from this activity are included in the results of Leeds Building Society and subject to taxation in the UK.

Results by country
The information for the year ended 31 December 2019 presented below is at a full Group level of consolidation, which has been prepared under IFRS. Total income is defined as net interest income plus fees and commissions receivable (net of fees and commissions payable), fair value gains less losses from financial instruments, together with all other components of operating income. Average monthly number of employees is shown on a full time equivalent basis. Staff costs comprise wages and salaries, social security costs and other pension costs.

Total income, profit before tax and corporation tax charge are as disclosed in the Group's Income Statement on page 122. Total staff costs are as disclosed in note 6 on page 139. Corporation tax paid represents the total payments as reported in the Statement of Cash Flows on page 126.

2019	UK*	Spain	Total	*UK includes Gibraltar*
Total income (£m)	188.8	0.5	189.3	*0.7*
Profit before tax (£m)	90.6	(2.6)	88.0	*0.3*
Total assets (£m)	20,739.2	68.6	20,807.8	*17.5*
Total assets less liabilities (£m)	1,017.5	68.6	1,086.1	*15.1*
Average number of FTEs	1,303	–	1,303	*4*
Staff costs (£m)	60.8	–	60.8	*0.2*
Corporation tax charge (£m)	21.8	–	21.8	–
Corporation tax paid (£m)	24.6	–	24.6	–

Return on assets
The return on assets, calculated as profit before tax divided by mean total assets, was 0.50% (2018: 0.62%) for the year ended 31 December 2019.

Public subsidies received
The Group received no public subsidies in the year ended 31 December 2019.

Glossary of Terms

Year ended
31 December 2019

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. Included are details of Alternative Performance Measures (APMs) used within the Annual Report and Accounts, with an explanation of how the APM is calculated and a reconciliation to the closest equivalent statutory measure, as defined or specified under International Financial Reporting Standards.

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 one 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 (CET1) ratio
This is a regulatory ratio, calculated as the total of CET1 capital divided by Risk Weighted Assets (RWAs). CET1 capital is the highest quality form of capital and comprises general reserves from retained profits, less the book values of any pension surplus, goodwill and intangible assets and other regulatory adjustments as defined under CRD IV.

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
An APM, the cost to income ratio is a measure of the efficiency of the Society by measuring costs in relation to income generation. It is calculated as management expenses (see below) divided by total income, as recorded in the Income Statement. There is no equivalent statutory measure, but all elements of the calculation are statutory measures.

Cost to mean asset ratio
The cost to mean asset ratio is an APM, and is another measure of the efficiency of the Society by measuring costs in relation to the value of assets. It is calculated as management expenses divided by mean total assets. There is no equivalent statutory measure, although all elements of the calculation are statutory measures.

Covered bonds
Debt securities backed by a portfolio of mortgages that is segregated from the issuer's other 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.

Default
IFRS 9 classifies an account in default if one of the following events occurs:

- the account is more than 90 days past due;
- the account is subject to certain forbearance activity;
- the account is in possession; or
- the customer has been identified as being bankrupt and is in arrears by more than a nominal amount.

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 foreign currency risk.

Effective interest rate method (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.

Expected loss
A calculation to estimate potential losses on current exposures due to potential defaults in the next 12 months; the term is used in relation to exposures modelled under the Internal Ratings Based (IRB) approach and is derived from the multiplication of the PD, LGD and EAD.

Glossary of Terms

Exposure at default (EAD)
An estimate of the maximum loss that an entity might suffer if a borrower or other counterparty fails to meet their obligations at default.

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 less tangible and intangible assets.

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.

Gross (new) residential lending
This is an APM, and represents the total amount of new loans and advances to customers secured on residential property advanced by the Society in the year. There is no equivalent statutory measure.

Impaired loans (credit impaired)
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.

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 number of stressed scenarios.

Internal Liquidity Adequacy Assessment Process (ILAAP)
The Group's own internal assessment of the level of liquidity that it needs to hold in respect of regulatory liquidity requirements in relation to a number of stressed scenarios.

Internal Ratings Based (IRB) Approach
An approach for measuring exposure to credit risk which is more sophisticated than the Standardised Approach, where an entity can calculate its own risk weights for certain assets. IRB approaches can only be used with the permission of the Prudential Regulation Authority.

International Swaps and Derivatives Association (ISDA) master agreement
A standardised contract developed by ISDA and used to enter into bilateral derivative 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.

Leverage ratio
A regulatory ratio which measures the value of the Society's Tier 1 capital as a proportion of total relevant non-risk weighted assets. The CRR leverage ratio is defined by the EU's Capital Requirements Regulation, while the UK leverage ratio modifies this ratio to exclude Central Bank reserves.

LIBOR
The average interest rate estimated by lending banks in London that the average lending bank would be charged if borrowing from other banks.

Liquid assets
Assets which are either in the form of cash or are readily convertible into cash. 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.

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)).

Glossary of Terms

Year ended
31 December 2019 **Continued**

Loans past due/past due loans
Loans are past due when a counterparty has failed to make a payment when contractually due.

Loss given default (LGD)
A parameter used in relation to credit risk exposures modelled under the IRB approach; an estimate of the difference between the EAD and the net amount recovered, expressed as a percentage of the EAD.

Management expenses
Management expenses represent the aggregate of administrative expenses, depreciation and amortisation as recorded in the Income Statement.

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.

Minimum Requirements for Own Funds and Eligible Liabilities (MREL)
MREL is the total loss absorbing capital a financial institution must hold to facilitate the recapitalisation of the institution in resolution.

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. This is the same as net interest receivable in the Income Statement.

Net interest margin
An APM calculated as net interest income, divided by mean total assets. There is no equivalent statutory measure, although the APM is fully derived from statutory measures.

Net Promoter Score®
The Net Promoter Score® is a measure of customer loyalty to the Group.

Net residential lending
This is an APM which represents the increase in the size of the residential mortgage book during the year. It is calculated as gross residential lending, less redemptions, contractual repayments and other capital repayments. The closest statutory measure is the movement in loans fully secured on residential property in the Statement of Financial Position. The main reconciling items to the statutory measure are the movements in impairment losses and EIR adjustments.

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 in the future.

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.

Probability of default (PD)
An estimate of the likelihood a borrower will not be able to meet their debt obligations as they fall due.

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.

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.

Repurchase agreements (Repo)
A repurchase agreement 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 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.

Risk Weighted Assets (RWAs)
A regulatory measure which adjusts the value of assets as recorded in the Statement of Financial Position to reflect the relative level of risk. This measure is used in calculating regulatory capital requirements.

Glossary of Terms

Year ended
31 December 2019 **Continued**

Securitisation
The process in which the parent company sells a group of mortgages to a special purpose vehicle (SPV). The SPV then uses the mortgages to issue mortgage backed securities in the form of class A and Z notes.

Shares
Money deposited by a person in a retail savings account with the Group. Such funds are recorded as liabilities for the Group.

Shares and borrowings
This 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 proportion of its risk weighted assets.

SONIA
The risk free rate calculated as the weighted average overnight deposit rate for each business day.

Sovereign debt
Bonds issued by a national government. Historically sovereign debt has been viewed as less risky than other forms of debt issued.

Subscribed capital
Debt securities issued by the Group which have certain terms and conditions attached relating to the payment of interest and principal such that they are treated as capital.

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 is defined above, while other Tier 1 capital includes qualifying capital instruments such as PIBS.

Tier 2 capital
A further component of regulatory and financial capital as defined by CRD IV which for the Society is represented by certain impairment provisions.

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.

Get in touch

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www.leedsbuildingsociety.co.uk/branch

Leeds Building Society