THE FAMILY BUILDING SOCIETY

ANNUAL REPORT & ACCOUNTS 2017

Your future is our business

ncbs national counties building society

CONTENTS

All the case studies included in this document are real life examples although some of the customers involved do not want their photos or identities disclosed. Models and fictitious names have been used instead.

FIRST CHOICE

OUR MISSION IS TO BE THE FIRST CHOICE FOR FAMILIES' MORTGAGES AND SAVINGS. WE BELIEVE THAT FAMILIES WHO WORK TOGETHER ACROSS THE GENERATIONS DESERVE SAVINGS AND MORTGAGE CHOICES THAT ARE BACKED BY EXCELLENT, PERSONAL SERVICE AND INNOVATIVE PRODUCTS.

That's why we are particularly pleased that some of the UK's leading mortgage and savings publications and websites have recognised our efforts across 2017.

At the ***What Mortgage*** Awards in July 2017 the Society was voted the 'Best Guarantor/Assisted Mortgage Lender', and was highly commended in the 'Best Lender Website' and 'Best Offset Mortgage Lender' categories.

In November 2017, the leading mortgage trade magazine ***Mortgage Finance Gazette*** and its panel of leading industry figures awarded the Society the award for 'Product Innovation – Medium to Large Lenders' for our Retirement Lifestyle Booster.

In addition, in May 2017 the Society was voted 'Highly Commended' by a panel of mortgage brokers in the 'Best lender for first time buyers (with family support)' category in the ***Moneywise Mortgage Awards 2017*** for the Family Mortgage.

Finally in June 2017, the UK's leading provider of savings account data, ***Moneyfacts*** awarded the Society 'Commended' in the 'Best Building Society Savings Provider' category.

CHAIRMAN'S STATEMENT

RODGER HUGHES

YOUR SOCIETY WAS THE FASTEST GROWING BUILDING SOCIETY IN THE UK IN 2016 WITH A 15% INCREASE IN THE GROUP MORTGAGE BOOK. IN 2017 WE CONTINUED TO GAIN MARKET SHARE, GROWING THE GROUP MORTGAGE BOOK BY A FURTHER 12%. AT 31 DECEMBER TOTAL ASSETS EXCEEDED £2BN – A LANDMARK MOMENT FOR THE SOCIETY.

+67%

£6.0m

2016: £3.6m

GROUP PROFIT BEFORE TAX

-49%

£3.0m

2016: £5.9m

*UNDERLYING GROUP PROFIT BEFORE TAX

+3%

£121.3m

2016: £116.5m

RESERVES

+8%

£2,022m

2016: £1,865m

TOTAL ASSETS

STRATEGY

This growth has been achieved in an extremely competitive market thanks to consistent focus on a clear strategy. I summarised that strategy in my report last year as "to grow the Society to gain economies of scale while staying true to our mutual culture and values and not taking unnecessary risks." We are doing this by delivering innovative and flexible products that meet the needs of today's families across the generations. This includes identifying potential borrowers who are not well served by standard products in the mass market e.g. older or self-employed people, and developing products tailored to their particular needs.

A continuing rise in the customer satisfaction survey score over the past three years to 92.2% in 2017.

THE BOARD

Chris Fry, our Finance Director, will be retiring at the AGM and I would like to take this opportunity to thank him for his outstanding contribution to the Society. His careful stewardship of our finances and treasury management and thoughtful and forthright contributions to the Board's deliberations will be missed. The recruitment process for a new finance director is well under way.

The Board's primary role is to provide, on behalf of members, oversight of management's implementation of the agreed strategy. In doing so we pay particular attention to the following:

TREATING MEMBERS (AND OTHER STAKEHOLDERS) FAIRLY

This is a core philosophy at the Society. We have continued to offer consistently good rates to savers, appearing often in Best Buy tables, and when the Bank of England increased rates by 0.25% recently we were scrupulous in passing the benefit on by reversing all the reductions made when the Bank last changed rates. Meanwhile our fair treatment of borrowers is evidenced by the growth in our loan book, range of innovative mortgage products and extremely low rate of arrears.

Our Retail Conduct Committee, which John Howard (Deputy Chairman) attends as a longstanding defender of consumer rights, specifically monitors Treating Customers Fairly. Staff have also been trained to identify and provide tailored treatment to vulnerable customers.

PROVIDING GREAT CUSTOMER SERVICE

Our customer satisfaction surveys show a continuing rise in the KPI score over the past three years from 87.5% in 2015 to 89.8% in 2016 and 92.2% in 2017. We also get a constant flow of positive feedback from members which is much appreciated by our staff. Our people are only human though so occasionally mistakes will be made (we receive less than one complaint a year per 1,000 accounts) and if so we seek to rectify them as soon as possible.

DRIVING INNOVATION

The Family Building Society is increasingly being recognised as the innovative building society. For the second year running it won the Mortgage

*See page 23 for definitions of underlying Group profit before tax.

Finance Gazette award for "Mortgage Product Innovation by Medium to Large lenders". In 2017 it was the Retirement Lifestyle Booster that achieved this recognition. We also won four other mortgage awards and a savings provider award. Staff are encouraged to come up with new ideas and we are constantly looking to develop new products or improve our systems to serve member needs.

MANAGING RISKS

In addition to the important work done by the Risk Committee (chaired by Fiona Crisp), before each Board meeting the non-executive directors sit down with the Chief Risk Officer to review current and potential risks.

While encouraging innovation we maintain a conservative risk appetite. As I noted in my report last year cyber risk is one area where we continue to be particularly vigilant.

▶ CUSTOMER COMMENT

"What I do want to say about Family Building Society is that everybody has been lovely. I like that it feels very personal, a little like banking was decades ago, but with the speed that everybody demands in today's market."

GROWING CAPITAL RESERVES

For a society of our size profits are the only source of capital to support future growth and so we are constantly seeking profitable new niches in our markets. For example, in 2017 we started to offer mortgages in Guernsey, albeit on a limited scale.

In 2017 we increased our reserves by £4.7 million to £121.3 million and so remain well capitalised.

CONTROLLING COSTS

Tight control has to be exercised over costs so we can both generate profits and invest in the systems necessary to support future growth. Administrative expenses increased by 10.5% in 2017, slightly less than the growth in the loan book, but the Group's cost/income ratio increased from 69% to 72%. This reflects the significant investment in staff, distribution and systems made in the year.

COMPLYING WITH REGULATIONS

Compliance with the extensive regulations that apply to the Society generates a huge volume of work for Society staff (and a lot of paperwork for the Board). While some does seem disproportionate we recognise that its overall purpose is beneficial and always seek to comply fully.

DEVELOPING OUR PEOPLE

We continue to support our staff through an extensive range of training courses and professional studies covering technical skills, regulatory compliance and commercial awareness. Close attention is paid to succession planning and we seek to develop key talent so they may grow to provide our leaders in the future. Our staff have adapted really well to the recent fast rate of change in technology and regulation. And yes, we also ensure that Board members continue their own education.

MAINTAINING THE "RIGHT" CULTURE

This underpins everything and we interpret "right" as a culture that preserves a strong mutual ethos and encourages behaviours that support all of the points above. The development of the Family Building Society brand has injected real dynamism to the organisation while retaining our longstanding core values. A specific review of culture was conducted by the HR department during 2017 and identified a number of themes which will be pursued further in 2018.

Any culture is the sum of the behaviours of the people who work in an organisation and the critical test is how it is perceived day in, day out, by those who have dealings with that organisation. That means you, our members. And the feedback you gave us was overwhelmingly positive in 2017. So I hope you will allow me on your behalf to thank our staff for the great job they did last year.

I look forward to meeting those of you who can make it at our AGM and to another successful year for your Society in 2018.

Rodger Hughes Chairman
28 February 2018

SAVINGS CASE STUDY

Simon

SIMON (62)

RETIRED

Posed by a model

"It's just incredible."

"Sometimes you just have to take a gamble in life and I've been unbelievably lucky."

With interest rates currently so low, people are looking at different ways to make the most of their savings aside from traditional savings accounts. And this is exactly what Simon was looking to do after receiving an inheritance.

Having seen an advert for the Windfall Bond and some write ups in the newspaper, Simon was intrigued by the savings account. The Windfall Bond offered Simon a safe place to put his savings in an account that earned interest at the Bank of England Bank Rate and also had an opportunity to win one of 13 prizes up to £50,000 each month.

After doing his own research and comparing with other products, Simon decided to open two Windfall Bonds with the Family Building Society.

"Interest rates at the moment are so low and, although the interest rate with the Windfall Bond is the Bank Rate, the opportunity if you had a win of say, £1,000, in the first year is effectively a 10% return or if it's in two years that's roughly 5%. With Premium Bonds there are so many stakes in the prizes you could win. I certainly didn't consider them at all."

Eight months after opening two Windfall Bonds, Simon received a phone call from the same person who talked him through opening his account to give him the good news – he had won £50,000.

"I've never won anything close to this before. My partner thought I was joking when I told her. It's just incredible, it really is."

Simon has already planned how he will spend the money:

"I've got one or two holidays lined up and I'm doing some work on the house. I do a fair bit of cycling so I'll upgrade my bike. And then I need to have some expensive dental work done which the winnings will go towards."

"I've already recommended the Windfall Bond to a friend. I think it's a product I would highly recommend, even if I hadn't won."

The Windfall Bond is a variable rate notice account that pays interest at the current Bank of England Bank Rate and offers a monthly prize draw* for the chance to win £1,000, £10,000 or £50,000. The chances of winning are 64 to one over your first 12 monthly draws as a bond holder.

*Terms and conditions apply.

For privacy reasons, the name in this case study has been changed.

CHIEF EXECUTIVE'S REVIEW

I AM PLEASED TO PRESENT THIS REVIEW OF THE GROUP'S ACTIVITIES DURING 2017. OVERALL, WE HAD ANOTHER GOOD YEAR.

MARK BOGARD

ECONOMIC, REGULATORY & POLITICAL BACKGROUND

First, I would like to set something of the background to our results. 2017 will go down as another "interesting" year. We ended it with a minority Government and no concrete idea yet as to what BREXIT will look like or what its real impact will be. The performance of the Opposition in the General Election may indicate a generational shift in our politics. Their manifesto is materially different from more recent Labour Governments. Whoever is in power, they need more of our money to do the things that they believe we want. Global geo-political uncertainty remains quite high. 2018 and beyond may hold more surprises. The range of possible outcomes is wide and we remain vigilant and cautious. The security of our depositors' money, and the rate of interest that we are able to pay, remain our primary concerns.

Against this background, the UK economy seems to be performing adequately.

The average first time buyer was 30, borrowing £138,000, at 3.6 times incomes, at a loan to value of 85%.

The Bank of England finally raised the Bank Base Rate on 2nd November 2017 to 0.5%, from its historic low of 0.25% which is what it was from August 2016, following the cut after the Brexit vote. Whilst this reflects the short-term price for money, longer term interest rates for 10, 20 and 30 years still remain at very low levels by historic standards. Incredibly, given all the events we saw, especially some return of inflation, the 30 year swap rate ended the year at 1.42%, just 1 basis point higher than it started the year. Rates have risen at the start of this year and, although markets may expect a further gradual rise in rates, they remain extremely difficult to predict. We saw ever lower mortgage rates for borrowers. However, it is possible that we have now seen the lowest rates for borrowers that we will see in this interest rate cycle or perhaps for the foreseeable future. The impact of low rates on savers has been exacerbated by two initiatives by the Bank of England to provide banks and building societies with additional cheap funding to help the economy. This material additional liquidity pumped into the system has pulled down savings rates in the market. The first of these, the Funding for Lending Scheme, is now closed for new drawings. The second however, the Term Funding Scheme, which makes four year funding available saw financial institutions draw £102.8 billion by 27 December 2017. Drawdowns on this scheme end in February. This should be good for deposit rates in time. For those taking the risk of investing in equities, the FTSE 100 share index hit new highs in 2017, but we have seen a return to greater volatility in early 2018. The fall in the Pound following the BREXIT vote has led to an increase in inflation. We have also seen an increase now in the oil price which is a further push on prices.

▶ CUSTOMER COMMENT

"I think you do a great job at doing the different interest rates that is why I came to you so I wouldn't have to change providers you just change the interest rates on my account."

Despite a lot of political focus and words, the ongoing structural imbalance between house building and demand does provide support for the housing market. However, confidence remains a key factor, together with mortgage affordability, which is a function of interest rates and wages.

Currently affordability remains surprisingly good. At the end of 2017, according to UK Finance, the average home-mover was 39, taking a loan of £175,000, at a multiple of 3.4 times income, at a loan to value on their home of around 72.5% and the mortgage was eating up 17.5% of their income. The average first time buyer was 30, borrowing £138,000, at 3.6 times income, at a loan to value of 85% and the mortgage was eating up 17.3% of their income. We are seeing estate agents struggle as transaction volumes have continued to decline and prices have certainly fallen in some areas of London. Over the country vendors are perhaps getting a dose of reality and dropping asking prices to achieve sales.

We continue to see current levels of Stamp Duty being a real factor in people not moving. Stamp duty is gumming up the market and providing a drag on the rest of the economy. Moving for a job, if you need an extra room for a new baby, or if you want to downsize, all mean paying what may be a significant sum. These seem odd things to tax. We did a study with the London School of Economics (available on our website) which shows that most stamp duty is paid by middle income earners rather than Russian oligarchs and that it is the second most important factor when older people consider downsizing. It is, of course, the easiest tax to avoid – you just don't move.

New regulatory initiatives continued in 2017. We understand why this is, but it inevitably drives up costs, which are always, in the end, paid for by the customers. So it is important that the benefits and the costs of each initiative are calculated and measured, especially as such costs are inevitably disproportionately larger for smaller organisations like us.

As well as being ever more regulated, the mortgage market is getting ever more competitive. We cannot compete with the largest players on price alone. This means we have to design products to meet specific client needs, whilst maintaining our underwriting standards and margin, and meeting the significant regulatory constraints that govern the overall shape of our mortgage book. We have to be both innovative and smart. We have not, as some have done, gone up the risk curve for example by doing higher loan to value, and/or higher loan to income loans, or offering mortgages to people who have had credit problems in the past. Not doing these things is a core part of the Society's

We are delighted to have received much positive press comment that often belies our size.

strategy. We are pleased that we have continued to win awards for our products.

Overall our average loan to value last year was less than 45%, which is a comfort both to the borrowers and the Society – we do not want to see borrowers overstretched or facing negative equity. We do not do lending above 80% loan to value (LTV), indeed we do not do much business above a 65% LTV. The exception is our Family Mortgages where we lend at up to 95% LTV but where the Society benefits from security offered by the borrower's family members which reduces the Society's exposure to 80% maximum.

We are particularly cautious about the background environment for 2018 and beyond. Whatever happens, we will continue to do the best that we can in balancing the interests of our depositors and our borrowers, whilst building for a long-term future.

▶ CUSTOMER COMMENT

"The application was easy and setup was fast. I received a telephone call to clarify the application. The person I spoke with was polite and helpful. No "computer says no" attitude which is refreshing."

WHO WE ARE

We launched the Family Building Society brand nearly four years ago now.

It has struck a chord for people with how we live today.

We believe that families who work together across the generations, to make the most of their money, welcome having their specific needs met with innovative, value for money products backed by excellent, personal service.

We are, however, very mindful of our need, and our obligation, to continue to serve existing National Counties' customers. We are gradually transferring them to Family Building Society products as they see fit.

We are delighted to have received much positive press comment that often belies our size. At the heart of this is that we treat people as individuals. Young or old, we look at your individual circumstances; we want to know and understand you. The biggest providers, whatever their intentions, just can't. They are driven too much by the volumes that they must achieve to keep their large operations going.

We generally get a hugely positive reaction from people. Our biggest issue remains that many have not heard of us and what we do. When we have the opportunity to tell them, they are almost always pleasantly surprised.

We do everything that we reasonably can to maintain our deposit rates. However we simply cannot buck the market. If we are even a little out of kilter with what others are paying, we would get engulfed in funds. Funds which we simply would not be able to lend out sensibly as mortgages. When we seek to attract new funds, we often offer a leading rate in the market. Though unlike some, we do not play the game of offering teaser rates in the hope that people forget to move their money once the tease is over. So, in a competitive market, we are pleased to have been able to offer existing and new members a good deal; yet we are constrained in what we can do for savers. The Society survives on the margin between the deposit rate we offer savers and the interest we can charge our mortgagors. That margin continues to tighten. It has come down over recent years and we have to maintain it – even although profits are not our focus, we must continue to build the Society's capital base to serve both existing and future customers. We seek to make a fair, sensible return which members understand and they are comfortable with.

We get most of our mortgage business via third party intermediaries. We have built a reputation with them for our underwriting process. We do not do this by computer, as our larger competitors do. In particular, we have built an expertise over many years of lending money to people in and into retirement. Provided older borrowers properly understand the issues they may face as they grow older – and we think that they should, having gone through our mortgage underwriting process – our experience is that they make good customers, almost without exception. Many also come to us through an independent mortgage adviser, who also has an obligation to explain the potential issues to them. Lending to older

We grew the Society's mortgage book by 16% in 2017.

borrowers has become something of a political issue over the last couple of years. Larger providers have talked about becoming more open to such customers – meanwhile we have just got on with what we have been doing for years and actually done it.

I'm pleased to report that our annual overall customer satisfaction survey result was the best ever.

We also monitor customer compliments, not just complaints (which our regulators require us to do), and the former are a multiple of the latter. We really would like to challenge the big banks to a complaints versus compliments competition over 2018 – we have yet to find a taker!

I would now like to turn to our financial performance in 2017.

OVERALL GROUP FINANCIAL PERFORMANCE

Group profit before tax in 2017 was £6.0 million, up on the previous year's figure of £3.6 million.

This is a good result, given a tough environment for our net margin across the year and because we have continued to invest in the infrastructure and staffing of the Society.

The Group's balance sheet was up at £2.02 billion. It took the Society from 1896 to 2006 to get to £1 billion and it has taken us 11 years to get to £2 billion. Now size for size's sake is not a sensible goal but scale is important to help us be able to meet the costs of IT, infrastructure and regulation and compliance. Our Common Equity Tier 1 capital ratio at 19.6% remains strong. The higher the capital the bigger the loss that can be sustained before the Society is unable to meet its liabilities.

▶ CUSTOMER COMMENT

"Many thanks for your email yesterday confirming that you had completed my remortgage with the Family Building Society. I would like to thank you very much indeed for your brilliant service. It has been an absolute delight dealing with FBS, and particularly with your good self Kathleen, if I may add."

RETAIL SAVINGS

Above all, we want to be a safe home for your savings and we retain one of the highest capital ratios in the industry.

We continue to run a strong liquidity position and, with an increased loan book and positive mortgage pipeline, we grew our member savings balances as well as taking more wholesale funding. In 2017, we opened nearly 15,000 new savings accounts, taking in around £300 million and paying back £275 million. This is obviously something of a merry-go-round; we would much rather retain our existing members' money. However, given that we are not running a branch based model, we naturally attract customers who are more sensitive to the best rates offered in the market for the time being. Given the current low rate environment, such customers have understandably become increasingly sensitive to smaller and smaller differences in rates. It is unfortunately not possible for us to pay our members the market leading rate the whole time.

MORTGAGES

We grew the Society's mortgage book by 16% in 2017 and further grew our market share.

The Society had a record level of mortgage applications at over £460 million. We had record levels of new mortgage business at £330 million, up 16.9% on last year. Net new mortgage lending was up £182 million. Total mortgage lending in the Society after fair value adjustments ended the year at £1.45 billion and £1.57 billion in the Group. This continues our trend of growth, helping people get a home. This was the founding purpose of building societies.

The Society's prudent lending risk appetite is implemented through the individual assessment of loan applications by experienced underwriters and the success of the approach is demonstrated by the incidence of arrears remaining low. Whilst we observe responsible lending principles, so that borrowers should find their mortgages affordable, genuine difficulties can arise in relation to maintaining mortgage payments in adverse economic conditions or changes in personal circumstances. We offer borrowers forbearance

MORTGAGES CASE STUDY

Rod & Susan

ROD (72) & SUSAN (70)

RETIRED, MARRIED

"You're doing it right"

Being of retirement age can be a red flag to many mortgage providers, with some outright refusing to lend to people in their 70s and beyond. This was an unfortunate truth that Rod and his wife Susan discovered when they decided to move closer to the town centre, in Exmouth, Devon. Despite having a healthy income from pensions, their current lender was unable to grant them a mortgage because of their ages.

"Our income is fairly solid. We have a few pensions, so in that sense it was okay. It was just their policy: they have an upper age limit and that was it."

This was frustrating for Rod and Susan, who now faced the choice between finding another lender or not buying at all. It seemed silly to them that their current lender was prepared to continue their current mortgage until Rod was 104, but weren't able to consider them for a new one. So Rod took to the web and, after a few searches, found the Family Building Society.

"The question used to be 'can you afford this mortgage?' Frankly, if you have a reasonable pension, you should be considered."

Because of our flexible approach to borrowers' ages, we were able to look at the couple's income from pensions and recognised that they could afford a capital repayment mortgage with a reasonable term. We gave them a single point of contact to guide them through the whole process and, along the way, it became apparent that Rod and Susan could benefit from an Offset Mortgage.

An Offset Mortgage works by using your savings to reduce either the term of your mortgage or your monthly repayments. As Rod and Susan's savings weren't earning very much in their current state, it made sense for the couple to use them to better advantage.

"With the interest rates on savings so low these days, it's effectively doubled the income we would get from savings."

Rod and Susan liked the personal approach to their case, where a single member of staff at the Family Building Society handled everything from start to finish. It was refreshing for them to see a financial institution work so closely with them.

"With the Family Building Society, because it's a smaller operation, it's much more personal. I quite like that."

With no more obstacles in their way, Rod and Susan moved into their new home, happy with the knowledge that a lender dealt with their circumstances with a bit of common sense. Not only did they manage to secure their mortgage, but along the way took advantage of an offer that helped them make the most of their savings.

Our goal is always to answer the telephone quickly – we all hate hanging on.

in accordance with our arrears policy and procedures which are compliant with regulatory guidance, best practice and the principles of Treating Customers Fairly (TCF). Reaching the best outcome for the customer is, though, dependent on borrowers making early contact with us and openly discussing their circumstances.

It is pleasing to report that only one residential property mortgaged to the Group had to be re-possessed during 2017 which was sold without loss. In the final analysis, most problems in banking are caused by lending money to people who are unable to repay it. This is why credit quality is so fundamental to the Society's security and its long-term future.

Our review of the arrears situation at the end of 2017 took the total of our provisions down to £1.2 million in the Society, equivalent to 0.09% of total balances outstanding. £0.4 million of this related to our small portfolio of commercial property, for example shops, which, as we have not sought any new business in this area since 2013, is in run-off, together with what is left of our historic development loans.

TREASURY OPERATIONS

The Society's overall funding last year remained largely stable. We were active in the wholesale money market and were pleased to take advantage of the relatively low interest rates on offer when compared with retail deposit rates. This activity is subject to careful management, with targets set for the mix of funding in terms of both source and duration and other limits set to ensure a prudential approach. It is pleasing that the Society's financial strength enabled it to raise more wholesale funding of varying maturities including some longer term funding on attractive terms.

Although the Society has not experienced any difficulties in raising funds throughout the different market conditions that have prevailed in recent years, we recognise the importance of maintaining a strong liquidity position at all times. The strengthened liquidity regime for deposit-taking financial institutions began being implemented in 2010, and continues to evolve and the Society's risk management framework is subject to a periodic review by the Prudential Regulation Authority. Central to this regime is the holding of a portfolio of high quality, readily realisable liquid assets, mainly UK Gilts and cash at the Bank of England, in order to provide a buffer in the event of any major funding issues arising for any reason. Alongside the holding of these assets, there is a requirement to prove their value at regular intervals, either through sale or use as collateral in sale and repurchase ('repo') transactions. In the course of such liquidity management operations, the Society achieved some gains on the sale of Gilts.

CUSTOMER SERVICES

Our guiding principles in relation to customer service, as set out in our corporate objectives, are consistently attractive and dependable products and convenient and personal service. We want to be modern, but with traditional values. So we offer online accounts, but we have experienced and well-trained people on the telephone in our Epsom office. We continue gradually and carefully upgrading and updating our systems. We hope to take some material steps forward in 2018. This pushed our cost income ratio up to 72% in 2017. This is not welcome but we do want to invest in our service to members. We continue to better manage the flow of calls that we receive from customers, potential customers and intermediaries. Our goal is always to answer the telephone quickly – we all hate hanging on. On those occasions where we cannot, we call people back promptly. We know that there is always more to do, including upgrading our websites. We are also working on increasing the pace at which we are able to make mortgage offers.

Consistent with the principles of TCF, we take care in the design of our products to ensure they will meet the needs of the customers for whom they are designed and we assess the impact of any new products on existing account holders. We do not reserve any of our products for new customers only and we notify our savers and borrowers of the products available to them upon expiry of special terms, such as fixed or discounted rates. Our websites are updated promptly and provide full details of our product range. In addition, there are a number of mailings undertaken each year which

I welcome this opportunity to acknowledge the commitment and industry of the Group's employees and to place on record my appreciation for all their efforts.

we use to keep customers advised generally of product and service developments.

We continue to put a lot of effort into understanding how best to deal with vulnerable customers, including additional staff training.

Feedback from customers is much appreciated, with positive comments reinforcing our actions, whilst any instances of unsatisfactory service cause us to investigate and determine improvements for the future. It is rare that complaints from our members are referred to the Financial Ombudsman Service (FOS), with just 6 cases arising in 2017 in the Group of which 4 were found in our favour, one against and one is outstanding.

SUBSIDIARY OPERATIONS

Counties Home Loan Management Limited is now the Society's only active subsidiary, although it has not acquired any new mortgages for some years. Its residual balances relate to past mortgage book acquisitions, including a portfolio of Lifetime Mortgages. As the books are in run-off and redemptions exceeded capitalised interest, the balances outstanding reduced during the year. It is funded by the Society.

PERSONNEL

2017 has been a very busy year again.

Across the Society, the people who answer calls, give customers advice, open and close accounts, underwrite the loans and process the business, manage the money, create innovative new products and produce our marketing materials, manage our risks, look after our staff, keep what we do legal and compliant, do the accounts and make sure that the office functions, have all dealt with more business than we ever have before. And, almost without exception, they have dealt with it to a high standard, at pace.

I welcome this opportunity to acknowledge the commitment and industry of the Group's employees and to place on record my appreciation for all their efforts. The compliments that we receive almost without exception name an individual.

2018 will be busy too. The Society recognises that its continued success depends significantly on the commitment, enthusiasm and professionalism of all of its staff and these attributes must be maintained through development during their careers with the Society, with financial support provided for those pursuing relevant professional study.

Unfortunately, we shall go into the rest of the year after the Annual General Meeting without Chris Fry, who has been the Finance Director here for the last 8 years. Chris joined the Society during a particularly difficult time for the financial services industry and at a time when the Society also faced some challenges. He has played a critical part in the Society coming through those challenges and members owe him a real debt of gratitude. We wish him a long and happy retirement, between the DIY and watching rugby.

His replacement is currently being recruited.

CORPORATE SOCIAL RESPONSIBILITY (CSR)

The Society has always recognised its community, marketplace, employer and environmental responsibilities.

We meet these responsibilities, almost instinctively, as a by-product of our mutual, customer owned status and business ethos, but they are also enshrined in a Board-approved CSR Policy Statement that encompasses all facets and provides a steer for the ongoing development of this important issue which is driven by a staff-led Committee.

Our activities in the community include support for selected charities, schools, clubs and voluntary organisations based locally to the Society's Head Office, including our local food bank. During 2017 we were pleased to participate in an Epsom-based business enterprise initiative, sponsoring the prize for the Best Business for Customer Service, a business competence we hold dear.

THE FUTURE

Looking forward, our strategy must remain live to dealing with the political, economic, competitive and regulatory issues and uncertainties that we all face and which, in significant part, continue to prescribe the Society's relationship with you, our members. Above all, we shall remain prudent and vigilant.

We continue to face the future with optimism. We are investing in that future. If we offer customers what they want – innovative products, that meet their needs sensibly, delivered efficiently but with old-fashioned customer service, we will continue to prosper.

Mark Bogard Chief Executive
28 February 2018

Prize winners for the Best Business for Customer Service

THE SOCIETY'S PRINCIPAL PURPOSE AND CORPORATE OBJECTIVE

THE SOCIETY'S PRINCIPAL PURPOSE IS TO MEET MEMBERS' REQUIREMENTS FOR RESIDENTIAL MORTGAGES AND SAVINGS ACCOUNTS.

THE SOCIETY'S PRIMARY OBJECTIVE IS TO MAXIMISE, FOR CURRENT AND FUTURE MEMBERS, THE LONG-TERM BENEFITS OF ITS OPERATIONS, THE KEY COMPONENTS OF THIS BEING:

- *Consistently attractive and dependable products*
- *Convenient and personal service*
- *Financially secure and efficient operations*

KEY PERFORMANCE INDICATORS

THE GROUP'S PROGRESS IS MONITORED BY THE BOARD USING A SET OF STRATEGIC KEY PERFORMANCE INDICATORS (KPI'S). THE OUTCOMES FOR THE KPIS ADOPTED DURING 2017, WITH COMPARISON AGAINST THE 2016 RESULTS, ARE REPORTED BELOW WITH EXPLANATORY COMMENT.

Group profit after tax to mean assets ratio: As a mutual organisation the Society does not seek to maximise profit in order to pay a dividend to external shareholders. Instead, the level of profit is managed to maintain its capital strength against possible losses and to provide the basis for future development. The Group profit after tax ratio in 2017 was 0.25% (2016: 0.17%).

Society net interest margin: This is the difference between the interest the Society receives on its loans less the interest it pays on its deposits. This needs to be large enough to allow a level of profit but not too high, in order to give members fair rates. In 2017, this remained at 1.1% (2016: 1.1%).

Society cost/income ratio: This ratio measures how efficient the Society is in terms of generating income from its cost base. For 2017 this was 72.2% (2016: 69.3%). This increase is a result of the Society's further investment in infrastructure, systems and additional staff in 2017.

Common Equity Tier 1 capital ratio: This ratio, which is widely used to compare credit institutions, takes into account the perceived risk within the Group's balance sheet due to its lending operations and liquidity investment holdings. Understandably, given the events of recent years, regulators and analysts are looking beyond simply the level of capital held, to its capacity to absorb losses and also the relative risks within an institution's operations. Virtually all the Group's capital is accumulated profits in its reserves which meet the definition of Common Equity Tier 1, the highest quality available. The ratio of this to the regulatory risk weighted assets was 19.6% in 2017 and, whilst a reduction on the 2016 level of 20.9% due to the increase in the Group's assets, it still continues to provide a very strong level of security for its members.

Movement in Group loan balances: 2017 saw a good, sensible level of growth in loan balances despite strong competition. The Group increased its loan balances by 14.4% (2016: 13.0%).

Group residential mortgages in arrears by more than three months as a percentage of all Group residential mortgage accounts: Our lending policy and underwriting processes are designed to ensure that our lending is responsible and affordable, but economic conditions and domestic situations inevitably give rise to some borrowers having difficulties maintaining their mortgage payments. It is pleasing that during 2017, the incidence of our borrowers incurring payment difficulties at the level of three months' payment or more remained very low at 0.3% (2016: 0.3%).

Number of complaints upheld in the year as a percentage of average number of Society members: This KPI tracks our service levels. In 2017 it was 0.13% (2016: 0.12%). We try to avoid any complaints, but inevitably some errors will be made. The percentage remains extremely low but we continue to work to remove any causes for complaint.

Percentage of members reporting good or better service in the annual customer survey: At 92.2% (2016: 89.8%) this shows that the Society is regarded by most members as giving consistently good service.

KEY PERFORMANCE INDICATORS	2017	2016
Group profit after tax to mean assets ratio	**0.25%**	0.17%
Society net interest margin	**1.1%**	1.1%
Society cost/income ratio	**72.2%**	69.3%
Common Equity Tier 1 capital ratio	**19.6%**	20.9%
Movement in Group loan balances*	**+14.4%**	+13.0%
Group residential mortgages in arrears by more than three months as a percentage of all Group residential mortgage accounts	**0.3%**	0.3%
Number of complaints upheld in the year as a percentage of average number of Society members	**0.13%**	0.12%
Percentage of members reporting good or better service in the annual customer survey	**92.2%**	89.8%

*Excludes fair value adjustments

STRATEGIC REPORT

THE STRATEGIC REPORT INCLUDES THE BUSINESS REVIEW AND OTHER INFORMATION ABOUT THE GROUP. IT IS INTENDED TO PROVIDE MEMBERS AND OTHER USERS OF THE ACCOUNTS WITH A STRAIGHTFORWARD REVIEW OF THE GROUP'S BUSINESS, ITS ENVIRONMENT AND ITS PERFORMANCE IN ADDITION TO THE COMMENTS IN THE CHAIRMAN'S STATEMENT AND CHIEF EXECUTIVE'S REVIEW.

WHAT WE DO

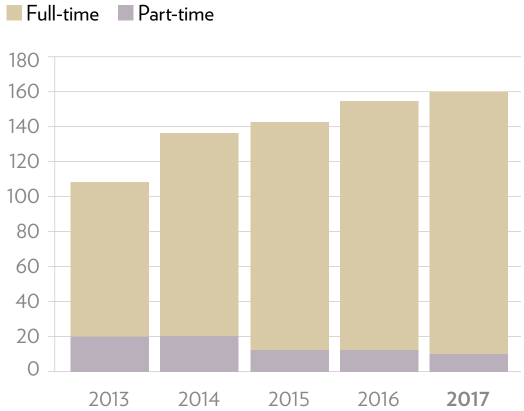
Essentially, the Society borrows money from members to provide them with a return on their savings and lends it out to other members in the form of mortgages to provide them with the finance to buy residential property mainly as their own home but also for some to rent out to provide homes. In doing this we try to balance the rate we pay to savers and the rate we charge borrowers to give a favourable outcome to both. The difference after costs is the profit. Although as a mutual organisation we do not have shareholders to whom we need to pay dividends, we need to make a profit to maintain a strong capital position for the security of members and to allow for growth. This is especially the case with increased regulatory capital requirements.

In addition to retail deposits, the Society takes deposits in the wholesale money markets as part of its Treasury operations. These help to reduce the overall cost of borrowing for the Society and diversify funding. In order to manage the various risks which are noted later in this report, the Society also transacts derivatives with major banks within the restrictions established by the regulators and Board.

The Society is regulated by law, in particular the Building Society Act 1986, and a number of bodies established by the Government. Our main regulator is the Prudential Regulatory Authority (PRA) and our conduct regulator is the Financial Conduct Authority (FCA), although we also have to comply with EU regulations. The amount of regulation and reporting, whether from a prudential or conduct and compliance viewpoint, is extensive and still increasing and this represents a significant cost to the Society.

In order to meet the regulatory requirements and keep up to date with technological and other developments so that we can provide members with the products and services they expect, the Society has invested heavily in upgrading its computer and telephone systems following a long period of underinvestment. Particularly in the last two years there has been significant expenditure on systems resilience and on measures to counter cyber attacks, an ever increasing threat to the Society. We are pleased that this has resulted in the Society being awarded Cyber Essentials accreditation status. This is a UK Government backed scheme, based on advice from the National Cyber Security Centre. Such certification requires an independent assessment to be carried out by a CREST accredited certification body to verify that the most important cyber security controls have been implemented. This is an area however where we need to be and are constantly vigilant. We have also been upgrading our on-line services and improving the efficiency of our processes throughout the business. This includes improvements in scalability but nevertheless investment in our staff is on-going with the average number employed increasing from 130 full time and 13 part time two years ago in 2015 to an average of 148 full time and 12 part time this year. Frequent staff training is given both internally and by external providers to give better service to members and ensure the Society demonstrates the right culture. This will continue into 2018 and beyond. Clearly this investment is expensive and has increased costs but the Board believe it is essential to the future of the Society and to improve service. Nevertheless overheads will remain tightly controlled.

SOCIETY AVERAGE STAFF NUMBERS



The Society tries to be innovative where it is sensible and fits with our business plan. We launched the Family Building Society (FBS) in July 2014 – the first new building society brand in over 30 years. A number of very successful new products have been launched through FBS including the Windfall Bond, the Market Tracker Saver and the Retirement Lifestyle Booster. Through FBS we have also been able to introduce members to other trusted service providers where they may meet their needs, for example with investment advice and insurance.

We continue to book record levels of new mortgage business.

The success of FBS resulted in the decision to make FBS the main brand for the Society from December 2016 onwards. It is important to note however that this Report & Accounts is still for the legal entity National Counties Building Society (NCBS), "the Society", because the legal name of the Society has not been changed. The results are for the Society's business whether that has been conducted under the NCBS or FBS brand; it is just that the branding has now been re-focussed on FBS. The Board is considering asking members to agree to change the Society's name to FBS but this would be a major project and no firm decision has yet been taken.

The Group results include Counties Home Loan Management Ltd which is a wholly owned subsidiary of the Society. It purchased a number of mortgage books in 2006-8 which are slowly running off and no further assets were purchased in 2017.

National Counties Financial Services Ltd has ceased trading and any future income receivable has been assigned to the Society. National Counties Estate Agents Ltd has been wound up.

ENVIRONMENT

Despite the fears of the Bank of England and economists generally following the Brexit vote, the economy has continued to grow at a reasonable rate, although recently not as fast as other major economies which are now beginning to recover from their poor economic performance since the financial crash. It remains to be seen whether the exchange rate fall, which has partly reversed now, will be overall beneficial to the UK or whether imported inflation and poor productivity, will prevent real wage growth and together with the impacts from leaving the EU and the effect of Trump's presidency on world trade will result in a worsening of or improvement in the UK economy.

In terms of the Society, the economic improvement saw the Bank of England, whilst continuing with large scale quantitative easing (QE), reverse its 2016 post-Brexit rate cut by increasing its base rate by 0.25% to 0.5%. This is still historically low but markets are forecasting, and the Bank has indicated, that further increases will follow in time. Your Society increased its savings rates as soon as possible after the base rate rise which has been positive for savers. Conversely we have had to increase the very low mortgage rates on offer in order to cover the higher borrowing costs. The Society believes that it offers more than just competitive rates for borrowers however and we continue to book record levels of new mortgage business.

The number of 'challenger banks' entering the market has continued to increase in 2017. This has further increased the level of competition in the savings and mortgage market with the major established banks wanting to maintain or increase their levels of mortgage business. This situation will continue into 2018 and together with interest rate changes will influence the Society's ability to grow its lending and maintain margins. In order to succeed regardless of the outcome however, the Society will continue to offer very high levels of service and establish new innovative products and services for our members.

KPI'S

The Board manages the Society and its business using many tools. One of these is the monitoring of Key Performance Indicators or KPIs. These are shown on page 16.

FINANCIAL PERFORMANCE

FRS 102

The Society was required by law to adopt either full International Financial Reporting Standards (IFRS) as adopted by the EU or FRS 102, the UK Standard, for the accounting period ended 31 December 2015 and subsequent years. The Society chose to adopt FRS 102. Although slightly less onerous than full IFRS, the adoption of IAS 39 on Financial Instruments is still required. This has a material effect on the accounting treatment of certain financial instruments. We are required to book these at their fair value which can have a significant impact on the results of the Society. We have chosen to adopt hedge accounting for many assets in order to reduce volatility in the profit of the Society and Group. The volatility however, cannot be eliminated entirely.

Growth in capital is important for the security and future growth of the Society.

PROFIT BEFORE TAX

Profit from the Group's activities is currently the only economic source of new capital. Growth in capital is important for the security and future growth of the Society. Despite the investments made in the year, the Group and Society both achieved improvements in profit levels. The Group's profit before tax for the year ended 31 December 2017 was £6.0 million compared with £3.6 million in 2016. This increase of £2.4 million reflects the improvement in net interest income by £1.4 million, a reduction of £2.3 million in the charge for derivative valuation and hedging adjustments booked under FRS 102 this year and reductions in the charges of £0.2 million for credit provisions and the Financial Services Compensation Scheme (FSCS) provision. In the Society, profit before tax also improved from £3.6 million in 2016 to £7.2 million in 2017.

	GROUP		
	2017	2016	Change
	£m	£m	£m
Net interest income	**21.3**	19.9	1.4
Other income/net losses from financial instruments	**(0.1)**	(2.4)	2.3
Management expenses	**(15.1)**	(13.6)	(1.5)
Impairment losses and provisions	**(0.1)**	(0.3)	0.2
Profit before tax	**6.0**	3.6	2.4

NET INTEREST INCOME

Net interest income is the amount of interest the Society receives less the interest it pays on its funding. It is the Society's main source of income. This increased by £1.4 million as lending increased. The pure lending income would have shown a larger increase, but the contribution from the gains from the management of the securities portfolio which is included in the net interest income, decreased in 2017 to £0.7 million from £3.4 million the year before.

In addition the underlying retail net interest margin came under pressure from the increasingly competitive mortgage market, and the regulatory requirement to maintain a minimum percentage of mortgages on an administered rate basis. Nevertheless income increased as a result of higher volume and the impact of reduced borrowing costs from the Bank of England's Term Funding Scheme (TFS), which replaced the previous Funding For Lending Scheme (FLS).

OTHER INCOME

Most of the fees received are now spread over the expected lives of the underlying asset or liability to which they relate under FRS 102. Net fees and commissions in 2017 were £0.2 million, in line with the previous year. Included is modest income from third party suppliers of services for referring our members to them when they have an interest in additional services not offered directly by the Society. Whilst improving, this income is proving harder to build than anticipated but we will continue with this strategy in order to benefit members.

NET GAINS AND LOSSES FROM FINANCIAL INSTRUMENTS

This category includes the movements in fair value of derivatives of a) derivatives that are not being accounted for as hedging underlying assets or liabilities b) the ineffectiveness under IAS 39 of any accounting hedges.

The former include: derivatives that are hedging the pipeline of mortgages that have yet to complete which although they are economically hedging the pipeline are not allowed to be hedge accounted until the underlying assets complete; swaps taken out to protect the Society from basis risk; and the movement in the valuation of the No Negative Equity Guarantee (NNEG) relating to the Lifetime Mortgages which is treated as an embedded derivative.

The main hedge ineffectiveness comes from the Lifetime Mortgage portfolio. Due to the value of the portfolio even small levels of ineffectiveness can cause relatively large movements in the valuation concerned. The hedging models for the main residential mortgage book, gilt asset swaps and the remains of the commercial lending book also cause some volatility.

Both the Society's and CHLM's lending includes portfolios of Lifetime Mortgages whose terms include a NNEG. Under IAS 39, this is treated as an embedded derivative and separately valued. In effect the value represents a provision against expected losses from the Lifetime Mortgages where the future value of the loan may exceed the sales proceeds from the property and so no separate provision is appropriate. The accounting standard, however, requires this to be included in derivative financial instruments on the balance sheet rather than provisions and movements in its value shown in net gains and losses from financial instruments in the Income Statement. The value of the NNEG is £2.3 million in the Society and £5.6 million in the Group (2016: £0.8 million and £2.4 million) and the Group charge for 2017 was £3.2 million (2016: £0.5 million).

MANAGEMENT EXPENSES

Management expenses include staff costs and other operating overheads plus the charge for depreciation of fixed and intangible assets. As noted elsewhere, the Group has continued to invest heavily in upgrading its technology and increasing staff numbers and training.

The investment in systems is clearly seen in the Group's depreciation charge which has increased by £0.1 million in 2017 compared with 2016 and the purchases of equipment and intangible assets. Along with this investment, the additional staff costs and continuing to invest in building the FBS brand, particularly in advertising and PR, have seen the Group's overall administration costs including depreciation increase by £1.3 million in 2017 but are subject to tight controls.

IMPAIRMENT LOSSES AND PROVISIONS

	GROUP		
	2017 £m	2016 £m	Change £m
Residential loan impairment provisions	**(0.2)**	0.3	(0.5)
Commercial and other loan impairment provisions	**0.1**	(0.3)	0.4
Loan impairment provisions	**(0.1)**	0.0	(0.1)
FSCS levy provision	**0.0**	(0.3)	0.3
Total impairments and provisions	**(0.1)**	(0.3)	0.2

The Society continues to experience low levels of impairment and arrears on its residential book.

RESIDENTIAL LOAN IMPAIRMENT AND PROVISIONS

The Society continues to experience low levels of impairment and arrears on its residential book as a result of its stringent lending policies and individual underwriting rather than computer scoring methodologies. Its subsidiary CHLM also has low levels of arrears and losses on the residential loan books it purchased.

For the individual impairment provisions against residential loans without a NNEG, 2017 saw a charge of £0.2 million (2016: write back of £0.4 million) and the collective provision charge was £24,000 (2016: £67,000). The total Group impairment provisions at the year end amounted to £1.5 million (2016: £3.7 million). This decrease in provisions reflects the reduction in the commercial loan book, quality of the portfolio and borrowers' house price increases.

LOAN FORBEARANCE AND ARREARS

At year end 2017, the Society had 53 accounts with balances totalling £7.0 million (2016: 62 accounts totalling £9.1 million) subject to forbearance against which provisions of £nil million (2016: £0.7 million) had been made. At the Group level, 62 accounts with balances of £8.2 million (2016: 71 accounts totalling £11.3 million) had been subject to forbearance, with provisions against them totalling £0.1 million (2016: £1.8 million).

In terms of accounts in arrears by more than 12 months, the Group had thirteen such accounts at 31 December 2017 (2016: ten) with balances of £2.1 million (2016: £2.0 million) and very low arrears of £0.1 million (2016: £1.0 million).

COMMERCIAL AND OTHER IMPAIRMENT LOSSES AND PROVISIONS

In the past the Society originated a commercial loan book secured on property which has been in run-off for several years. One of these loans is in arrears and some have impairment provisions. The Group impairment credit for 2017 was £0.1 million (2016: charge of £0.4 million).

In addition, the Society has some commercial property loans that it acquired from Hampshire Trust prior to its sale which no longer have a material book value as they have been in run-off and substantial losses have been booked in previous years. Similarly the ex-Hampshire Trust solicitors' practice funding portfolio has been fully run off and been written off in the year. There was a £0.1m credit from these portfolios in 2017 (2016: £0.1 million charge).

Where management believe there is no realistic prospect of recovering any more of the debts, the loans and provisions have now been written out of the books.

FSCS LEVY

The Financial Services Compensation Scheme (FSCS) provides eligible savers with insurance against the failure of financial institutions up to a maximum level during 2017 of £85,000 per institution. The FSCS charges deposit-taking financial institutions levies based on their level of eligible deposits. The levies cover the administrative costs of the FSCS, shortfalls on the recovery of the loans of failed institutions and the cost of interest paid on loans supporting the compensation paid out to depositors until recoveries are made. More detail is given in Note 28 to the Annual Accounts. The charge has been decreasing in recent years as recoveries have been made from the assets of institutions that failed in the financial crisis. The charge for 2017 was £14,000 (2016: £287,000).

TAXATION

The Group corporation tax expense of £1.2 million (2016: £0.7 million) represents an effective rate of 19.4% (2016: 20.2%). There are special tax provisions for the treatment of the FRS 102 transition and subsequent adjustments and pension payments which affect the timing of the amount of tax payable. Further detail is provided in Notes 11 and 12 to the Annual Accounts.

▶ CUSTOMER COMMENT

“Impressive level of personal service, the process was a transfer of an existing ISA with the potential to be complex, but it was quick and entirely pain-free. Staff were courteous, friendly and efficient, and the whole process felt very professional.”

UNDERLYING PROFIT

The statutory figures included in the Annual Accounts are prepared under FRS 102 and include the impact of fair valuing derivatives and ‘ineffectiveness’ when accounting for the hedges the Society takes out to economically protect itself from movements in interest and other market rates. These create profit volatility, for example from movements in market interest rates. An exception to this is the NNEG valuation change. This is because it is in effect a credit provision and the Board believes it should be included in Underlying profit as are all other credit provisions.

The Board also believes it appropriate to remove the effect of the charge for the Financial Services Compensation Scheme. This charge is a cost for the failures of other financial institutions, not our performance, and removing it is in keeping with many other larger societies. It is immaterial for 2017.

The Board believes it is appropriate to remove the effect of these adjustments when looking at the underlying performance of the Society and Group. This year the NNEG charge which is valued as a derivative and continues to suffer from low interest rates, has been larger than in the past. Although partly offset at the total profit before tax level by the positive revaluation of other derivatives, when excluded from Underlying profit this results in a fall of £2.9m.

The Group’s underlying profit can therefore be summarised as follows:

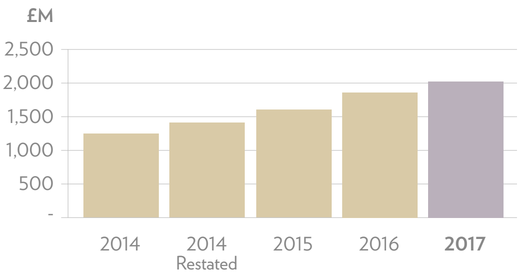
	GROUP		
	2017	2016	Change
	£m	£m	£m
Profit before tax per statutory accounts	**6.0**	3.6	2.4
Add back FRS 102 valuation and hedging adjustments	**(3.0)**	2.0	(5.0)
Add back FSCS charge	**0.0**	0.3	(0.3)
Underlying profit before tax	**3.0**	5.9	(2.9)

BALANCE SHEET

TOTAL BALANCE SHEET

The Group balance sheet increased in the year by 8.4%, which resulted in total assets of over £2.02 billion for the first time (2016: £1.87 billion) in the Society's history. The recent growth is shown below.

GROUP TOTAL ASSETS



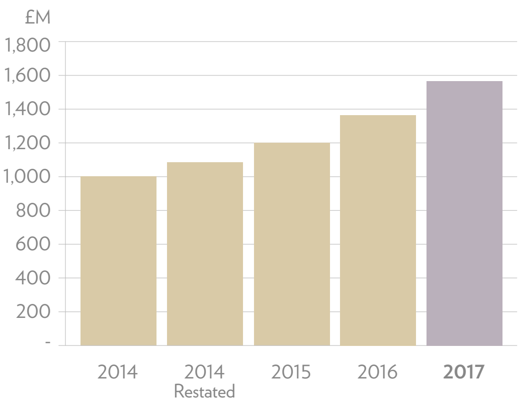
Restated 2014 figures are amended for the effects of FRS 102.

RESIDENTIAL LENDING

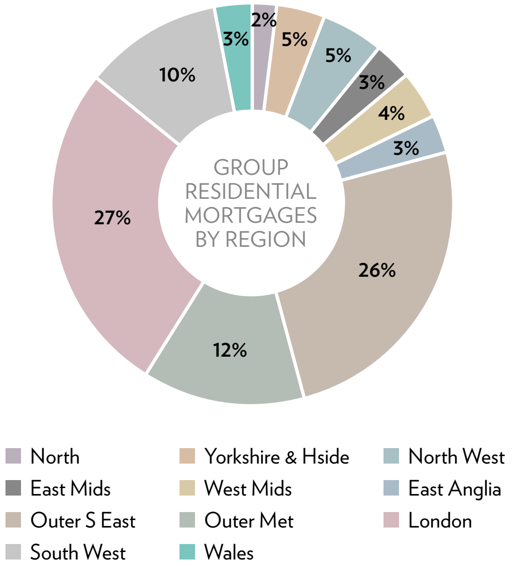
Total Group lending fully secured on residential property (FSRP) as at 31 December 2017 before fair value adjustments was £1.41 billion (2016: £1.22 billion). Including the fair value adjustments from hedging, the figure was £1.55 billion (2016: £1.37 billion).This represents a growth rate of 13.1% in 2017 (2016: 15.1%).

This was achieved by the continuation of the Society's strategy of individually underwriting mortgages and providing innovative products and marketing this effectively to bring in new business and combining this with strong levels of retention of existing borrowers i.e. who remain with the Society when their initial product term expires. This strong growth was despite the very fierce market competition described above.

GROUP RESIDENTIAL MORTGAGES

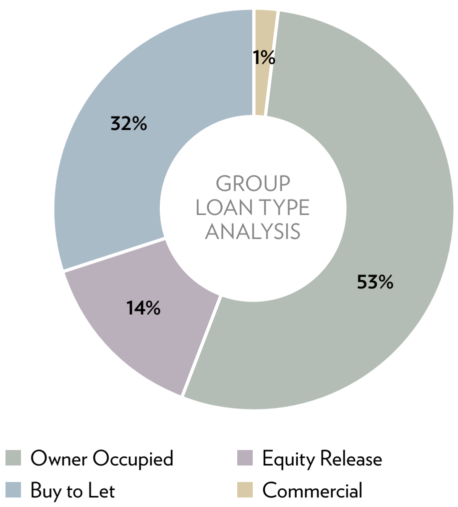


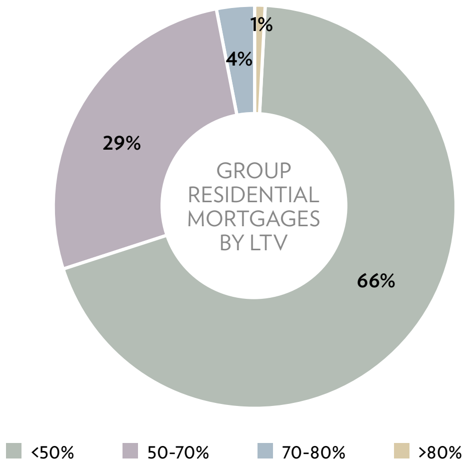
Restated 2014 figures are amended for the effects of FRS 102.



The Society's residential portfolio by geographic region is shown in the diagram above. Although the Society lends throughout England and Wales, there is a concentration towards the South East of England. The Society does not lend overseas, except to Guernsey.

The Society's residential lending is mainly to prime owner occupiers. We also lend to customers to fund Buy to Let properties. As with all the Society's lending, this is underwritten on an individual loan basis. The loan books that were purchased by our CHLM subsidiary are a mixture of Lifetime, Owner Occupied and Buy to Let mortgages.





The Society does obtain direct business and is able to advise customers when choosing a mortgage. The vast majority of lending however is sourced from mortgage intermediaries. The Society has traditionally had a conservative risk policy and has not sought to increase the level of risk in recent years in order to counter increased competition and to grow. This applies to both income cover levels and loan to value (LTV) levels. Clearly over time the value of some properties has decreased, which can lead to LTVs increasing on an indexed basis. The chart above shows the breakdown of LTV levels on the Society's residential mortgage book.

OTHER CUSTOMER LENDING

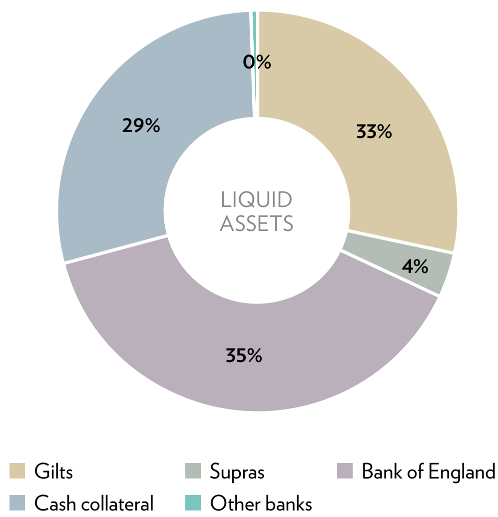
The Society does not carry out new commercial lending. It does, however, have a legacy book of loans secured on commercial property which is now in run-off and includes some loans transferred from Hampshire Trust, a former subsidiary, before its sale. The net balance on these loans before fair value adjustments has reduced from £17.6 million at the end of 2016 to £11.2 million this year.

LIQUID ASSETS

The Society maintains a portfolio of liquid assets in order to manage its liquidity risk in accordance with the Board's risk appetite and regulatory requirements. These assets are invested very conservatively and are available to meet the Society's payment obligations as they fall due.

The regulatory requirements for liquidity have been evolving since the financial crash and, under CRD IV, the current key measure introduced in 2015 is the Liquidity Coverage Ratio (LCR). The Society's LCR at 31 December 2017 was 146% (2016: 179%) significantly above the regulatory minimum of 100%.

Total liquid assets at 31 December 2017 held by the Group were £445.7 million (2016: £462.9 million) and represented 22.0% (2016: 24.8%) of the balance sheet. As can be seen from the chart below, the assets are mainly held as cash deposited at the Bank of England and cash collateral supporting derivative transactions, UK Government debt (Gilts) and securities issued by AAA rated European multilateral development banks ('Supras') e.g. the European Investment Bank.

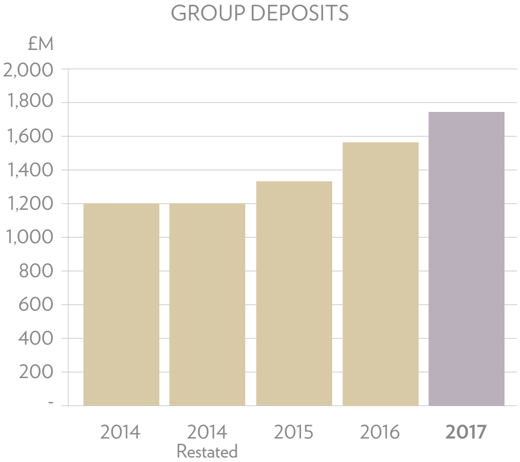


▶ CUSTOMER COMMENT

"Have dealt with larger Financial Institutions before but service much better from initial phone call to speed of processing application. Great to put my money in a Building Society having used to work for one myself prior to going plc."

DEPOSIT BASE

The Society's traditional funding base consists of retail deposits from its members and wholesale deposits from the money markets mainly via brokers. The Society has not issued any covered bonds or securitised bonds. The Society also uses Bank of England facilities such as the Funding for Lending Scheme (FLS) and Indexed Long-Term Repo (ILTR) for funding when appropriate. The Society has accessed the Bank's new Term Funding Scheme (TFS) in 2017. Access to these facilities also provides contingent liquidity for the Society. The growth in the deposit base is shown in the graph below.



Restated 2014 figures are amended for the effects of FRS 102.

This illustrates the success of the Society in attempting to offer consistently competitive rates on its savings accounts, bonds and ISAs, even in the current very low interest rate environment. The use of innovative products such as the FBS Windfall Bond and Market Trackers also helps attract solid funding.

CAPITAL

The Group's capital position is one of the key indicators of its financial strength and security. It reflects its ability to absorb shocks both to the sector as a whole and any specific shocks to the Society without putting it at risk of failure. Group capital as at 31 December 2017 stood at £121.3 million up from £116.5 million in 2016 and consists of reserves built up from the accumulation of profit plus the balance on the Available for Sale reserve. The Society has not issued Permanent Interest Bearing Shares (PIBs) or subordinated debt to the market. The level of reserves is also impacted by credits or charges for potential net liabilities under its defined benefit pension schemes which for 2017 were a credit of £0.1 million net of tax compared with a £1.1 million charge in 2016.

The Group has grown its assets significantly as noted above which reduces the Group's capital ratios. Nevertheless its capital position remains very strong in the sector with a Common Equity Tier 1 ratio of 19.6% (2016: 20.9%), still significantly in excess of the regulatory requirements. The Society's Individual Capital Guidance from the PRA at the year end was to hold a minimum amount of capital of 11.03% of Risk Weighted Assets plus a static add-on of £6.3 million. Again the Society's capital was significantly in excess of this requirement.

A further important regulatory metric is the proposed leverage ratio, although this is not yet in force. This is the ratio of regulatory capital to defined liabilities. The Group's leverage ratio at 31 December 2017 was 6.1% (2016: 6.5%).

FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

RISK MANAGEMENT STRATEGY & FRAMEWORK

The Society has adopted an Enterprise Risk Management Strategy and Framework which sets out the risk categories, governance framework and policies, risk appetites and supporting stress testing used to manage the Group's risks. This includes the establishment of triggers and limits, reporting lines, mandates and other control procedures.

The management of balance sheet exposures and the use of financial instruments for risk management purposes are contained within the Board-approved Liquidity Policy and Financial Risk Management Policy. Full details regarding the risks and the financial instruments used by the Group are given in Note 29 to the Accounts.

In addition Board members and function heads have been given individual responsibilities under the Senior Management Regime (SMR) which is a regulatory requirement to ensure it is clear that an individual has specific responsibility for all the identified risks and functions.

RISK GOVERNANCE ARRANGEMENTS

The Board exercises governance over risk in the Group through Sub-Committees with Terms of Reference set by the Board. The Committees are:

- ***Group Audit Committee***
- ***Board Group Risk Committee***
- ***Remuneration Committee***
- ***Nomination Committee***

The members of these Committees are all Non-executives of the Board with the exception of the Nomination Committee on which the Chief Executive also sits. The Board approves policies containing the risk appetites, methodologies, monitoring and reporting requirements for material business activities. In particular the key policies relating to Lending, Liquidity and Financial Risk Management are reviewed at least annually and approved by the Board.

These Committees are supported by Executive Management Committees which report through to the Board Committees and have Terms of Reference approved by the Board or relevant Sub-Committee and act with delegated authority from the Board.

- ***Executive Management Committee***
- ***Executive Group Risk Committee***
- ***Retail Conduct Risk Committee***
- ***Asset and Liability Committee***

The Committees are supported by the Risk Oversight function, the head of which reports to the Chairman of the Board Group Risk Committee.

Further details of the Committees and their function are contained in the Report on Corporate Governance on pages 42 to 49.

The Group maintains an Internal Capital Adequacy Assessment Process (ICAAP) and an Internal Liquidity Adequacy Assessment Process (ILAAP). These are used to identify and quantify the financial, conduct and other risks faced by the Group. Stress and reverse stress testing is employed separately, and as part of these processes, to ensure that the Group identifies and understands the extent of potential risks. The output is then used to decide the Group's risk appetite, objectives and limits and encapsulate them in the Financial Risk Management, Liquidity and Lending Policies to ensure that the Group operates within the parameters set by the Board. A Recovery Plan (RP), as required by the Bank of England, has also been prepared to illustrate and help deal with extreme stress situations.

In addition, the PRA carries out an annual assessment of the Society. Following these reviews, the PRA may issue revised Individual Capital Guidance (ICG) and/or Individual Liquidity Guidance (ILG). These specify the minimum amounts of capital and liquidity the Society must hold regardless of its own risk management assessments and appetites.

MORTGAGES CASE STUDY

Sarah & Adam

"The Family Mortgage has significantly reduced our monthly payments."

SARAH (25) & ADAM (28)

TEACHERS

Sarah and Adam were both first time buyers looking to purchase a house together. They were in a good financial position to get a mortgage by themselves with around a 10% deposit however, Sarah's parents were keen to help.

"When I first mentioned that we were looking to buy a house and were considering mortgage options my Dad kindly set out his financial situation. He said that he had a sum of money that he would be prepared to use to support us. The main issue was finding a way to use his money that allowed it to still belong to him and didn't require a share in the ownership of the house but somehow benefited us financially."

"The most important things to us when looking for our mortgage was maximising the amount we could borrow but keeping our monthly repayments low."

Having looked around at high street lenders that offered a family support option nothing quite suited. They then found the Family Building Society's Family Mortgage. Adam had never heard of the Society before, but Sarah had as her Dad has a Market Tracker account with the Society. The couple decided the Family Mortgage was the best option for them. It allowed Sarah's parents to use their savings without gifting the money and minimised the couple's repayments. It also meant Sarah and Adam were 50/50 owners and Sarah's parents had no involvement in the ownership, allowing her parents' money to remain theirs.

"Had we not had my parents' support our monthly repayments would have been much higher than we currently pay."

The Family Mortgage brings wider family assets, such as family savings or property, into the mortgage calculation, helping to reduce the cost for the buyer but not asking family members to hand it over as a gift. Family members are able to help buyer's access lower interest rates than the traditional 95% mortgage and in turn, lower monthly payments. The Family Mortgage is designed to help the next generation own their home.

Sarah and Adam found the service from the Society "excellent." As they are both teachers finding time to talk to their financial advisor or anyone else was next to impossible and with Sarah's parents being an hour and a half drive away signing forms was also pretty difficult. However, none of that was ever an issue.

"The fact that all correspondence happened over the phone, via email or by post meant that we never had to take time off work to meet in person and could complete the process at a time convenient to us. This was also useful as, living an hour and a half away from my parents, when we both had to sign forms we never needed to be in the same place at the same time."

"Our financial advisor was fantastic. We were able to arrange phone calls with him outside of 'normal' office hours – even as late as 6pm, which was very convenient. He was supportive and informative, and made the process clear and easy to understand."

With Sarah and Adam happily settled in their first home, they would definitely recommend the Family Mortgage to others in their situation.

"If you are able to put the deposit down yourself and can achieve the monthly payments required, the added bonus of being able to reduce this amount through placing savings in an offset account means that you have that little bit of extra money to save, spend on the house or make overpayments on the mortgage. This flexibility gives us a little more comfort and means that we aren't stretching our finances or making ourselves uncomfortable – we can enjoy our new house without the worry of meeting higher monthly repayments."

PRINCIPAL RISKS & UNCERTAINTIES

The principal risks and uncertainties facing the Group, and which are managed under the risk management framework, are noted below.

Each function is responsible for ensuring that risks are identified and managed and policies and processes complied with as the first line of defence.

The Society has a dedicated Risk Oversight function which is run by the Director of Risk and reports to the Board Group Risk Committee. It represents the second line of defence against loss for the Society. The Society also has a Compliance function which acts as the second line of defence overseeing conduct and regulatory risks. The Director of Risk is responsible for maintaining oversight of all the Group's risks and these are reviewed regularly by the Executive Group Risk Committee. This Committee also reports to the Board Group Risk Committee, which comprises Non-executive Directors with specific responsibility to monitor risk management across the Group. This includes compliance with regulatory guidance in respect of lending, treasury and business conduct activity, as well as the ongoing update of the ILAAP, ICAAP and the RP.

The third line of defence is Internal Audit, which is outsourced to a major accountancy firm. Following a competitive tender in late 2016, Deloitte currently perform this role exclusively, overseen by the Group Audit Committee which consists of Non-executive Directors.

▶ CUSTOMER COMMENT

"I'm happy with it as it stands - you offered a sensible savings option that offers fair rates that last, rather than headline chasing rates that drop after a year. Others should follow your example!"

CREDIT RISK

Credit risk is the risk that a financial loss will arise from a customer or counterparty failing to meet their obligations or from a deficiency in the value of property held as collateral for a loan. This primarily arises from the Group's lending activities, which are mainly secured on property, and as a result of the Group's Treasury investments and transactions. This risk is mitigated by the Group's conservative lending and investment approach as prescribed in the Board-approved lending and liquidity policies. All of the Group's non-customer lending is represented by securities issued in Sterling by AAA-rated Supras, Gilts and deposits with the Bank of England or UK financial institutions.

MARKET RISK

Market risk is the risk of loss through adverse movements in market rates which, for the Group, is mainly changes to, and relative movements in, interest rates. This risk is managed through a combination of natural hedges in the Group balance sheet and the use of derivative contracts, principally interest rate swaps, as permitted under the Financial Risk Management Policy approved by the Board. The Group is not directly exposed to foreign exchange risk as all its transactions are denominated in Sterling. With the adoption of FRS 102, movements in interest rates now affect the balance sheet valuation of many financial instruments, particularly derivatives, and this increases the consequent risk of volatility in profits.

LIQUIDITY RISK

Liquidity risk is the risk that the Group will not have sufficient funds to meet its financial obligations as they fall due. This could arise for example as a result of imbalances in the cash flows of its activities. The amount of collateral the Society is required to pledge in support of its derivative hedging transactions can also have an adverse effect on the liquidity position. This is mitigated through adherence to the Liquidity and Financial Risk Management Policies approved by the Board and by conducting an ILAAP, as required by the PRA. Consequently, the Society maintains a significant portfolio of highly liquid securities that may be sold or used as collateral in sale and repurchase ('repo') transactions. This portfolio is supplemented by large call and overnight deposits with the Bank of England and UK clearing banks and with liquidity insurance facilities maintained at the Bank of England to ensure that the Group can meet all its financial obligations.

The Society has not suffered any material losses from fraud so far but remains vigilant.

OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequacies, or failures, in the Group's internal processes and systems, or the actions of its staff. The Society has policies and processes to manage operational risk to ensure it remains within its risk appetite which is set by the Board.

Due to the increase in the volume and sophistication of actual and attempted frauds and cyber attacks directed against financial institutions, the Society recognises the increasing risk of financial and reputational loss and disruption from these activities. Whilst improvements in and the extended use of technology to benefit the Society's operations and products are essential, they add to the risk of criminal attack. The Society has therefore stepped up its defences with significant investment in this area. Reviews and enhancements to its operational controls to maintain their effectiveness are undertaken and advice sought and audits undertaken by specialists. Consequently, the Society has not suffered any material losses from fraud so far but remains vigilant.

CONDUCT RISK

Conduct risk is linked with regulatory risk noted below and Board expectations of the service levels that we provide to our customers. The Society's conduct record is very good, with low levels of complaints. All functions in the Society are responsible for ensuring the highest standards of conduct and regular training takes place to ensure that 'treating customers fairly' is embedded in the Society's culture. The Compliance function, acts within the second line of defence and additional oversight is provided by the Retail Conduct Risk Committee.

REGULATORY RISK

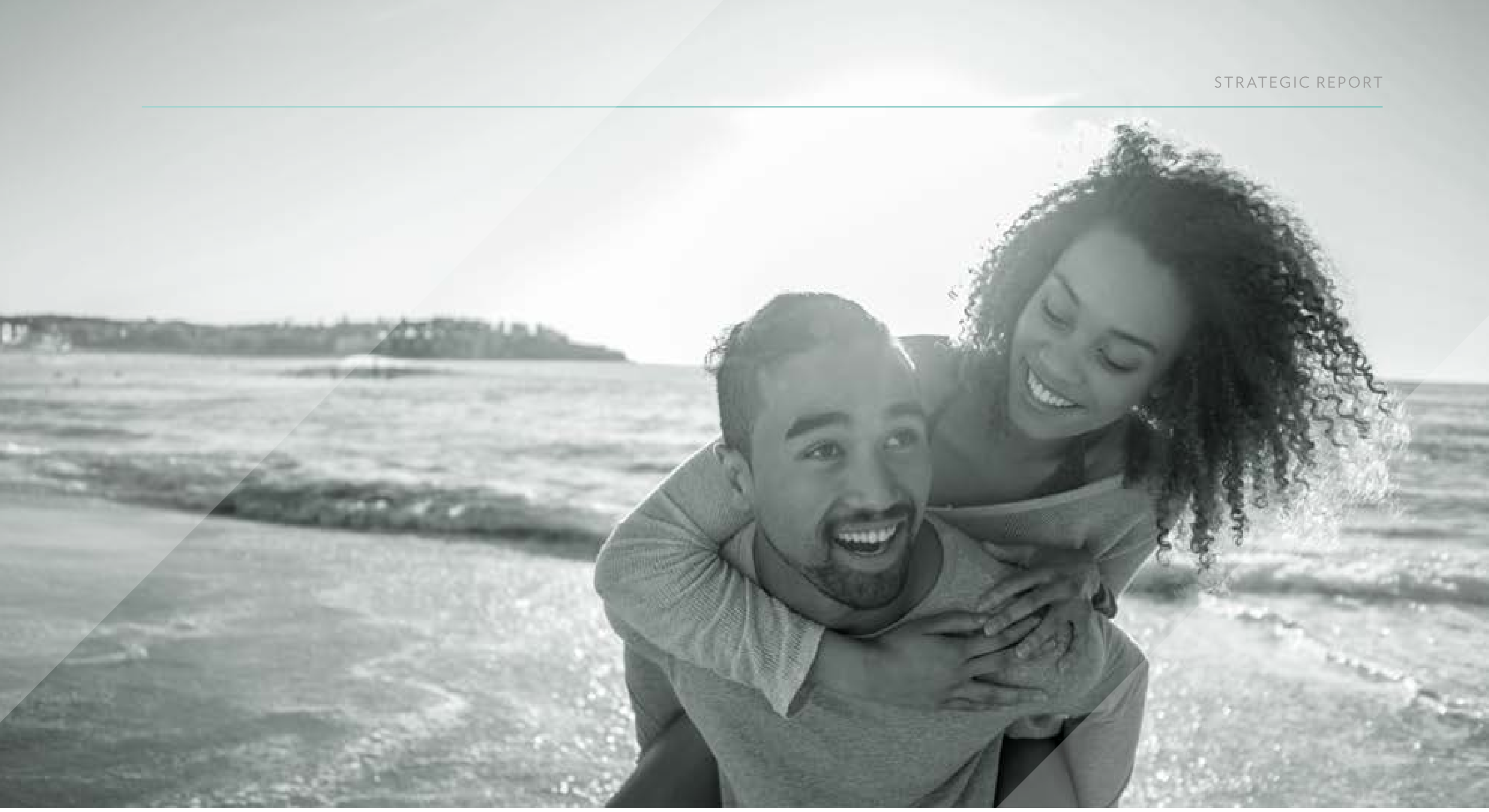
Regulatory risk is the risk of loss arising from failure to comply with statutory and regulatory requirements and the risk that the volume, complexity and cumulative effect of regulatory issues may impact the Society's ability to compete and function effectively. The amount of regulatory change in the wake of the financial crisis continues unabated both from the EU and the many UK regulators who oversee the Society, principally the PRA and the FCA. The impact of the latter and the changes to requirements they have introduced, have caused us to increase the resources in this area a trend that continues. These requirements and resources of course result in additional cost which is ultimately passed on to members. For example, the requirement to produce Annual Accounts under FRS 102 from 2015 has resulted in increased expenditure on technical advice, staffing, audit and systems development. Work to implement the PRA's ring-fencing requirements, and the Payment Systems Directive (PSD2), MIFID 2/ MIFIR and the General Data Protection Regulation (GDPR) have had a similar impact in 2017 and will continue into 2018.

A Retail Conduct Risk Committee has been established to oversee the Society's compliance with regulations affecting our customers and to ensure that the correct culture in terms of 'treating customers fairly' is adhered to and embedded in the Society. It is noted that the Society has a very low level of upheld complaints.

UNCERTAINTIES

The lower growth economic conditions in the UK compared recently with the US, Europe and China and the developing economies, mean that a number of uncertainties are faced by the Group. Although some of the economic data in the UK remains positive overall, the impact of Brexit is very unclear. The most significant issue is the future cost of funding to support lending activities and maintain liquidity at an appropriate level to meet ongoing operations. The Society's wholesale funding is subject to market sentiment and conditions and retail funding varies according to economic activity and competition from the many new challenger banks. The Society has secured funding from the TFS which has replaced the Bank of England's FLS. This four year funding has reduced the funding risk but replacement funding will be required in 2021/2022. These funding schemes have the effect of reducing rates offered to customers, but if Bank Base Rate and market rates start to increase and QE is reduced this may put upward pressure on funding rates.

Political uncertainty is also increasingly significant, Brexit may be "soft" or "hard" and be a longer process than envisaged or may not even happen. Resulting political differences may cause a general election which may see Labour in power with many policies not seen for some time which would directly affect the mortgage market and



financial sector generally and result in an increase in interest rates.

Changes in the economy potentially have a mixed impact on the credit risk of the Group's mortgage and commercial loans, despite the strict criteria that the Group applies to all of its lending operations. The improvement in the economy, particularly unemployment levels, should reduce arrears and defaults on loans and this has proven to be the case for the Group. We are mindful, however, that when interest rates eventually rise which becomes more likely if inflation increases further, this could lead to fresh affordability issues. These concerns are factored into our underwriting process which is based on individual case assessment by experienced personnel, low LTVs and the affordability requirements of the regulators.

The Society monitors the payment performance of its existing loan book very closely.

The Society monitors the payment performance of its existing loan book very closely and encourages borrowers to contact it in the event of any potential difficulties so that the Society can try and help alleviate the situation. Instances of arrears in payments are followed up promptly and the full range of forbearance options is considered. These usually include either a temporary reduction in the monthly repayment amount, temporary transfer of the mortgage to interest-only terms or an extension of the term. These actions, designed primarily to assist borrowers facing short-term difficulties, are taken after an individual assessment of the case has been undertaken to ensure that the action is in the best interests of both the borrower and the Society because in some instances foreclosure can result in a better outcome for the borrower than temporary help.

Forbearance is also taken account of in the exercise designed to highlight impaired loans and determine appropriate, prudent loss provisioning. This is covered by a specific policy on forbearance.

There are a number of risks and uncertainties in respect of the Group's Lifetime Mortgage portfolio that may affect its performance and ultimate recoverability. As a result of the NNEGs noted above, an increase in longevity/ morbidity levels or a reduction in house price inflation or its volatility could result in some mortgages suffering losses. The NNEGs are treated as an embedded derivative under FRS 102 and losses charged to the income statement effectively create a provision against potential losses, see Note 2.

The Group has hedged some of the risks relating to its Lifetime Mortgage portfolios with an interest rate derivative, the notional value of which varies with the underlying amount of the mortgages. It is subject however to maximum and minimum boundary amounts. The Lifetime Mortgages have pre-paid more quickly than expected so that the value of the portfolio is lower than the minimum boundary. This has an adverse effect on the effectiveness of the hedge and results in a charge to the income statement. Changes in interest rates also affect the value of the ineffectiveness and these factors cause profit volatility. The level of interest rates also affects the amount of collateral required to support derivative transactions. The higher the collateral level the more funding is required to maintain adequate liquidity which represents a cost to the Society. The Society monitors the risks associated with the lifetime portfolios and their hedging carefully and will take mitigating action where appropriate.

As is usual when selling a company, an indemnity was given to the purchaser against certain future liabilities arising from pre-purchase transactions. This was the case when the Society sold Hampshire Trust in 2014. The likelihood of future losses arising from this indemnity is regarded as remote and diminishes with time.

The Society pays levies to the FSCS as explained in the Directors' Report and Note 28. Levies will continue to be made in future years in order to pay the Scheme's liabilities. The levy will vary depending on the interest rate charged by the Government to the FSCS, as well as the Society's share of total deposits covered by the FSCS. Should further financial institutions fail and the FSCS covered losses increase, further levies would become payable. The future FSCS cost is therefore uncertain and may represent a substantial burden for the Society.

The Society has a funding obligation for the National Counties Building Society Pension and Life Assurance Scheme. This obligation gives rise to the risk that additional funding may be required should the value of the Scheme's assets, together with ongoing employer and member contributions, be insufficient to cover the accrued scheme member benefits. A full actuarial valuation is carried out by a qualified independent actuary every three years. The latest of these as at 30 April 2017 has been completed subject to final approval by the Trustees. The account deficit booked this year end is £1.6 million (2016: £1.3 million).

The deficit is a consequence of a period of low Gilt yields coupled with past poor fund performance. The Board will decide shortly how to make good this deficit and meet the Pension Ombudsman's requirements to remove the deficit over time; either through higher monthly contributions or a lump sum payment.

In order to reduce the exposure to further actuarial risks, the Society decided to cease further accrual in the final salary part of the scheme from May 2013, with all employees being eligible for the hybrid cash benefit part of the scheme instead. In January 2015, the Society closed this remaining part of the scheme to new employees, who are eligible instead for a cash contribution scheme which does not present any future actuarial risk for the Society.

The Society is also subject to general business risk from economic uncertainty and competition from existing and new entrants to the sector and key-man risk.

CUSTOMER COMMENT

"Thank you so much. You helped me last time and you have such a lovely reassuring voice and a good manner compared to anyone I ever speak to at the banks, so just passing that on!"

DIRECTORS' REPORT

THE DIRECTORS HAVE PLEASURE IN PRESENTING THEIR ANNUAL REPORT, TOGETHER WITH THE ANNUAL ACCOUNTS AND ANNUAL BUSINESS STATEMENT OF THE SOCIETY AND ITS SUBSIDIARY UNDERTAKINGS (THE GROUP) FOR THE YEAR ENDED 31 DECEMBER 2017.

INFORMATION ON THE GROUP'S STRATEGY AND BUSINESS REVIEW IS CONTAINED IN THE STRATEGIC REPORT, CHAIRMAN'S STATEMENT AND CHIEF EXECUTIVE'S REVIEW.

The Group total assets at 31 December 2017 were £2,022 million (2016: £1,865 million).

ASSETS & LIABILITIES

The Group total assets at 31 December 2017 were £2,022 million (2016: £1,865 million).

Total loans and advances to customers at the year-end were £1,565 million (2016: £1,392 million). At 31 December 2017, a total provision of £1.5 million, comprising £1.0 million individual impairment and £0.5 million collective (2016: £3.7 million, comprising £3.2 million individual impairment and £0.5 million collective), was made in the Annual Accounts for possible credit losses. Mortgage arrears are detailed in the Strategic Report.

Liquid assets amounted to £446 million at the year-end (2016: £463 million), representing 26% (2016: 29%) of total shares and borrowings and 22% (2016: 25%) of total assets of the Group. Changes in tangible fixed assets during the year are detailed in Note 17 to the Accounts and in intangible fixed assets in Note 18.

Savers' share balances totalled £1,332 million at 31 December 2017 (2016: £1,287 million) and deposits by credit institutions and other customers amounted to £405 million at the year-end (2016: £290 million), representing 23% (2016: 18%), of total shares and borrowings.

PROFIT & CAPITAL POSITION

The Group operating profit before impairment losses and provisions was £6.2 million (2016: £3.9 million). After impairment losses and provisions, Group profit before tax was £6.0 million (2016: £3.6 million). The Group profit for the year after tax was £4.9 million (2016: £2.9 million).

The Group's capital position is represented by general reserves and the Available for Sale (AFS) reserve. Group gross capital at 31 December 2017 amounted to £121.3 million, an increase from 2016's £116.5 million. The Group however, has increased its lending to members significantly again in 2017 and a consequence is that it has utilised its capital more effectively leading to a reduction in capital ratios. Gross capital represented 6.0% (2016: 6.2%) of Group total assets at the year-end, or 7.0% (2016: 7.4%) of total shares and borrowings. Group free capital (i.e. capital plus collective impairment provisions, less tangible and intangible fixed assets) amounted to £114 million at the end of the year (2016: £109 million), equivalent to 6.6% (2016: 6.9%) of total shares and borrowings. A key indicator of the Group's capital strength is its Common Equity Tier 1 capital ratio. At 31 December 2017 this ratio stood at 19.6%, (2016: 20.9%), which remains very strong.

PAYMENTS TO SUPPLIERS

The Society is committed to maintaining good relationships with its suppliers and its practice has and will continue to be, to pay invoices within 14 days of receipt. The amounts owed to trade creditors at 31 December 2017, as a proportion of the amounts invoiced by suppliers during the full year, was equivalent to ten days (2016: ten days).

PRINCIPAL RISKS & UNCERTAINTIES

The principal business risks to which the Group is exposed are credit, market, liquidity, operational, conduct and regulatory. To the extent that these risks are affected by the UK's economic position, the impact of "Brexit" over the next few years is a key consideration. Further explanation and details of the approach the Board takes to managing these risks can be found in the Strategic Report on pages 18 to 33.

CORPORATE GOVERNANCE

The Society's approach to corporate governance is covered in the Report on Corporate Governance on pages 42 to 49. The Directors' responsibilities are set out on pages 54 to 55. The Group's charitable donations and work are set out in the Corporate and Social Responsibility section of the Chief Executive's Review on page 14. No political donations were made in 2017 (2016: nil).

PILLAR 3 & COUNTRY-BY-COUNTRY REPORTING

The disclosures required under EU Directives for Pillar 3 risk disclosure reporting will be published on the Society's website. The requirements for Country-by-Country Reporting are disclosed in Note 32.

▶ CUSTOMER COMMENT

"I like BS's. Usually better customer service. Very personable staff, would rather go into branch than do things on line. Mostly good interest rates too compared to other providers!"

DIRECTORS

Full details relating to the Society's Directors can be found in the Annual Business Statement.

Under the requirements of the Society's Rules, John Howard and Chris Croft are required to seek re-election to the Board. John was appointed as a Non-executive Director in May 2008. Chris was appointed as the Secretary and an Executive Director of the Society in May 2014.

In summary, the following Directors served during 2017:

- ***Rodger Hughes***
- ***John Howard***
- ***Mark Bogard***
- ***Chris Croft***
- ***Fiona Crisp***
- ***Christopher Fry***
- ***Patrick Muir***
- ***Simon Wainwright***

At the end of the year, no Director had a beneficial interest in any shares or debentures of any connected undertaking of the Society.

GOING CONCERN

The Society's and Group's business activities and objectives, together with the factors likely to affect its future development, performance and position, are set out in the Chief Executive's Review on pages 8 to 16 and the Strategic Report on pages 18 to 33. The financial position of the Society and principal risks and uncertainties are described earlier within this Report and in the Strategic Report. The Society's position in respect of liquidity risk and other financial risks is shown in Note 29 to the Accounts.

The Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the Annual Accounts.

AUDITOR

In accordance with EU law and Financial Reporting Council guidance, the Society held a competitive tender in November 2016 for the Group's external audit work. After a rigorous process of selection by the Group Audit Committee, KPMG LLP was chosen and was elected at the AGM to act as auditor for the Society for the year ended 31 December 2017.

It is proposed that KPMG are re-elected as the Society's auditor at the AGM in April 2018.

POST BALANCE SHEET EVENTS

In the Directors' opinion, no post balance sheet events have occurred since the year-end that would have a material effect on the financial position of the Group as disclosed in the Annual Accounts.

Rodger Hughes Chairman
28 February 2018

MORTGAGES
CASE STUDY
David

Posed by a model

DAVID (79)

RETIRED

"The Retirement Lifestyle Booster was ideal for my situation."

At some point in the future, David is intending to downsize but he isn't quite ready for that just yet. Instead he really wants to take a holiday to Australia and to carry out some work on his home. After doing some research, David quickly found that mortgage lenders were unable to provide money to fund a holiday. He considered increasing his existing mortgage with the Society to fund the work on his home, but this still meant he couldn't have his dream holiday.

As an existing customer, David previously had discussed his situation and ambitions with the Society. After updating our Retirement Lifestyle Booster, one of our advisors contacted him to let him know about the mortgage. It seemed to suit his requirements and meant he would be able to do some work on his house and have his much wanted holiday to Australia.

"Fortunately the updated version of the Retirement Lifestyle Booster provided both a lump sum and a monthly payment. Because these funds could be used for any purpose, it was ideal for my situation."

"The additional monthly payments from the Society will enable me to carry out the work I need to do on my house without impacting on other aspects of my life, such as holidays."

The Retirement Lifestyle Booster means David will receive a lump sum at the beginning of the term. Each month he will also receive a fixed amount for 10 years. In return, David will pay us a set amount each month to cover the 'average' interest due. At the end of the mortgage term, David will be able to sell his current home and downsize as a means of paying off the capital outstanding on the mortgage, just as he'd always planned to do.

"The Retirement Lifestyle Booster is more flexible, the mortgage can be repaid at any time and the monthly income can also be stopped if my circumstances change."

"Obviously each person's situation is different and the Retirement Lifestyle Booster may not suit everyone. However I believe it is an excellent product, preferable to equity release and I would recommend anyone in a similar situation to mine to consider this option."

David was happy with the service he received from our advisor and is very excited for his much longed for holiday.

"When Peter, my advisor, contacted me he opened up a much more favourable possibility and provided a very helpful, well-informed and personal service, which culminated in a very satisfactory solution."

For privacy reasons, the name in this case study has been changed.

GROUP AUDIT COMMITTEE REPORT

THE GROUP'S AUDIT COMMITTEE IS A SUB-COMMITTEE OF THE BOARD AND CONSISTS OF NON-EXECUTIVE DIRECTORS. IT IS CHAIRED BY SIMON WAINWRIGHT AND FIONA CRISP AND PATRICK MUIR ARE MEMBERS. IT IS ATTENDED BY THE EXECUTIVE DIRECTORS AND THE EXTERNAL AND INTERNAL AUDITORS WHERE APPROPRIATE. THE CHAIRMAN, RODGER HUGHES AN EX-PWC PARTNER ALSO ATTENDS.

By having only Non-executive Directors as members, this ensures the independence of the Committee. Following a competitive tender process in late 2016 for both internal and external audit work, the Society appointed KPMG as External Auditor and Deloitte as its Internal Auditor. The latter enhances the independence and skill set of the audit function compared with employing our own audit staff. Both KPMG and Deloitte have formally confirmed their independence for the year.

The Committee's purpose is to monitor the activities of the Internal Audit function to ensure that controls are in place and effective and to make recommendations to the Board upon any issues of concern. It also considers and reviews the findings arising from External Audit control and systems work and reviews, prior to approval by the Board, the final Annual Report and Accounts, Directors Report and Summary Financial Statement.

The full Terms of Reference of the Committee can be found on the Society's website.

The Committee is required to self-assess its performance during the year. It is content that it has operated effectively, met its Terms of Reference and has the appropriate resources and experience of the financial sector to perform its role.

INTERNAL AUDIT

The Committee reviews the proposed Internal Audit programme of work regularly and as well as ensuring a balanced set of audits is performed across the whole business on a three year cycle, it focuses the team on any particular areas of concern or attention that it would like audited. This includes any areas that the Society's regulators have identified specifically or across the sector as requiring review.

At each Committee the internal audit reports completed in the period are reviewed and management's responses challenged. If necessary the Executive are required to follow up further on issues identified.

The Committee appoints and removes the Internal Auditors and monitors their performance. It also agrees their fees for the year.

The Committee has considered Deloitte's overall internal audit report for 2017 and is content with the conclusions. It is also content with Deloitte's independence and performance during the year and they have confirmed that they have sufficient resources to undertake their role.

EXTERNAL AUDIT

The Committee also recommends the appointment and removal of the External Auditors, subject to approval by members at the Annual General Meeting, and monitors their performance and agrees their fees for the year. It also agrees any non-audit work carried out by the External Auditors to ensure there is no conflict of interest.

The Committee meets with the External Auditors to discuss key areas of significance and concern throughout the year. KPMG's views are considered together with the Committee's and the Executive's so that all the areas which should be given more focus and audited in more depth are identified, included in the audit plan and subsequently reviewed in more detail. These areas for 2017 are noted below. Any other findings and any management letter points are also reviewed and challenged.

The Committee has considered KPMG's interim audit report and final memorandum of findings for 2017 and is content with the conclusions and management's responses. It is also content with KPMG's independence and performance during the year.

FINANCIAL REPORTING

When producing the management and statutory financial statements, it is essential that they are produced in accordance with the applicable accounting standards, particularly in the Society's case, FRS 102 and IAS 39. The Accounting Policies need review to ensure that they are still

applicable and challenged if necessary. It is also important that the Annual Report contains balanced, understandable information for Members to assess the performance of the Society and its strategy, business model and governance. The Committee is satisfied that the 2017 Annual Report and Accounts do so and that the accounting policies are appropriate.
In preparing the accounts a number of significant judgments, assumptions and estimates need to be made. These are noted in Note 2 of the Annual Report and Accounts. They are discussed with management and the External Auditors and for 2017 the following items were given particular attention.

HEDGE ACCOUNTING

The Society adopts hedge accounting in accordance with IAS 39 where it uses interest rate swaps to hedge the risk of changes in interest rate risk. This reduces the volatility through the Income Statement from valuations of the swaps. It is used for its main residential mortgage portfolio, for its asset swapped gilts, its legacy commercial lending portfolio and its Lifetime Mortgage portfolio.

The Committee considered the appropriateness of the hedging arrangements and processes and agreed them and that they had been applied in accordance with IAS 39.

LIFETIME MORTGAGES

The Group has a legacy portfolio of Lifetime Mortgages (LMs) with a book value of approximately £200m. It has a swap with a variable notional value which was taken out to hedge the LMs throughout their life against movements in market interest rates. The hedge accounting is complex with the expected cashflows generated by a model which has longevity, morbidity, interest rates, future drawdowns and voluntary repayments as inputs. The Committee has reviewed and challenged the treatment regularly and during 2017 commissioned an independent firm of Actuaries to review the appropriateness of the actuarial assumptions. It has asked KPMG to audit this in particular detail and agree the treatment adopted by the Society. As noted above the Committee is content with the treatment.

The LMs also have a no negative equity guarantee (NNEG) included in their terms. For accounting purposes under IAS 39, this is treated as a derivative and must be fair valued with movements taken to the Income Statement. The valuation of the NNEG depends on expected future loan balances, interest rates, property sale costs and assumptions for long term house price movements and volatility. The Committee has reviewed the assumptions and is content with the valuation.

PROVISIONS

The Group makes provisions against loans that have suffered impairment as at the balance sheet date but not yet crystallised in accordance with IAS 39. These are either individual or collective. This involves making assumptions about default rates, emergence periods and loss given default rates.

At 31 December 2017 the Group had total impairment provisions of £1.5 million (2016: £3.7 million) see Note 10a of the Annual Report and Accounts for more detail. Provisions against the LMs are effectively covered by the valuation of the NNEG instead of a provision.

The Society also has a provision for FSCS levies (Note 10b). This has decreased to £109,000 at the end of 2017.

The Committee reviewed and challenged the level of impairment provisions and assumptions used in their calculation and is content. It is also content with the FSCS levy provision.

REVENUE RECOGNITION

Income and expenditure is recognised in accordance with the Accounting Policies and Standards with accruals and prepayments made to allocate it to the correct accounting period. One area that relies significantly on assumptions and estimations is with the application of Effective

Interest Rates (EIR). The intention is to spread the overall interest and fees received and paid on lending and borrowing over the expected life of the loan by adjusting the interest rate accordingly. This mainly applies to fees received and paid on mortgages and assumptions have been made about the expected lives of the mortgages based on behavioural analysis. At the year end, the Society had a net asset for deferred income of £1.3 million and the Group had a net creditor for deferred costs of £0.1 million which were included in the balance sheet.

The Committee reviewed the assumptions made and agreed the judgments were reasonable.

GOING CONCERN

The Committee has reviewed management's assessment of its viability for the foreseeable future and agrees with their opinion that the Society is a going concern and that is the appropriate basis for preparing the Annual Report and Accounts

Simon Wainwright
Chairman, Group Audit Committee

REPORT ON CORPORATE GOVERNANCE

THE BOARD OF DIRECTORS IS COMMITTED TO BEST PRACTICE IN CORPORATE GOVERNANCE.

THIS REPORT EXPLAINS HOW THE SOCIETY HAS REGARD TO THE PRINCIPLES IN THE UK CORPORATE GOVERNANCE CODE ISSUED BY THE FINANCIAL REPORTING COUNCIL IN APRIL 2016 (THE CODE), WHICH WAS THE PREVAILING GUIDANCE FOR THE YEAR COVERED BY THIS REPORT. THE BOARD IS AWARE THAT THE FINANCIAL REPORTING COUNCIL IS UNDERTAKING AN EXTENSIVE REVIEW OF THE CODE AND WILL REPORT IN DUE COURSE ON HOW IT WILL HAVE REGARD TO ANY REVISED CODE.

THE ROLE OF THE BOARD

CODE PRINCIPLE A.1:
EVERY COMPANY SHOULD BE HEADED BY AN EFFECTIVE BOARD, WHICH IS COLLECTIVELY RESPONSIBLE FOR THE LONG-TERM SUCCESS OF THE COMPANY.

SOCIETY'S APPROACH
The Society's Board is collectively responsible for the long-term success of the organisation. Its principal function is to determine the strategy and policies of the Society within an effective control framework which enables risk to be assessed and managed. The Board has responsibility for ensuring that the necessary financial and human resources are in place for the Group to meet its objectives and that business and management performances are reviewed. Furthermore, the Board ensures that the Group operates within the Society's constitution, relevant legislation and regulation and that proper accounting records and effective systems of business control are established, maintained, documented and audited.

There are at least ten formal Board meetings each year. In addition, at least once a year, the Non-executive Directors meet without the Executive Directors present. The Non-executive Directors also meet with the Director of Risk without the Executive Directors present prior to each formal Board meeting. All Board members have the benefit, at the Society's expense, of liability insurance in respect of their responsibilities as Directors and have access to independent legal or other professional advice if required.

The Board has a formal schedule of matters which are reserved for its consideration at its meetings and it has established four Committees to consider specific issues in greater detail, being the Group Audit, Board Group Risk, Remuneration and Nomination Committees. The Terms of Reference for each of these Committees are published on the Society's website.

GROUP AUDIT COMMITTEE
The Group Audit Committee meets at least four times each year and comprises three Non-executive Directors, currently Simon Wainwright (Chairman), Fiona Crisp and Patrick Muir. The Chairman of the Board, the Executive Directors and representatives from the internal and external auditors attend by invitation. Its role is described more fully below.

More details relating to the role of the Group Audit Committee can be found in the Group Audit Committee Report on pages 38 to 41.

BOARD GROUP RISK COMMITTEE
The Board Group Risk Committee also comprises three Non-executive Directors, currently Fiona Crisp (Chairman), Simon Wainwright and John Howard. The Executive Directors, the Director of Risk and the Manager, Operational Risk attend by invitation. The Committee meets at least four times a year and is responsible for reviewing the Society's risk management framework as described later.

REMUNERATION COMMITTEE
The Remuneration Committee usually meets at least twice a year and comprises three Non-executive Directors, Patrick Muir, John Howard and Rodger Hughes, with the Chief Executive and the Group Secretary attending by invitation. It is currently chaired by Patrick Muir, and is responsible for determining the remuneration of all Executive Directors and functional Directors. It also sets the additional payments for the Chairman of the Board, the Chairmen of the Group Audit, Remuneration and Board Group Risk Committees and the Senior Independent Director, with Committee members not taking part in discussions concerning their own remuneration. More detail relating to the role of the Remuneration Committee can be found in the Report on Directors' Remuneration on pages 50 to 53.

NOMINATION COMMITTEE
The Nomination Committee, which meets at least once a year, is comprised of the Society's Chairman (Rodger Hughes), the Senior Independent Director (John Howard) and the Chief Executive. It is chaired by Rodger Hughes and is responsible for making recommendations to the Board on matters relating to the composition of the Board, including Executive and Non-executive Director succession planning, the appointment of new Directors and the election and re-election of Directors.

DIVISION OF RESPONSIBILITIES

CODE PRINCIPLE A.2:

THERE SHOULD BE A CLEAR DIVISION OF RESPONSIBILITIES AT THE HEAD OF THE COMPANY BETWEEN THE RUNNING OF THE BOARD AND THE EXECUTIVE RESPONSIBILITY FOR THE RUNNING OF THE COMPANY'S BUSINESS. NO ONE INDIVIDUAL SHOULD HAVE UNFETTERED POWERS OF DECISION.

SOCIETY'S APPROACH

The offices of Chairman and Chief Executive are distinct and held by different people. The role of each is set out in their respective job descriptions. In addition, under the Senior Managers Regime, every person holding a regulated senior manager's role which includes both the Chairman and the Chief Executive has a specific written statement of their responsibilities. The Chairman is responsible for chairing and overseeing the performance of the Board of the Society. His responsibilities include leading the Board in setting clear expectations concerning the Company's culture, values and behaviours. The Chief Executive is responsible for managing the Society's business and operations within the parameters set by the Board.

THE CHAIRMAN

CODE PRINCIPLE A.3:

THE CHAIRMAN IS RESPONSIBLE FOR LEADERSHIP OF THE BOARD AND ENSURING ITS EFFECTIVENESS ON ALL ASPECTS OF ITS ROLE.

SOCIETY'S APPROACH

The Chairman sets the direction of the Board and promotes a culture of openness and debate by facilitating the effective contribution of Non-executive Directors and ensuring constructive relations between Executive and Non-executive Directors. The Chairman also ensures that Directors receive accurate, timely and clear information.

NON-EXECUTIVE DIRECTORS

CODE PRINCIPLE A.4:

AS PART OF THEIR ROLE AS MEMBERS OF A UNITARY BOARD, NON-EXECUTIVE DIRECTORS SHOULD CONSTRUCTIVELY CHALLENGE AND HELP DEVELOP PROPOSALS ON STRATEGY.

SOCIETY'S APPROACH

The Non-executive Directors are responsible for bringing independent judgement to the discussions held by the Board, using their breadth of experience and understanding of the business. Their key responsibilities are to challenge constructively and contribute to strategic proposals, and to monitor performance, resources, and standards of conduct, compliance and control, whilst providing support to Executive management in developing the Society.

THE COMPOSITION OF THE BOARD

CODE PRINCIPLE B.1:

THE BOARD AND ITS COMMITTEES SHOULD HAVE THE APPROPRIATE BALANCE OF SKILLS, EXPERIENCE, INDEPENDENCE AND KNOWLEDGE OF THE COMPANY TO ENABLE THEM TO DISCHARGE THEIR RESPECTIVE DUTIES AND RESPONSIBILITIES EFFECTIVELY.

SOCIETY'S APPROACH

At the year end, the Board comprised five Non-executive Directors (including the Chairman) and three Executive Directors. All Non-executive Directors are considered by the Board to be independent in character and judgement and to have an appropriate balance of skills and experience. They are all also considered to be free of any relationship or circumstances which could materially interfere with the exercise of their judgement, impede the provision of constructive challenge to management and provide assistance with the development of strategy. The Vice Chairman is designated to be the Senior Independent Director, to act as a sounding board for the Chairman and an intermediary for the other Directors when necessary. The Board and the Nominations Committee consider the overall Board skills and are satisfied as to the overall balance of skills which has been endorsed by the recent external review of board effectiveness referred to below. The Society also maintains a Board Skills matrix to record the skills and experience of the Directors which is reviewed from time to time. In addition the Society makes available skills training to the Directors on relevant regulatory and technical matters.

APPOINTMENTS TO THE BOARD

CODE PRINCIPLE B.2:

THERE SHOULD BE A FORMAL, RIGOROUS AND TRANSPARENT PROCEDURE FOR THE APPOINTMENT OF NEW DIRECTORS TO THE BOARD.

SOCIETY'S APPROACH

The principal purpose of the Nomination Committee is to undertake the assessment of the balance of skills, experience, independence and knowledge on the Board against the requirements of the business, with a view to determining whether any shortages exist. Having completed the assessment, the Committee makes recommendations to the Board accordingly. Appointments to the Board are made on merit, with due regard to the benefits of diversity, including gender. Within this context, the paramount objective is the selection of the best candidate, irrespective of background, and it is the view of the Board that establishing quotas or targets for the diversity of the Board is not appropriate. Candidates for Non-executive Directorship are identified in a variety of ways as determined by the Nomination Committee, including the use of recruitment specialists, notification in the Society's periodic newsletters to customers and through press advertisements.

No Non-executive Directors have retired from the Board during the year and the Nominations Committee has reviewed board composition during 2017 and has not recommended any further recruitment at this time. However Chris Fry the Finance Director has indicated his intention to retire following the Annual General Meeting and the process of recruitment of a successor has been overseen by the Nominations Committee and the Board.

All Directors must, before they are appointed to the Board, meet the tests of fitness and propriety as laid down by the regulators and are required to be authorised by the regulators under the Senior Managers Regime to undertake their respective roles as Directors.

COMMITMENT

CODE PRINCIPLE B.3:

ALL DIRECTORS SHOULD BE ABLE TO ALLOCATE SUFFICIENT TIME TO THE COMPANY TO DISCHARGE THEIR RESPONSIBILITIES EFFECTIVELY.

SOCIETY'S APPROACH

Prior to appointment, Non-executive Directors are required to demonstrate that they are able to allocate sufficient time to undertake their duties. The formal performance evaluations carried out each year also assess whether Non-executive Directors have demonstrated this ability during the year.

Attendance of Directors at the Board and its committees during 2017 is shown in the table below, with the total number of meetings each Director was eligible to attend shown in brackets.

DIRECTOR	BOARD	AUDIT	RISK	REMUNERATION	NOMINATION
Rodger Hughes	10 (10)			4 (4)	2 (2)
John Howard	10 (10)		4 (4)	4 (4)	2 (2)
Fiona Crisp	10 (10)	4 (4)	4 (4)		
Simon Wainwright	10 (10)	4 (4)	4 (4)		
Patrick Muir	10 (10)	3 (4)		4 (4)	
Mark Bogard	10 (10)				2 (2)
Chris Fry	10 (10)				
Chris Croft	10 (10)				

MORTGAGES CASE STUDY

Peter & Pat

PETER (71) AND PAT (70)

RETIRED

"Absolutely first class."

Peter and Pat moved into their home two years ago with the idea of converting the purpose built office, which was put in by the previous owners, into something more useful to them. The remaining space that was left in the garage from the office conversion meant that they couldn't even use it to put their car in. The couple felt they would make more use of a shower room and breakfast room with the space. With that decided, all they needed now was the money to pay for it.

Peter and Pat wanted a further advance that would suit both their financial needs and they wanted a competitive rate. It was important to them both that it was provided by a trusted and reliable lender. However, having started their mortgage with the Family Building Society just two years ago, Peter wasn't sure that they would be able to get a further advance to cover the cost of the conversion.

"Initially we were going to approach our bank for a home improvement loan, as we were unsure if the Family Building Society would increase our lending after only two years. However an initial call to their offices confirmed we would be considered if we met all the necessary affordability requirements. My first telephone interview with a mortgage advisor was on 12 September. The advisor went through the financial and affordability checks and we received our further advance offer on 27 September. By 4 October, the funds were in our account!"

"Although we could have obtained a loan from our bank, the repayment period would have been much shorter. We felt a lot more comfortable with the loan period provided by the Family Building Society."

The couple have friends who are struggling to obtain finances due to their age but here at the Family Building Society, we look at each situation individually. We offer a range of products to suit the needs of multiple generations. Each case is underwritten manually, not by a computer, to allow us to help more people reach their financial goals.

Happy with how quickly the process was managed, Peter and Pat can now enjoy the once wasted space in their home with their new breakfast room and shower room.

"The application process and advice from our mortgage advisor was excellent. My conversations with the Legal department again were excellent. We have had several mortgages over the last 50 years, none of whom provided the same level of personal service."

For privacy reasons, the names in this case study have been changed.

DEVELOPMENT

CODE PRINCIPLE B.4:
ALL DIRECTORS SHOULD RECEIVE INDUCTION ON JOINING THE BOARD AND SHOULD REGULARLY UPDATE AND REFRESH THEIR SKILLS AND KNOWLEDGE.

SOCIETY'S APPROACH

All new Directors undergo formal induction with any training or development needs being identified during this process and in the course of the annual performance evaluations referred to below. Directors continue to attend external and internal seminars and presentations to maintain and update their knowledge and skills and the Society has introduced e-Learning programmes for Directors.

INFORMATION AND SUPPORT

CODE PRINCIPLE B.5:
THE BOARD SHOULD BE SUPPLIED IN A TIMELY MANNER WITH INFORMATION IN A FORM AND OF A QUALITY APPROPRIATE TO ENABLE IT TO DISCHARGE ITS DUTIES.

SOCIETY'S APPROACH

The Chairman ensures that the Board receives accurate, timely and clear information in a form and of sufficient quality to enable it to fulfil its responsibilities, with a review being undertaken by the full Board at least annually. All Directors have access to the advice and services of the Secretary who is responsible for ensuring compliance with all Board procedures and advising the Board on governance matters.

EVALUATION

CODE PRINCIPLE B.6:
THE BOARD SHOULD UNDERTAKE A FORMAL AND RIGOROUS ANNUAL EVALUATION OF ITS OWN PERFORMANCE AND THAT OF ITS COMMITTEES AND INDIVIDUAL DIRECTORS.

SOCIETY'S APPROACH

A formal internal process exists to evaluate, on an annual basis, the performance and effectiveness of individual Directors and of the Board and its Committees. The Non-executive Directors are evaluated by the Chairman, taking into account the views of other Directors, and the Chairman is evaluated by the Vice Chairman, as Senior Independent Director, also having regard for the views of the other Directors.The Chief Executive's appraisal is conducted by the Chairman, after taking into account the views of other Directors and his immediate subordinates and the Chief Executive appraises the other Executive Directors again taking into account other Directors' views.

In accordance with the Code provisions applicable to larger companies, an external evaluation of the Board, its Committees and the Directors should be carried out every three years. The Board underwent an external evaluation by Thorburn McAlister in the autumn of 2016 and the report has been considered by individual Directors and by the Board at its meeting in January 2017. The outcome of the evaluation indicated no concerns and any recommendations have been evaluated and actioned appropriately.

RE-ELECTION

CODE PRINCIPLE B.7:
ALL DIRECTORS SHOULD BE SUBMITTED FOR RE-ELECTION AT REGULAR INTERVALS, SUBJECT TO CONTINUED SATISFACTORY PERFORMANCE.

SOCIETY'S APPROACH

The Society's Rules require that all Directors are submitted for election at the AGM following their first appointment to the Board, except where their appointment occurs in the period between the end of the Society's financial year and the AGM itself, in which case they must seek election at the AGM in the following year. Having considered the Code provisions as they apply to larger companies in relation to the annual re-election of all Directors, the Board does not believe it is appropriate for a building society to subject all Directors to annual re-election because of the continuity and succession needs of an effective Board. Instead it has concluded that, consistent with the provisions of the Society's Rules, all Directors should seek re-election at least every three years. The Board's policy with regard to maintaining the independence of Non-executive Directors is that they can expect to serve between two and three, full three-year terms, with the exception of the Chairman who may serve a maximum of four. These terms may be extended if the Nomination Committee is satisfied that the relevant Director continues to make a particularly valuable contribution and remains independent. As stated above, the Nomination Committee is responsible for recommending to the Board whether an individual should be submitted for re-election. Appointments lasting beyond six years are subject to particularly rigorous annual review, reflecting the need for progressive refreshment of the Board.

FINANCIAL AND BUSINESS REPORTING

CODE PRINCIPLE C.1:

THE BOARD SHOULD PRESENT A FAIR, BALANCED AND UNDERSTANDABLE ASSESSMENT OF THE COMPANY'S POSITION AND PROSPECTS.

SOCIETY'S APPROACH

The Board confirms that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the Society's performance, business model and strategy. The responsibilities of the Directors in relation to the preparation of the Society's accounts are set out on pages 54 to 55. The Chief Executive's Review, Strategic Report and the Directors' Report on pages 8 to 36 provide a detailed review of the Society's business activities and future prospects and include the statement that the Directors consider that the business is a going concern.

RISK MANAGEMENT AND INTERNAL CONTROL

CODE PRINCIPLE C.2:

THE BOARD IS RESPONSIBLE FOR DETERMINING THE NATURE AND EXTENT OF THE PRINCIPAL RISKS IT IS WILLING TO TAKE IN ACHIEVING ITS STRATEGIC OBJECTIVES. THE BOARD SHOULD MAINTAIN SOUND RISK MANAGEMENT AND INTERNAL CONTROL SYSTEMS.

SOCIETY'S APPROACH

The Board is responsible for determining a framework for risk management and control, to include the Group's risk appetite and tolerance. Senior management are responsible for designing, operating and monitoring risk management and internal control processes in line with the risk appetite and tolerance while the Group Audit and Board Group Risk Committees, on behalf of the Board, are responsible for reviewing the adequacy and effective operation of these processes. The role of the Group Audit Committee is described below, while that of the Board Group Risk Committee is to provide the Board with independent assurance that the Group is operating specifically in accordance with the risk appetite parameters determined and approved by the Board and to ensure that the outcomes for the Group's various activities are in line with those parameters. The system of internal control overall is designed to enable the Group to achieve its corporate objectives within the Board's pre-determined risk appetite, not to eliminate risk. The internal audit function, now undertaken by Deloitte LLP, provides independent and objective assurance that these processes are appropriate and effectively applied.

AUDIT COMMITTEE AND AUDITORS

CODE PRINCIPLE C.3:

THE BOARD SHOULD ESTABLISH FORMAL AND TRANSPARENT ARRANGEMENTS FOR CONSIDERING HOW THEY SHOULD APPLY THE CORPORATE REPORTING AND RISK MANAGEMENT AND INTERNAL CONTROL PRINCIPLES AND FOR MAINTAINING AN APPROPRIATE RELATIONSHIP WITH THE COMPANY'S AUDITORS.

SOCIETY'S APPROACH

At the end of the year the Group Audit Committee comprised three Non-executive Directors. The Chairman of the Board is not a member of the Committee but may attend by invitation. The Board is satisfied that the Committee is comprised of members with recent relevant financial experience who are capable of discharging its duties and responsibilities. The role of the Committee is to review the integrity of the financial statements and the balance of information disclosed in the accompanying Directors' Report, Audit Committee Report and Strategic Report and to review the effectiveness of internal controls and risk management systems, to monitor and review the effectiveness of the internal audit function and to consider and recommend to the Board (for approval by the members) the appointment or re-appointment of the external auditor. The Committee reviews and monitors the external auditor's objectivity, competence, effectiveness and independence, ensuring that if they or their associates are invited to undertake non-audit work it will not compromise auditor objectivity and independence. The activities of the Group's internal audit function, which is undertaken by Deloitte LLP, are overseen by the Group Secretary but the firm has direct access to the Committee Chairman.

REMUNERATION

CODE PRINCIPLE D.1:

EXECUTIVE DIRECTORS' REMUNERATION SHOULD BE DESIGNED TO PROMOTE THE LONG-TERM SUCCESS OF THE COMPANY. PERFORMANCE-RELATED ELEMENTS SHOULD BE TRANSPARENT, STRETCHING AND RIGOROUSLY APPLIED.

CODE PRINCIPLE D.2:

THERE SHOULD BE A FORMAL AND TRANSPARENT PROCEDURE FOR DEVELOPING POLICY ON EXECUTIVE REMUNERATION AND FOR FIXING THE REMUNERATION PACKAGES OF INDIVIDUAL DIRECTORS. NO DIRECTOR SHOULD BE INVOLVED IN DECIDING HIS OR HER OWN REMUNERATION.

SOCIETY'S APPROACH

The Report on Directors' Remuneration, prepared by the Chairman of the Society's Remuneration Committee, is to be found on pages 50 to 53 and explains how the Society complies with the Code Principles relating to remuneration. Details of Directors' Emoluments during 2017 can be found in Note 9 to the Accounts.

DIALOGUE WITH SHAREHOLDERS

CODE PRINCIPLE E.1:

THERE SHOULD BE A DIALOGUE WITH SHAREHOLDERS BASED ON THE MUTUAL UNDERSTANDING OF OBJECTIVES. THE BOARD AS A WHOLE HAS RESPONSIBILITY FOR ENSURING THAT A SATISFACTORY DIALOGUE WITH SHAREHOLDERS TAKES PLACE.

SOCIETY'S APPROACH

As a mutual body, the Society does not have institutional shareholders but has a membership composed exclusively of individuals, all of whom are also customers of the Society. Periodic customer newsletters are produced and mailings undertaken to ensure that members are kept informed of developments, with reaction and feedback encouraged. Communication with members is also increasingly undertaken through the Society's websites. John Howard, as Senior Independent Director, is the point of contact for members if for any reason they feel communication with the Chief Executive or Chairman is inappropriate.

CONSTRUCTIVE USE OF THE AGM

CODE PRINCIPLE E.2:

THE BOARD SHOULD USE GENERAL MEETINGS TO COMMUNICATE WITH INVESTORS AND TO ENCOURAGE THEIR PARTICIPATION.

SOCIETY'S APPROACH

Each year the Society sends details of the AGM, including appointment of a proxy and voting forms, to members who are eligible to vote. Consistent with the Code, the AGM voting forms include a 'Vote withheld' option. The Society's normal practice is that a poll is called in relation to each resolution at the AGM and all proxy votes cast are included in the voting results which are published subsequently on the Society's website. All members of the Board are normally present at the AGM each year and the Chairmen of the Board and its four Committees are therefore available to answer any questions.

Rodger Hughes Chairman
28 February 2018

REPORT ON DIRECTORS' REMUNERATION

THIS REPORT ILLUSTRATES HOW THE SOCIETY HAS REGARD TO THE PRINCIPLES SET OUT IN THE UK CORPORATE GOVERNANCE CODE 2016 RELATING TO DIRECTORS' REMUNERATION.

PATRICK MUIR

The Society has adopted a Remuneration Policy, which describes how the Society complies with the relevant sections of the Financial Conduct Authority's Remuneration Code. This Policy is reviewed periodically by the Remuneration Committee. It was reviewed by the Committee in April 2017. The Committee wished to enable members to understand more about how remuneration is decided and the Policy Statement is published on the Society's website. The remuneration details of individual Directors are set out in Note 9 to the Accounts, which should be read in conjunction with this report.

THE LEVEL AND COMPONENTS OF EXECUTIVE DIRECTOR REMUNERATION

CODE PRINCIPLE D.1:
EXECUTIVE DIRECTORS' REMUNERATION SHOULD BE DESIGNED TO PROMOTE THE LONG-TERM SUCCESS OF THE COMPANY. PERFORMANCE-RELATED ELEMENTS SHOULD BE TRANSPARENT, STRETCHING AND RIGOROUSLY APPLIED.

SOCIETY'S APPROACH
As set out in its Remuneration Policy Statement, the primary objective of the Society is to operate for the financial benefit of its members and not for the disproportionate financial benefit of any of its employees.

However, the Board also believes that employees should be fairly rewarded for their efforts. The aim of the Society's Remuneration Policy is therefore to achieve a fair level of financial reward for the Society's staff whilst ensuring primacy of members' interests and avoiding incentives to take inappropriate levels of risk. Against this background the objectives of the Remuneration Policy include the following:

- ***To attract and retain staff with the appropriate skills, attitude and motivation.***

- ***To reward staff fairly, paying due regard to the statutory duties of equality and non-discrimination.***

- ***To benchmark salaries and benefits against prevailing industry/sector/role norms.***

- ***To take account of prevailing economic and employment trends.***

- ***To prevent inappropriate risk-taking with the potential to damage the interests of the Society's stakeholders and the viability of the business.***

In line with the Board's approach, which reflects that adopted within other comparable organisations, the Society's remuneration policy provides for the reward of Executive Directors through salaries and other benefits. The overall remuneration of the Executive Directors was reviewed in 2017 following the expiry of the incentive plan introduced in 2014.

EXECUTIVE DIRECTORS' EMOLUMENTS

The remuneration for Executive Directors reflects their responsibilities. It comprises basic salary, performance related variable pay and various benefits detailed below. Performance-related payments are not pensionable. The Society has no share option scheme and none of the Directors has any beneficial interest in, or any rights to subscribe for shares in or debentures of any connected undertaking of the Society.

As with staff generally, whose salaries are now subject to annual reviews, basic salaries payable to Executive Directors are reviewed periodically with reference to jobs carrying similar responsibilities in comparable financial organisations, market conditions generally and local employment competition in view of the Society's geographical position. As part of the overall review Executive Directors' salaries were revised in 2017 to reflect market changes, inflation and the revised terms of the Medium Term Incentive Plan. The salaries of staff beneath the level of Executive Director were reviewed in April 2017, taking account of externally compiled data relating to pay awards across the economy and the prevailing employment dynamics. This resulted in a cost of living rise for most staff equating to 3% of salaries, plus in a number of cases, adjustments to allow for anomalies arising from market conditions and promotions. The salary uplift for relevant staff was brought into effect from 1 May 2017. The Executive Directors were eligible to participate in an incentive scheme based upon both individual performance and that of the Society. The incentive scheme is subject to detailed rules which permit clawback of any award in the event of any unforeseen circumstances or any evidence of inappropriate conduct in full compliance with the Remuneration Rules set out by the Prudential Regulation Authority. As noted in last year's report, in January 2017 the Remuneration Committee reviewed the overall incentives package for Executive Directors. It was decided to introduce a new variable pay scheme similar to the previous scheme for the period 1 January 2017 to 31 December 2019. The new scheme however has been revised with even more challenging performance targets and reduces the overall level of performance related pay as a percentage of remuneration. Salaries will be reviewed in line with the rate of increase for staff generally.

Under the scheme, Executive Directors are eligible for an annual variable pay award based upon personal performance. This award is limited to a maximum of 25% of base pay. In addition, the Medium Term Incentive Plan is based upon the Society's performance over a three year period ending 31 December 2019. The amount of the award depends upon the Society's performance over the period as measured by five Key Performance Indicators: Customer satisfaction, Capital growth, Maintaining profit, Loan growth and Culture. The maximum possible bonus accruing under this scheme over three years is between 45% and 75% of base salary. Payments will be split equally and paid out in two annual payments in 2020 and 2021. This incentive plan is subject to normal restrictions so that the entitlement lapses if the Director leaves in the scheme period otherwise than through redundancy or other similar circumstances that make the Director a good leaver. The incentive plan is subject to an overriding discretion by the Remuneration Committee.

Executive Directors are eligible to receive other taxable benefits including a car, or car allowance and healthcare provision for themselves and their immediate family, standard professional body subscriptions and travelling and subsistence expenses are also met.

As a result of changes in legislation relating to the treatment of pension benefits all of the Executive Directors have opted out of the pension scheme. The Society has replaced their pension benefit with a taxable cash payment based on basic pay (excluding any performance related pay). Directors' overall pension benefits have reduced as a result. Pension payments are detailed in Note 9.

EXECUTIVE DIRECTORS' CONTRACTUAL TERMS

In keeping with current recommended practice, the standard terms for new Executive Director appointments include a contractual notice period of no more than 12 months by the Society and six months by the Executive Director. Mr M A Bogard and Mr C J Fry both have contracts on this basis issued in 2012 and 2010 respectively. Mr C R Croft has a contract which requires 12 months' notice from either party issued in 2014.

NON-EXECUTIVE DIRECTORS' REMUNERATION

Non-executive Directors do not receive any benefits other than their fees and travelling and training expenses for which they may be reimbursed. The level of fees payable to Non-executive Directors is assessed using benchmarks from a group of comparable financial organisations. In recognition of the increased responsibility associated with the roles, additional fees are paid to the Chairmen of Board Sub- Committees and the Senior Independent Director. Non-executive Directors' fees were increased by 3% in line with increases awarded to Society staff. This increase was recommended by the Executive Directors in accordance with the Society's Remuneration Policy as noted below.

THE PROCEDURE FOR DETERMINING REMUNERATION

CODE PRINCIPLE D.2:
THERE SHOULD BE A FORMAL AND TRANSPARENT PROCEDURE FOR DEVELOPING POLICY ON EXECUTIVE REMUNERATION AND FOR FIXING THE REMUNERATION PACKAGES OF INDIVIDUAL DIRECTORS. NO DIRECTOR SHOULD BE INVOLVED IN DECIDING HIS OR HER OWN REMUNERATION.

SOCIETY'S APPROACH
The Remuneration Committee, which comprises three Non-executive Directors, Patrick Muir, John Howard and Rodger Hughes and is chaired by Patrick Muir, is responsible for setting the remuneration of the Executive Directors. The Committee also sets the additional payments for the Chairman of the Board, the Chairmen of the Group Audit, Remuneration and Board Group Risk Committees and the Senior Independent Director, with Committee members not taking part in discussions concerning their own remuneration. The basic Non-executive Director fee is set by the Executive Directors. Minutes of the Committee's meetings are distributed to all Board members, and the Chairman of the Committee reports at the Board meeting following a Committee meeting.

It is the view of the Committee that Directors' remuneration for the year has been in accordance with the Society's stated Remuneration Policy and, on behalf of the Committee; I recommend that you endorse this report.

Patrick Muir
Chairman, Remuneration Committee
28 February 2018

DIRECTORS' RESPONSIBILITIES

DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT, THE ANNUAL BUSINESS STATEMENT, THE DIRECTORS' REPORT AND THE ANNUAL ACCOUNTS.

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

The Building Societies Act 1986 (the Act) requires the Directors to prepare Group and Society Annual Accounts for each financial year. Under that law they have elected to prepare the Group and Society Annual Accounts in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

The Group and Society Annual Accounts are required by law to give a true and fair view of the state of affairs of the Group and of the Society as at the end of the financial year and of the income and expenditure of the Group and of the Society for the financial year.

IN PREPARING THESE ANNUAL ACCOUNTS, THE DIRECTORS ARE REQUIRED TO:

- ***select suitable accounting policies and then apply them consistently;***
- ***make judgements and estimates that are reasonable and prudent;***
- ***state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Annual Accounts;***
- ***assess the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and***
- ***use the going concern basis of accounting unless they either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.***

In addition to the Annual Accounts the Act requires the Directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Group.

DIRECTORS' RESPONSIBILITIES FOR ACCOUNTING RECORDS AND INTERNAL CONTROLS

The Directors are responsible for ensuring that the Group:

- ***keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act;***
- ***takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Conduct Authority and Prudential Regulation Authority under the Financial Services and Markets Act 2000.***

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

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

DIRECTORS' RESPONSIBILITIES IN RELATION TO THE COUNTRY-BY-COUNTRY REPORTING (CBCR) INFORMATION

The CBCR Information comprises the information disclosed below.

The Directors of the Society are responsible for preparing the CBCR Information for the year ended 31 December 2017 in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013. In preparing the CBCR Information, the Directors are responsible for:

- ***interpreting the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013;***
- ***determining the acceptability of the basis of preparation of the CBCR information set out in Note 32;***
- ***making judgements and estimates that are reasonable and prudent; and***
- ***establishing such internal control as the Directors determine is necessary to enable the preparation of CBCR Information that is free from material misstatement, whether due to fraud or error.***

Independent auditor's report

to the members of National Counties Building Society

1. Our opinion is unmodified

We have audited the Group and Society annual accounts of National Counties Building Society for the year ended 31 December 2017 which comprise the Group and Society Income Statements, Statement of Comprehensive Income, Statements of Financial Position, Statement of Changes in Members' Interests, Group Cash Flow Statement and the related notes, including the accounting policies in note 1.

In our opinion the annual accounts:

- give a true and fair view of the state of affairs of the Group and of the Society as at 31 December 2017 and of the income and expenditure of the Group and the Society for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it.

Basis for opinion

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

We were appointed as auditor by the members in 2005. We were reappointed in November 2016 following a competitive tender process. The period of total uninterrupted engagement is for the 13 financial year~~s~~ ended 31 December 2017.

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

£272k (2016: £250k)
4.5% (2016: 7.0%) of Group Profit before tax

Materiality: Group annual accounts as a whole		£272k (2016:£250k) 4.5% (2016: 7.0%) of Group Profit before tax (see page 62)
Risks of material misstatement		**vs 2016**
Recurring risks	Lifetime mortgages	◄►
	Impairment of loans and advances to customers	◄►
	Revenue recognition	◄►

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

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the annual accounts and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters which have not changed from prior year, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the annual accounts as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
Lifetime mortgages: Valuation of the derivative and hedging adjustment applied to the portfolio FV derivative: £145.9m (2016: £150.7m) FV adjustment mortgages: £144.0m (2016: £146.6m) **Valuation of no negative equity guarantee** NNEG: £5.6m (2016: £2.4m) *Refer to page 40 (Audit Committee Report), pages 69-70 (accounting policy 1.8), page 72 (critical accounting estimates and judgements in applying accounting policies, 2.3 and 2.2) and page 82 (financial disclosures, Note 14).*	**Subjective estimate:** The Group holds a balance guarantee swap against its exposure to lifetime mortgages, the notional principal of which is adjusted each quarter in response to the balance of the mortgage portfolio between pre-agreed upper and lower boundaries. The Group determines the value of both the derivative and the fair value hedge adjustment to apply to the loan book using a forecast balance model. This model forecasts the mortgage balances over the remainder of the term of the loans using assumptions in respect of voluntary prepayment, redemption in the event of death or admittance to a care home and additional drawdown. Significant judgement is required to determine each of these key factors, which then influence the balances posted in the financial statements. The Group then inputs these balances to an external valuation tool alongside estimates of yield curves to determine a valuation of the swap and fair value hedge adjustment to the mortgage balance. The forecast balance model is most sensitive to movements in the prepayment assumption. The Group's approach to determining the valuation of the no negative equity guarantee (NNEG) also uses the forecast balance model but then applies a Black-Scholes stochastic model to determine the valuation. The Black-Scholes model is most sensitive to movements in the HPI and volatility assumptions.	**Our procedures included:** — **Our sector experience:** We challenged the key assumptions used in the model for voluntary prepayment and additional drawdown using the Group's recent experience and considering the availability of alternative credit for customers. — **Sensitivity analysis:** We performed sensitivity analysis on the key assumptions in the NNEG model for HPI and volatility as well as comparing to external market data. — **Tests of detail:** We tested the application of the mortality curve and mathematical accuracy of the model through building our own version and then comparing the output to the Group's model. We challenged management to provide rationale for any significant differences. We reperformed the valuation of the derivative and fair value hedge adjustment using our own valuation tool. — **Assessing transparency:** We assessed the adequacy of the Group's disclosures in respect of the degree of estimation involved in arriving at the valuations. **Our results:** — The results of our testing were acceptable (2016: acceptable).

	The risk	Our response
Impairment of loans and advances to customers Income statement charge: £137k (2016: £26k) Balance sheet: £1,541k (2016: £3,720k) *Refer to page 40 (Audit Committee Report), page 70 (accounting policy 1.9), pages 72-73 (critical accounting estimates and judgements in applying accounting policies, 2.4) and pages 77-78 (financial disclosures, Note 10).*	**Subjective estimate:** Individual impairment allowances cover loans specifically identified as impaired and a collective impairment allowance is held for all other loans where impairments are incurred but not yet specifically identified. The Directors assess individual impairments by reference to loans that have suffered significant financial difficulty of the borrower, the restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider or indications that a borrower will enter bankruptcy. The collective impairment allowance is derived from a model that uses a combination of the Group's historical experience, segmentation of the high risk loans, for example, any in forbearance, and due to the Group's limited loss experience, external data, adjusted for current conditions. In particular, judgement is required on the key assumptions of probability of default, emergence period and forced sale discount against collateral. The impairment model is most sensitive to movements in HPI and emergence period.	**Our procedures included:** — **Control testing:** We tested controls over the acceptance, monitoring and reporting of credit risk. — **Benchmarking assumptions:** We compared the key assumptions used in the impairment model, being probability of default, emergence period and forced sale discount, with those applied at peer organisations. — **Our sector experience:** We challenged the key assumptions used in the impairment model, being probability of default and forced sale discount, using our knowledge of recent impairment experience in this sector. — **Sensitivity analysis:** We assessed the model for its sensitivity to changes in the key assumptions of probability of default, house price index, emergence period and forced sale discount by performing stress testing to help us assess the reasonableness of the assumptions and identify areas of potential additional focus. — **Tests of detail:** We identified a selection of loans by filtering data from loan book reports and examined accounts with higher loan to value ratios (LTVs) to identify individual loans which may have unidentified impairments. We tested the impairment balance attached to these loans by reference to relevant supporting information such as the core loan system in addition to other factors such as the existence of additional collateral, to challenge the completeness and accuracy of the Group's specific impairment estimate. — We assessed the application of the HPI assumption by agreeing it to external data and reperforming the model calculations to ensure the accuracy of its application. — **Assessing transparency:** We assessed the adequacy of the Group's disclosures in respect of the degree of estimation involved in arriving at the balance. **Our results:** — We found the assumptions used in the calculation of the impairment allowance in respect of loans and advances to customers to be acceptable (2016: acceptable).

	The risk	Our response
Revenue Recognition EIR Income Adjustment: Charge of £400k, (2016: Charge of £1,149k) EIR Asset: £130k, (2016: £380k) *Refer to pages 40-41 (Audit Committee Report), pages 67-68 (accounting policy 1.3), page 72 (critical accounting estimates and judgements in applying accounting policies, 2.1) and page 83 (financial disclosures, Note 15).*	**Subjective estimate:** Using spreadsheet models, interest earned, fees received and incurred on loans, and premium paid on acquisition are recognised using the effective interest rate ('EIR') method that spreads directly attributable expected cash flows over the expected lives of the loans. The Directors apply judgement in deciding and assessing the expected repayment profiles used to determine the EIR period. The most critical element of judgement in this area is the estimation of the future redemption profiles of the loans. This is informed by product mix and past customer behaviour of when loans are repaid. The EIR adjustment is most sensitive to movements in the redemption profiles.	**Our procedures included:** — **Our sector experience**: We assessed the key assumptions for the expected customer lives and profiles of all material loan products against our own knowledge of industry experience and trends, including benchmarking with comparable lenders. — **Methodology implementation**: We assessed the segmentation of the loan portfolio into product groups, to ensure appropriateness of the EIR model. — **Historical comparison**: We assessed the reasonableness of the model's expected repayment profile assumptions against historical experience of loan lives based on customer behaviour, product mix and recent performance. — **Assessing transparency:** We assessed the adequacy of the Group's disclosures in respect of the degree of estimation involved in EIR accounting. **Our results:** — We found the resulting estimate of the EIR adjustment to be acceptable (2016: Acceptable).

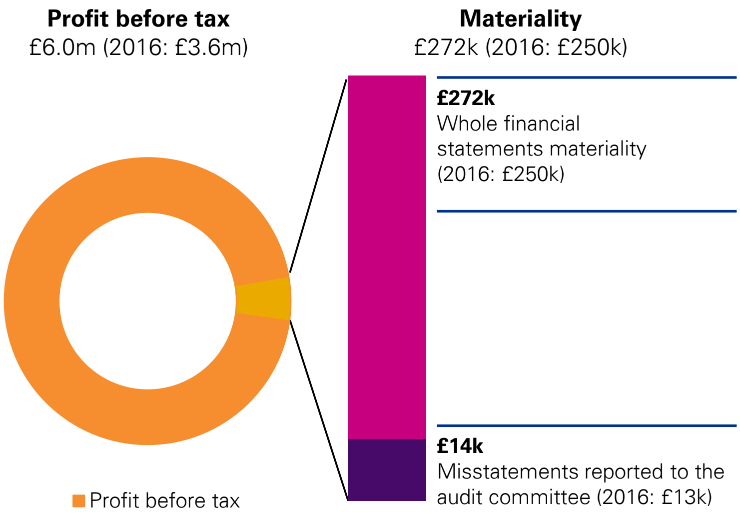
3. Our application of materiality and an overview of the scope of our audit

Materiality for the annual accounts as a whole was set at £272k (2016: £250k), determined with reference to a benchmark of Group profit before tax, of which it represents 4.5% (2016: 7.5%).

The Society profit before tax is higher than that of the Group. We have therefore used Group materiality for the Society.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £14,000 (2016: £13,000), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit of the Group was undertaken to the materiality level specified above and was all performed at the Group's head office in Epsom. The Group team performed the audit of the Group as if it was a single aggregated set of financial information. The audit was performed using the materiality level set out above.



4. We have nothing to report on going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the annual accounts. We have nothing to report in these respects.

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

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

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

Annual Business Statement and Directors' Report

In our opinion:

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

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

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

- adequate accounting records have not been kept by the Group; or
- the annual accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on pages 54-55, the directors are responsible for: the preparation of annual accounts which give a true and fair view; such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error; assessing the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the annual accounts as a whole are free from material misstatement, whether due to fraud, other irregularities, or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the annual accounts. The risk of not detecting a material misstatement resulting from fraud or other irregularities is higher than for one resulting from error, as they may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control and may involve any area of law and regulation not just those directly affecting the annual accounts.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified relevant areas of laws and regulations that could have a material effect on the financial statements from our sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Group's regulatory correspondence.

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

In addition we considered the impact of laws and regulations in the specific areas of regulatory capital and liquidity and conduct risk. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the directors and other management and inspection of regulatory correspondence. We considered the effect of any known or possible non-compliance in these areas as part of our procedures and related annual accounts items.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

As with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Society's members, as a body, in accordance with section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Richard Gabbertas (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
One Snowhill
Snow Hill Queensway
Birmingham
B4 6GH
28 February 2018

INCOME STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

		GROUP		SOCIETY	
		2017	2016	**2017**	2016
	Note	**£'000**	£'000	**£'000**	£'000
Interest receivable and similar income	3	**40,983**	42,152	**40,053**	41,296
Interest payable and similar charges	4	**(19,647)**	(22,300)	**(19,647)**	(22,300)
Net interest income		**21,336**	19,852	**20,406**	18,996
Fees and commissions receivable		**186**	169	**175**	156
Fees and commissions payable		**(48)**	(77)	**(48)**	(77)
Net (losses)/gains from financial instruments	5	**(221)**	(2,532)	**1,499**	(2,126)
Income from investments in subsidiaries	6	**-**	-	**108**	350
Other income		**106**	102	**106**	103
Total net income		**21,359**	17,514	**22,246**	17,402
Administrative expenses	7	**(14,123)**	(12,778)	**(13,975)**	(12,659)
Depreciation and amortisation	17, 18	**(1,009)**	(865)	**(1,009)**	(865)
Pension scheme finance (charge)/credit	24	**(29)**	24	**(29)**	24
Operating profit before impairment losses and provisions		**6,198**	3,895	**7,233**	3,902
Provisions for impairment losses on loans and advances	10a	**(137)**	(26)	**(1)**	(29)
Provisions for liabilities	10b	**(14)**	(287)	**(14)**	(287)
Profit before tax		**6,047**	3,582	**7,218**	3,586
Tax expense	11	**(1,174)**	(724)	**(1,378)**	(649)
Profit for the financial year	25	**4,873**	2,858	**5,840**	2,937

The Notes on pages 67 to 112 form part of these Accounts.

The above results are all derived from continuing operations.

STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2017

		GROUP		SOCIETY	
		2017	2016	**2017**	2016
	Note	**£'000**	£'000	**£'000**	£'000
Profit for the financial year	25	**4,873**	2,858	**5,840**	2,937
Other comprehensive income					
Items that will not be re-classified to the income statement					
Remeasurement of retirement benefit obligations	24	**69**	(1,362)	**69**	(1,362)
Tax credit	11	**(13)**	272	**(13)**	272
		56	(1,090)	**56**	(1,090)
Items that may subsequently be re-classified to the income statement					
Available-for-sale investments:	26				
Fair value movements taken to reserves		**435**	4,211	**435**	4,211
Amount transferred to income statement		**(698)**	(3,418)	**(698)**	(3,418)
Tax credit/(expense)	11	**60**	(181)	**60**	(181)
		(203)	612	**(203)**	612
Other comprehensive income for the year net of tax		**(147)**	(478)	**(147)**	(478)
Total comprehensive income for the year		**4,726**	2,380	**5,693**	2,459

The Notes on pages 67 to 112 form part of these Accounts.

STATEMENTS OF FINANCIAL POSITION

AS AT 31 DECEMBER 2017

		GROUP		SOCIETY	
		2017	2016	**2017**	2016
	Note	**£'000**	£'000	**£'000**	£'000
Assets					
Liquid assets					
Cash in hand and balances with the Bank of England	13a	**279,860**	313,378	**279,860**	313,378
Loans and advances to credit institutions	13b	**1,239**	2,036	**1,239**	2,036
Debt securities	13c	**164,609**	147,500	**164,609**	147,500
Total liquid assets		**445,708**	462,914	**445,708**	462,914
Derivative financial instruments	14	**1,531**	322	**1,531**	322
Loans and advances to customers	15	**1,565,258**	1,392,220	**1,446,670**	1,269,150
Investments in subsidiary undertakings	16	**–**	–	**116,425**	120,446
Property, plant and equipment	17	**6,648**	7,227	**6,648**	7,227
Intangible assets	18	**1,183**	781	**1,183**	781
Other assets	19	**710**	515	**679**	515
Current tax asset		**–**	627	**–**	627
Deferred tax asset	12	**740**	838	**601**	677
Total assets		**2,021,778**	1,865,444	**2,019,445**	1,862,659
Liabilities					
Shares	20	**1,331,532**	1,286,835	**1,331,532**	1,286,835
Other borrowings					
Amounts owed to credit institutions	21	**213,323**	78,996	**213,323**	78,996
Amounts owed to other customers	22	**191,532**	211,319	**191,532**	211,319
Total other borrowings		**404,855**	290,315	**404,855**	290,315
Total shares and borrowings		**1,736,387**	1,577,150	**1,736,387**	1,577,150
Derivative financial instruments	14	**159,208**	164,211	**155,915**	162,639
Other liabilities	23	**2,462**	5,426	**3,389**	5,417
Provisions for liabilities	10b	**109**	289	**109**	289
Retirement benefit obligations	24	**1,614**	1,253	**1,614**	1,253
Current tax liabilities		**732**	575	**958**	531
Total liabilities		**1,900,512**	1,748,904	**1,898,372**	1,747,279
Reserves					
General reserves	25	**120,662**	115,733	**120,469**	114,573
Available-for-sale reserve	26	**604**	807	**604**	807
Total reserves and liabilities		**2,021,778**	1,865,444	**2,019,445**	1,862,659

The Notes on pages 67 to 112 form part of these Accounts.
These Accounts were approved by the Board of Directors on 28 February 2018 and were signed on its behalf by:

Rodger Hughes Chairman **Mark Bogard** Chief Executive **Christopher Fry** Finance Director

STATEMENT OF CHANGES IN MEMBERS' INTERESTS

FOR THE YEAR ENDED 31 DECEMBER 2017

	GROUP 2017		
	General reserves £'000	**Available-for-sale reserve £'000**	**Total £'000**
Balance as at 1 January 2017	**115,733**	**807**	**116,540**
Profit for the financial year	**4,873**	**–**	**4,873**
Other comprehensive income for the year	**56**	**(203)**	**(147)**
Balance as at 31 December 2017	**120,662**	**604**	**121,266**

	GROUP 2016		
	General reserves £'000	Available-for-sale reserve £'000	Total £'000
Balance as at 1 January 2016	113,965	195	114,160
Profit for the financial year	2,858	–	2,858
Other comprehensive income for the year	(1,090)	612	(478)
Balance as at 31 December 2016	115,733	807	116,540

	SOCIETY 2017		
	General reserves £'000	**Available-for-sale reserve £'000**	**Total £'000**
Balance as at 1 January 2017	**114,573**	**807**	**115,380**
Profit for the financial year	**5,840**	**–**	**5,840**
Other comprehensive income for the year	**56**	**(203)**	**(147)**
Balance as at 31 December 2017	**120,469**	**604**	**121,073**

	SOCIETY 2016		
	General reserves £'000	Available-for-sale reserve £'000	Total £'000
Balance as at 1 January 2016	112,726	195	112,921
Profit for the financial year	2,937	–	2,937
Other comprehensive income for the year	(1,090)	612	(478)
Balance as at 31 December 2016	114,573	807	115,380

STATEMENT OF CASH FLOW

FOR THE YEAR ENDED 31 DECEMBER 2017

		GROUP	
		2017	2016
	Note	**£'000**	£'000
Cash flows from operating activities			
Profit before tax		**6,047**	3,582
Adjustments for:			
Depreciation and amortisation		**1,009**	865
(Profit)/loss on disposal of property, plant and equipment		**(1)**	2
Amortisation of debt securities		**2,281**	2,750
Provision for impairment losses on loans and advances		**137**	26
Loans and advances written off		**(2,316)**	(440)
Pension scheme charge		**807**	701
		7,964	7,486
Changes in operating assets and liabilities:			
(Increase)/decrease in prepayments, accrued income and other assets		**(333)**	1,834
(Decrease)/increase in accruals, deferred income and other liabilities		**(3,815)**	311
Net increase in loans and advances to customers		**(176,994)**	(142,976)
Net increase in shares		**45,190**	198,823
Net increase in amounts owed to other credit institutions and other customers		**114,716**	50,301
Net (decrease)/increase in derivatives and fair value adjustments		**(588)**	10,977
Contributions to the pension scheme		**(377)**	(361)
Taxation paid		**(245)**	(173)
Net cash flows from operating activities		**(22,446)**	118,736
Cash flows from investing activities			
Purchase of debt securities		**(125,537)**	(137,852)
Disposal of debt securities		**106,535**	171,513
Purchase of property, plant and equipment		**(83)**	(300)
Disposal of property, plant and equipment		**17**	7
Purchase of intangible assets		**(765)**	(513)
Net cash flows from investing activities		**(19,833)**	32,855
Net (decrease)/increase in cash and cash equivalents		**(34,315)**	159,077
Cash and cash equivalents at 1 January		**315,414**	156,337
Cash and cash equivalents at 31 December	27	**281,099**	315,414

NOTES TO THE ACCOUNTS

1. PRINCIPAL ACCOUNTING POLICIES

THE PRINCIPAL ACCOUNTING POLICIES ADOPTED AND APPLIED CONSISTENTLY IN THE PREPARATION OF THE ANNUAL ACCOUNTS OF THE GROUP AND SOCIETY ARE SET OUT BELOW:

1.1 BASIS OF PREPARATION

The Annual Accounts have been prepared in accordance with applicable United Kingdom Accounting Standards issued by the Financial Reporting Council – Financial Reporting Standard 102 (FRS 102) including the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement (as adopted for use in the EU)*, and where relevant and material, the Building Societies (Accounts and Related Provisions) Regulations 1998 and the Building Societies Act 1986. The Annual Accounts have been prepared under the historical cost convention as modified by the fair value revaluation of available-for-sale assets, derivatives and hedged items.

The preparation of the accounts in accordance with FRS 102 requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. These estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may differ from those estimates. Details of the critical accounting estimates and judgements in applying the accounting policies are set out in Note 2.

As noted in the Directors' Report, the Directors are satisfied that the Group has adequate resources to continue in operational existence for the foreseeable future and therefore these Accounts are prepared on the going concern basis.

The parent Society is included in the consolidated annual accounts, and is considered to be a qualifying entity under FRS 102 paragraphs 1.8 to 1.12. The following exemptions available under FRS 102 in respect of certain disclosures for the parent Society Annual Accounts have been applied:

- No separate parent Society Cash Flow Statement with related notes is included; and
- Key Management Personnel compensation has not been included a second time.

The Country by Country information for the year ended 31 December 2017 has been prepared on the following basis:

- The number of employees has been calculated as the average number of full and part-time employees, on a monthly basis, as disclosed in Note 8.
- Turnover comprises net interest income, fees and commissions receivable and payable and other income as reported in the Group Income Statement.
- Pre-tax profit or loss represents the Group profit or loss before tax, as reported in the Group Income Statement.
- Corporation tax paid represents the cash amount of corporation tax paid during the year, as disclosed in the Group Statement of Cash Flow.

1.2 BASIS OF CONSOLIDATION

The Group Accounts consolidate the assets, liabilities, income and expenditure and cash flows of the Society and all its trading subsidiary undertakings, all of which are made up to 31 December.

The acquisition method of accounting has been adopted, under which the results of subsidiary undertakings acquired or disposed of in a year are included in the Income Statement from the date of acquisition or up to the date of disposal.

In the Society's Accounts, loans to subsidiary undertakings are stated at amortised cost as adjusted for fair value hedge accounting. Shares in subsidiary undertakings are stated at cost less provisions for impairment.

1.3 INTEREST RECEIVABLE AND PAYABLE

Interest income and interest expense for all interest bearing financial assets and liabilities that are measured at amortised cost, are recognised in interest receivable and interest payable in the Income Statement using the effective interest rate method.

The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial asset or liability or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. Upfront fees charged to customers and direct external costs incurred in relation to originating mortgage loans such as broker and packager fees and the cost of other incentives are included in the calculation of the effective interest rate. This has the effect of spreading these fees and costs over the expected life of the loan. Expected lives are estimated using historic data and management judgement and the calculation is adjusted when actual experience differs from estimates, with the impact of these changes in estimates on the net carrying amount of the asset or liability being recognised immediately in the Income Statement.

Interest on impaired financial assets is recognised at the effective interest rate for the relevant loan. To the extent that interest is not expected to be recovered an allowance for this is included in the provisions for impairment losses.

Premiums paid on the acquisition of mortgage books are included in the effective interest rate of the mortgages acquired and are therefore spread over the expected lives of those mortgages.

1.4 FEES AND COMMISSIONS RECEIVABLE AND PAYABLE

Fees and commissions receivable and payable that are not part of the effective interest rate are recognised in the period during which they are earned or incurred.

1.5 PROPERTY, PLANT AND EQUIPMENT

The cost of additions and major alterations to land and buildings, and additions to equipment, fixtures, fittings and vehicles, are capitalised. Depreciation is provided at rates calculated to write down the assets to their estimated residual values over the course of their anticipated useful lives. The principal rates and bases of depreciation applied are as follows:

Office equipment, fixtures, fittings and motor vehicles:
25% per annum on a reducing balance basis.

Computer equipment:
25% per annum on a straight line basis commencing from operational deployment within the business.

Computer equipment leased:
Computer equipment that is the subject of a finance lease is depreciated over the period of the lease.

Freehold buildings:
Freehold buildings are properly maintained in a state of good repair and are considered to have a useful life of at least fifty years. The Directors believe that the recoverable amount exceeds the book value and consequently no depreciation has been provided. In accordance with FRS 102, non-depreciated assets are reviewed annually for impairment. Any such impairment would be charged to the Income Statement immediately.

Depreciation methods, useful lives and residual values are reviewed if there is an indication of a significant change since the last annual reporting date in the pattern by which the Society expects to consume an asset's future economic benefits.

1.6 INTANGIBLE ASSETS

Purchased software and external costs directly associated with the internal development of computer software are capitalised as intangible assets where the software is an identifiable asset controlled by the Group which will generate future economic benefits and where costs can be reliably measured.

Intangible assets are stated at cost less cumulative amortisation.

Amortisation begins when the asset becomes available for operational use and is charged to the Income Statement on a straight line basis over the estimated useful life of the software, which is generally four years. The assets and amortisation periods used are reviewed annually for impairment with any impairment being charged immediately to the Income Statement.

1.7 LEASES

Assets acquired by the Group under finance leases are capitalised and depreciated over the term of the lease and the future payment obligations are shown in other liabilities.

If the Group enters into an operating lease, the rental charges are charged to the Income Statement on a straight line basis over the life of the lease.

1.8 FINANCIAL ASSETS

Under the requirements of IAS 39, the Group classifies financial assets in the Statement of Financial Position as either loans and receivables, assets available-for-sale or assets at fair value through profit or loss.

ASSETS CLASSIFIED AS LOANS AND RECEIVABLES

The Group's loans and advances to customers are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group values its loans and receivables at amortised cost less any provision for impairment. Any upfront fees paid by customers and costs paid to third parties directly related to the origination of the loans, including premiums paid on loans acquired, will be added to the initial value of the loan and then recognised over the expected life of the loan as part of the effective interest rate. Any short-term discount interest rate or fixed interest rate will be included within the initial effective interest rate calculation and spread over the expected life of the loan. Throughout the year and at each year end, the assumptions made around the average life of the loans are reviewed for appropriateness. The impact of any change to these assumptions on the value of the loans carried in the Statement of Financial Position will be recognised immediately through interest receivable and similar income and reflected in the carrying value of those assets.

The value of loans and advances to customers that are included in designated hedging relationships, which includes the Lifetime Mortgages, is adjusted for changes in the fair value of the risk being hedged.

Loans and advances to credit instiutions, which are included in liquid assets, are classified as loans and receivables.

ASSETS CLASSIFIED AS AVAILABLE-FOR-SALE

Available-for-sale assets are non-derivative financial assets that are intended to be held for a non defined period of time. These assets may be sold to meet the regulatory requirements to test market conditions for liquidity, to alter the liquidity portfolio or in response to changes in interest rates. The Group's debt securities are classified as available-for-sale assets and these assets are valued in the Statement of Financial Position at fair value with subsequent changes in this value being recognised through Other Comprehensive Income except for any impairment losses which are recognised in the Income Statement. Upon sale or maturity of the asset, the cumulative gains and losses that have been recognised in Other Comprehensive Income are transferred from the available-for-sale reserve and recognised in the Income Statement.

The fair values of available-for-sale assets are based on quoted market prices.

Debt securities held by the Society may be sold subject to a commitment to repurchase them (repo). Where substantially all the risks and rewards of ownership are retained by the Society, the securities remain on the Statement of Financial Position and the counterparty liability is included separately in the Statement of Financial Position. Where the Society purchases debt securities with a commitment to resell them (reverse repo) it does not retain the risks and rewards of the securities and therefore treats them as secured loans.

The difference between the sale and repurchase price is accrued as income or expenditure over the life of the agreements.

ASSETS CLASSIFIED AS FAIR VALUE THROUGH PROFIT OR LOSS

Derivatives are used by the Group as a means of hedging market risk, primarily interest rate fluctuations, and are not used for trading purposes. Derivatives are included within the Statement of Financial Position at fair value. These fair values are based on external counterparty valuations and are included within assets when the fair value is positive and as liabilities when the fair value is negative.

The Group designates certain of its derivatives as hedging instruments in qualifying hedging relationships. These designated Fair Value Hedges hedge the Group's exposure to variability in the fair value of hedged financial assets and liabilities.

On initial designation of the fair value hedge relationship, the Group formally documents the relationship between the hedging instrument and the asset or liability that is being hedged, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis as to whether the hedging instrument is expected to be highly effective in offsetting the change in the fair value of the respective hedged item during the period for which the hedge is designated, and whether the actual results of each hedge effectiveness test are within a range of 80-125 per cent.

Changes in the fair value of hedging derivatives are recognised immediately in the Income Statement together with changes in the fair value of the item being hedged with respect to the hedged risk. Whilst the intention of the designated hedge relationship is for the change in value of the hedging instrument and the hedged asset or liability to be exactly matched this is unlikely to be the case. The difference between these values is termed hedge ineffectiveness and will result in a net income or charge to the Income Statement in the period.

If at any point the hedging relationship no longer meets the criteria for fair value hedge accounting then hedge accounting is discontinued prospectively. Any hedging adjustment up to the point of the hedging relationship being discontinued is amortised to the Income Statement over the remaining life of the hedged asset or liability.

Certain derivatives do not qualify for hedge accounting as they are not in designated hedging relationships. For example, as part of the Group's risk management practices a number of fixed interest rate swaps are entered into to hedge future fixed rate mortgage completions. This hedging relationship can only be formally designated after the loans have completed. Changes in the fair value of these derivatives are recognised immediately in the Income Statement, with no offsetting fair value adjustment to the hedged items.

Virtually all of the Society's and Group's Lifetime Mortgages include a No Negative Equity Guarantee which is valued as an embedded derivative in the Statement of Financial Position. Any change in the value of this derivative is recognised immediately in the Income Statement. More details are given in Note 2.2.

One of the derivatives hedging the Society's Lifetime Mortgages and inter-company loan to fund a subsidiary's Lifetime Mortgages includes a contractual upper and lower boundary on the principal amount of the derivative. Changes in the fair value of this derivative therefore are affected by, amongst other variables, the principal amounts of the loans being hedged. Changes in the overall fair value of the derivative contract are included in the Statement of Financial Position however the relevant offsetting hedging adjustment in the value of the Lifetime Mortgages will differ if the principal value of the mortgages is above or below the derivative boundaries. More details are given in Note 2.3.

The Society enters into credit support agreements, which protect against counterparty default in respect of hedging instruments by means of collateral transactions which reflect movements in the market values of the instruments involved. Interest on cash collateral is included within interest receivable and similar income or interest payable and similar charges, as appropriate. Collateral is included in the Statement of Financial Position within liquid assets, other assets or other liabilities, as appropriate.

1.9 IMPAIRMENT OF FINANCIAL ASSETS

IMPAIRMENT LOSSES ON LOANS AND ADVANCES

Provisions are made to reduce the value of loans and advances to customers to the amount which the Directors consider to be recoverable.

The Group assesses during the year and at each year end date whether there is objective evidence that a loan is impaired. Objective evidence of impairment can be defined as one or more events occurring after the initial recognition of the loan that have an impact on the estimated future cash flows of the loan that can be reliably estimated. The Group first assesses whether objective evidence of impairment exists for loans using the following criteria:

- whether those properties are in possession, or,
- when monthly repayments on the loans have not been maintained for one month or more, or,
- when forbearance has been exercised in the conduct of the account due to actual or apparent financial stress of the borrower, whether in arrears or not, or,
- when loans have no monthly repayment requirement and eventual cash flows may be insufficient to fully repay those loans, or,
- when there is other objective evidence of loan impairment.

If there is objective evidence of impairment of an individual loan, the amount of the loss is measured as the difference between the outstanding loan balance and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the loan's original effective interest rate. This calculation takes into account the Group's experience of default rates, collection periods, the effect of regional movements in house prices based upon a recognised index, adjustments to allow for a forced sale valuation and costs of the property sale. If this calculation shows a potential loss against the loan's carrying value then this is recognised in the Income Statement and included in the Statement of Financial Position.

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

For the remainder of the loans where no objective evidence of impairment has been identified at the reporting date, the loans are grouped together based on those with similar credit risk characteristics and they are collectively assessed for impairment.

A collective provision is made against a group of loans and advances where there is objective evidence based on the Group's experience that credit losses have been incurred, but not yet identified at the reporting date.

Where certain emerging impairment characteristics are considered significant but have not been included as part of the impairment calculation, management may elect to apply an overlay to the calculated impairment provision to ensure the Group has sufficient impairment provisions at the Statement of Financial Position date.

The amount charged in the Income Statement represents the net change in the individual and collective provisions, after allowing for impairment losses written off in the year and impairment recoveries.

Provisions for impairment losses on loans and advances are deducted from loans and advances to customers in the Statement of Financial Position. Interest on impaired loans is recognised at the effective interest rate for the relevant loan. To the extent that interest is not expected to be recovered an allowance for this is included in the provisions for impairment losses.

IMPAIRMENT LOSSES ON AVAILABLE-FOR-SALE ASSETS

At each reporting date the Group assesses whether or not there is objective evidence that individual debt securities are impaired due to for example default of a counterparty or disappearance of an active market.

Where the Group determines that there is objective evidence of impairment the cumulative gain or loss that had been recognised directly in the available-for-sale reserve is removed from reserves and recognised in the Income Statement.

If, in a subsequent period, the fair value of a debt security classified as available-for-sale increases and the increase can be related to an event occurring after the impairment loss was recognised through the Income Statement, the impairment loss will be reversed, with the amount of the reversal recognised through the Income Statement.

1.10 FINANCIAL LIABILITIES

All non derivative financial liabilities of the Group, which include shares and amounts owed to credit institutions and other customers are included in the Statement of Financial Position at amortised cost.

Costs incurred in raising wholesale funds are amortised over the period to maturity using the effective interest rate method.

1.11 RETIREMENT BENEFITS

The Society operates a defined benefits pension scheme under the National Counties Building Society Pension and Life Assurance Scheme (the Scheme) providing benefits for Society employees.

The Pension Benefit section of the Scheme was closed to new members with effect from the renewal on 1 May 2007 and future service accrual ceased on 30 April 2013. From 1 May 2007, a Cash Benefit section was introduced and all Pension Benefit section members became eligible for the Cash Benefit section from 1 May 2013. The Cash Benefit section is now closed to new entrants.

Employees who joined the Society after 1 January 2015 are enrolled into a defined contribution scheme – Group Personal Pension Plan.

All pension schemes are held in separate funds, managed and administered by third parties. The schemes are funded by contributions from the Society and its employees.

The costs of benefits accruing during the year are charged to the Income Statement as administrative expenses to the extent that they are not covered by employee contributions.

In respect of the Scheme, the extent to which the interest cost of scheme liabilities exceeds the expected return on scheme assets, or vice versa, is charged/credited to the Income Statement as a pension finance charge/credit.

At the Statement of Financial Position date, the assets of the Scheme are measured at market value and the liabilities are measured using the projected unit valuation method. The resulting pension scheme surplus or deficit is recognised immediately in the Statement of Financial Position with the corresponding deferred taxation asset or liability. Any resulting actuarial gains and losses are recognised immediately in the Statement of Comprehensive Income, along with the resultant change in the deferred taxation asset or liability.

1.12 PROVISIONS FOR CONTINGENT LIABILITIES

The Group recognises a provision when there is a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

1.13 TAXATION

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred taxation is recognised in full, without discounting, in respect of all such timing differences which have arisen but not reversed by the Statement of Financial Position date, except as otherwise required by FRS 102.

1.14 CASH AND CASH EQUIVALENTS

For the purposes of the Statement of Cash Flow, cash comprises cash in hand and balances with the Bank of England and unrestricted loans and advances to credit institutions repayable on demand. Cash equivalents comprise highly liquid unrestricted investments that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than three months.

The Statement of Cash Flow has been prepared using the indirect method.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

THE GROUP MAKES ESTIMATES AND ASSUMPTIONS THAT AFFECT THE REPORTED AMOUNTS OF ASSETS AND LIABILITIES. ESTIMATES AND JUDGMENTS ARE CONTINUALLY EVALUATED AND ARE BASED ON HISTORICAL EXPERIENCE AND OTHER FACTORS, INCLUDING EXPECTATIONS OF FUTURE EVENTS THAT ARE BELIEVED TO BE REASONABLE UNDER THE CIRCUMSTANCES. THESE ARE DESCRIBED BELOW:

2.1 EFFECTIVE INTEREST RATE – EXPECTED MORTGAGE LIVES

The calculation of an effective interest rate requires the Group to make assumptions around the average expected lives of mortgage loans. In determining these expected lives the Group uses historical and forecast redemption data as well as management judgement. These assumptions are regularly reviewed for reasonableness taking into account changes in actual experience. If the Directors consider that a change in assumption is needed the impact of the change on the carrying value of the loans would be reflected immediately in the Income Statement.

If the average lives of the mortgage loans were to decrease on average by one month, the carrying value of mortgages would decrease by £0.4m with a corresponding charge to the Income Statement.

2.2 LIFETIME MORTGAGES – NNEG

The Group's mortgage portfolio includes a pool of Lifetime Mortgages. All the loans were advanced at low Loan to Value ratios and the rates of interest charged are fixed for the duration of the mortgage. Borrowers do not make monthly repayments and instead, under their contractual terms, interest is capitalised within the balance and becomes repayable on redemption of the loan.

The mortgage contract for most of these loans contains a clause where in certain circumstances, if the amount received on the sale of the property on redemption of the loan is less than the contractual loan balance due to the Society, the Society cannot purse the borrower or the estate for the shortfall – a No Negative Equity Guarantee (NNEG). This exposes the Society to the risk that the redemption balance may not be fully recovered. This exposure is represented in the Statements of Financial Position as a derivative liability and any change in value of this derivative is immediately recognised in the Income Statement. As redemptions can be many years in the future, dependent on the morbidity/mortality of the borrowers, the value of this derivative is most sensitive to the value of the property at redemption. A small change in the expected future house price inflation assumptions can have a notable impact on the estimated redemption proceeds from the property sale.

If the average long-term annual house price rise included in the calculation was 0.25% per annum lower than forecast the Group's NNEG derivative value would increase, resulting in an additional charge to the Income Statement of £1.7m.

If the house price volatility assumption included in the calculation was to increase by 1%, the Group's NNEG derivative value would increase resulting in an additional charge of £1.9m to the Income Statement.

2.3 LIFETIME MORTGAGES – HEDGING DERIVATIVE FINANCIAL INSTRUMENT

The Group has entered into a fixed interest rate swap to hedge its exposure to the fixed interest rate Lifetime Mortgage book. This swap includes an upper and lower contractual boundary around the expected future value of the mortgage book over time. The Society has adopted fair value hedge accounting and so changes in the fair value of the swap are offset in the Income Statement by changes in the fair value of the Lifetime Mortgage book, but with net ineffectiveness being recognised. The Group's expectations of the future value of the Lifetime Mortgage book have changed such that the lower boundary has been breached. This has resulted in increased ineffectiveness being recognised in the Income Statement. The voluntary repayment of the lifetime loans by customers has the biggest impact on whether the lower boundary continues to be breached and an increase in this repayment rate by 10% a year for the next five years would result in an additional charge to the Income Statement of £1.9m.

2.4 IMPAIRMENT LOSSES ON LOANS AND ADVANCES

The creation of impairment provisions for a portfolio of mortgage loans is inherently uncertain and requires the exercise of a significant degree of judgment.

Provisions are calculated using historic default and loss experience, but require judgment to be exercised in predicting future economic conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates), the length of time before impairments are identified (emergence period) and the length of time before a security is taken into possession and sold (collection period). The accuracy of the provision would therefore be affected by unexpected changes to these assumptions.

The most critical estimate is of the level of house prices where a further property value reduction, in addition to that already included in the provisioning methodology, of 10%, would increase the loss provision by £0.3m. Other sensitivities include the emergence period, which is the time elapsed between a default event occuring and the Group being made aware of it, where an increase of six months would result in an additional provision of £0.2m.

2.5 IMPAIRMENT OF TREASURY INVESTMENTS

Treasury investments are regularly reviewed for objective evidence of impairment. In determining whether objective evidence exists, the Group considers, amongst other factors, current market conditions, fair value volatility, appropriateness of valuation techniques and the financial stability of the counterparty.

2.6 FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The Group's derivatives are valued at fair value using counterparty valuations. We replicate these values using market yield curves to ensure these valuations are reasonable.

A change in the market yield curves of plus 1% would change the total net fair value of derivative financial instruments included in the Statement of Financial Position by £70m. The change in yield curves would also impact the fair value of the items being hedged by the derivatives, offsetting the impact to the extent that the hedging relationship was effective.

2.7 DEFERRED TAX ASSETS

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. The recognition of the deferred tax asset is dependent upon the projection of future taxable profits and future reversals of existing taxable temporary differences and it is necessary for management to evaluate whether the deferred tax asset has arisen due to temporary factors or is instead indicative of a permanent decline in earnings.

Management has made detailed forecasts of future taxable income in order to determine that profits will be available to offset the deferred tax asset. These projections are based on business plans, future capital requirements and current and future economic conditions.

The assumptions surrounding new business volumes and changes in market interest rates represent the most subjective areas of judgment in management's projections of future taxable profits. Management's forecasts support the assumption that it is probable that the results of future operations will generate sufficient taxable income to utilise the deferred tax assets and it is on this basis that the deferred tax assets have been recognised. Deferred tax has been recognised at the rate expected to be prevailing when the timing differences reverse.

2.8 EMPLOYEE PENSION BENEFITS

The Group operates a defined benefit pension scheme. Significant judgments (on areas such as future interest and inflation rates and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme.

These judgments, which are based upon the Board receiving external advice from the scheme actuaries, are outlined in Note 24 to the Accounts.

Of these judgements, the main assumption affecting the liability is the discount rate used. A variation of 0.1% in discount rate will change the liability by £0.5m.

2.9 FINANCIAL SERVICES COMPENSATION SCHEME (FSCS)

The Group has a provision for the FSCS levy of £109,000 included in the Statement of Financial Position covering the period April 2017 to March 2018. This provision amount has been determined by reference to expected future interest rates applicable at the Statement of Financial Position date. Changes in interest rates over the period of the levy will impact the final amount payable.

3. INTEREST RECEIVABLE AND SIMILAR INCOME

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
On loans fully secured on residential property	**49,816**	46,458	**46,030**	42,506
On other loans:				
Connected undertakings	**-**	-	**2,855**	3,096
Other	**882**	1,156	**882**	1,156
On debt securities:				
Interest and other income from fixed income securities	**2,126**	2,705	**2,126**	2,705
Net gains arising on realisation	**698**	3,418	**698**	3,418
On other liquid assets:				
Interest and other income	**729**	898	**729**	898
Net expense on financial instruments	**(13,268)**	(12,483)	**(13,267)**	(12,483)
	40,983	42,152	**40,053**	41,296

4. INTEREST PAYABLE AND SIMILAR CHARGES

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
On shares held by individuals	**17,388**	19,722	**17,388**	19,722
On deposits and other borrowings:				
Other	**2,259**	2,544	**2,259**	2,544
Other interest payable:				
Net expense on financial instruments	**-**	34	**-**	34
	19,647	22,300	**19,647**	22,300

5. NET (LOSSES)/GAINS FROM FINANCIAL INSTRUMENTS

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
Gain/(loss) on derivatives in designated fair value hedge relationships	**9,399**	(42,611)	**9,399**	(42,611)
Adjustments to hedged items in fair value hedge relationships	**(6,915)**	40,268	**(6,915)**	40,268
(Loss)/gain on other derivatives not in designated fair value hedging relationships	**(2,705)**	(189)	**(985)**	217
	(221)	(2,532)	**1,499**	(2,126)

6. INCOME FROM INVESTMENTS IN SUBSIDIARIES

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
Dividends from subsidiary undertakings	**–**	–	**108**	350

The dividend received in 2017 was declared by National Counties Financial Services Ltd, a wholly owned subsidiary of the Society. (2016 – Dividend received from Counties Home Loans Management Ltd).

7. ADMINISTRATIVE EXPENSES

		GROUP		SOCIETY	
		2017	2016	**2017**	2016
	Note	**£'000**	£'000	**£'000**	£'000
Staff costs	8	**9,457**	8,451	**9,457**	8,451
Other administrative expenses		**4,666**	4,327	**4,518**	4,208
		14,123	12,778	**13,975**	12,659
Other administrative expenses include:					
Remuneration of Auditor and its associates (excluding Value Added Tax):					
Group and Society statutory audit		**133**	110	**133**	110
Subsidiary statutory audit		**8**	8	**8**	8
Prior year		**–**	31	**–**	31
		141	149	**141**	149
For other services:					
Services to associated pension scheme		**9**	11	**9**	11
Other services pursuant to legislation		**8**	11	**8**	11
Consultancy services		**41**	–	**41**	–
Services relating to corporate finance transactions		**–**	12	**–**	12
Total Auditor remuneration		**199**	183	**199**	183

There were no other payments made to the Auditor or their associates during 2017 (2016: No other payments made).

8. EMPLOYEES

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	Number	Number	**Number**	Number
The average number of persons employed (including Executive Directors) during the year was as follows:				
Full-time	**148**	140	**148**	140
Part-time	**12**	14	**12**	14
	£'000	£'000	**£'000**	£'000
The aggregate staff costs were as follows:				
Wages and salaries	**7,498**	6,700	**7,498**	6,700
Social security costs	**823**	719	**823**	719
Other pension costs	**1,136**	1,032	**1,136**	1,032
	9,457	8,451	**9,457**	8,451

9. DIRECTORS' EMOLUMENTS

Emoluments of the Directors of the Society totalling £1,226,000 (2016: £1,208,000) are detailed as follows:

a) Executive Directors

	2017					
	Salary £'000	Performance bonus £'000	Medium-term incentive plan £'000	Benefits £'000	Pension £'000	Total £'000
Mark Bogard	240	63	54	16	54	427
Christopher Fry	174	45	31	14	39	303
Chris Croft	166	42	22	16	37	283
	580	150	107	46	130	1,013

A medium term incentive plan ("Plan") for the Executive Directors was approved by the Remuneration Committee covering performance over three years from 1 January 2017 (see Report on Directors' Remuneration). One third of the expected payment has been accrued in 2017 and is disclosed in the table above.

Christopher Fry is retiring in April 2018. Under the terms of the Plan, the accrual to 31 December 2017 shown above will crystalise and be paid in two equal amounts in 2019 and 2020.

Mark Bogard, Christopher Fry and Chris Croft are no longer active members of the Group's Pension Scheme. Their pension emoluments in 2017 represent monthly cash payments in lieu of contributions to the Scheme.

	2016					
	Salary £'000	Performance bonus £'000	Medium-term incentive plan £'000	Benefits £'000	Pension £'000	Total £'000
Mark Bogard	211	53	81	15	47	407
Christopher Fry	156	39	60	13	35	303
Chris Croft	151	30	58	14	40	293
	518	122	199	42	122	1,003

b) Non-executive Directors

	2017 Fee £'000
Rodger Hughes	56
John Howard	39
Fiona Crisp	40
Simon Wainwright	40
Patrick Muir	37
	212

	2016 Fee £'000
Rodger Hughes	55
John Howard	37
Fiona Crisp	38
Simon Wainwright	39
Patrick Muir	36
	205

With effect from 17 October 2016, the fees due to Fiona Crisp have been paid directly to a charity on her behalf. The amount paid to the charity in 2017 was £40,287 (2016: £8,354).

Mr Howard received benefits in the year of £1,216 (2016: £nil) in respect of travel expenses.

Directors' loans and related party transactions

A register is maintained at the Head Office of the Society, in accordance with the requirements of Section 68 of the Building Societies Act 1986, which shows details of all loans, transactions and arrangements with Directors and connected persons. The register will be available for inspection at the Society's Head Office during the period of fifteen days up to and including the date of the Annual General Meeting.

There were no outstanding loans with Directors at 31 December 2017 or 31 December 2016.

10. PROVISIONS

a) Provision for impairment losses on loans and advances

GROUP	Loans fully secured on residential property		Loans fully secured on land		Other loans		Total	
	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000
At 1 January 2017	412	512	1,991	–	805	–	3,208	512
Provision utilised net of recoveries	–	–	(1,527)	–	(789)	–	(2,316)	–
Charge/(credit) for the year	192	24	(63)	–	(16)	–	113	24
At 31 December 2017	604	536	401	–	–	–	1,005	536

SOCIETY	Loans fully secured on residential property		Loans fully secured on land		Other loans		Total	
	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000
At 1 January 2017	323	435	1,399	–	381	–	2,103	435
Provision utilised net of recoveries	–	–	(933)	–	(366)	–	(1,299)	–
Charge/(credit) for the year	69	12	(65)	–	(15)	–	(11)	12
At 31 December 2017	392	447	401	–	–	–	793	447

	GROUP							
	Loans fully secured on residential property		Loans fully secured on land		Other loans		Total	
	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000
At 1 January 2016	1,185	445	1,611	–	893	–	3,689	445
Provision utilised net of recoveries	(423)	–	–	–	(17)	–	(440)	–
(Credit)/charge for the year	(350)	67	380	–	(71)	–	(41)	67
At 31 December 2016	412	512	1,991	–	805	–	3,208	512

	SOCIETY							
	Loans fully secured on residential property		Loans fully secured on land		Other loans		Total	
	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000	Individually identified £'000	Collectively identified £'000
At 1 January 2016	999	420	1,019	–	469	–	2,487	420
Provision utilised net of recoveries	(381)	–	–	–	(17)	–	(398)	–
(Credit)/charge for the year	(295)	15	380	–	(71)	–	14	15
At 31 December 2016	323	435	1,399	–	381	–	2,103	435

Where possible, forbearance measures are offered to assist borrowers experiencing financial difficulties. Included within provisions for impairment losses on loans and advances are provisions for £79,000 in relation to 62 accounts under forbearance (2016: £1,846,000; 71 accounts). Of this, £3,000 relates to the 53 Society customers (2016: £743,000; 62 customers) currently being helped by such measures (note 29).

b) Provisions for liabilities – FSCS compensation costs levy

		GROUP		SOCIETY	
	Note	**2017 £'000**	2016 £'000	**2017 £'000**	2016 £'000
At 1 January		**289**	285	**289**	285
Amounts paid	28	**(194)**	(283)	**(194)**	(283)
Charge for the year	28	**14**	287	**14**	287
At 31 December		**109**	289	**109**	289

11. TAX EXPENSE

		GROUP		SOCIETY	
		2017	2016	**2017**	2016
	Note	**£'000**	£'000	**£'000**	£'000
Current tax		**(1,116)**	(662)	**(1,342)**	(617)
Adjustment in respect of prior years		**–**	67	**–**	67
Deferred tax	12	**(65)**	(50)	**(43)**	(20)
Adjustment in respect of prior years	12	**7**	(79)	**7**	(79)
Total tax expense		**(1,174)**	(724)	**(1,378)**	(649)
The total tax charge for the year differs from that calculated using the UK standard rate of corporation tax. The differences are explained below:					
Tax on profit at the standard rate of corporation tax of 19.25% (2016: 20%)		**(1,164)**	(717)	**(1,389)**	(718)
Other items not deductible for tax		**(1)**	(1)	**(1)**	(1)
Non-taxable income		**–**	–	**21**	70
Adjustment in respect of prior years		**7**	(12)	**7**	(12)
Corporation and deferred tax rate differences		**(16)**	1	**(16)**	6
Other timing differences		**–**	5	**–**	6
Tax expense for the year		**(1,174)**	(724)	**(1,378)**	(649)
Tax recognised directly in other comprehensive income					
Tax on available-for-sale assets					
Corporation tax		**(62)**	(104)	**(62)**	(104)
Deferred tax	12	**122**	(77)	**122**	(77)
		60	(181)	**60**	(181)
Tax on retirement benefit obligations					
Corporation tax		**149**	191	**149**	191
Deferred tax	12	**(162)**	81	**(162)**	81
		(13)	272	**(13)**	272
		47	91	**47**	91

Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and to 17% (effective from 1 April 2020) were substantively enacted on 6 September 2016. This will reduce the company's future current tax charge accordingly. The deferred tax asset at 31 December 2017 has been calculated based on these rates.

12. DEFERRED TAX

		GROUP		SOCIETY	
		2017	2016	**2017**	2016
	Note	**£'000**	£'000	**£'000**	£'000
Movement on deferred tax					
At 1 January		**838**	963	**677**	772
Income statement charge	11	**(58)**	(129)	**(36)**	(99)
Recognised directly in other comprehensive income	11	**(40)**	4	**(40)**	4
At 31 December		**740**	838	**601**	677
The deferred tax asset is attributable to the following items:					
FRS 102 transitional adjustments		**371**	429	**265**	306
Pension and other post retirement benefits		**536**	712	**536**	712
AFS timing differences		**(228)**	(357)	**(228)**	(357)
Other timing differences		**61**	54	**28**	16
		740	838	**601**	677

The FRS 102 transitional adjustments reverse over the next seven years and the expected reversal in 2018 is £57,000 in the Group and £41,000 in the Society. The expected reversal in 2018 of the pension scheme deferred tax asset relating to the additional one-off contributions made to the scheme during prior years is £229,000.

13. LIQUID ASSETS

a) Cash in hand and balances with the Bank of England

Included within cash in hand and balances with the Bank of England of £279,860,000 is £124,627,000 (2016: £133,694,000) of cash collateral pledged against derivative financial instruments.

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
b) Loans and advances to credit institutions				
Repayable on demand	**1,239**	2,036	**1,239**	2,036
Repayable within 30 days	**–**	–	**–**	–
	1,239	2,036	**1,239**	2,036
c) Debt securities				
Gilts	**147,467**	133,135	**147,467**	133,135
Multinational Development Banks	**17,142**	14,365	**17,142**	14,365
	164,609	147,500	**164,609**	147,500
Debt securities have remaining maturities as follows:				
Accrued interest	**1,214**	1,075	**1,214**	1,075
In not more than one year	**10,066**	10,212	**10,066**	10,212
In more than one year	**153,329**	136,213	**153,329**	136,213
	164,609	147,500	**164,609**	147,500
Debt securities analysed, excluding accrued interest				
Transferable securities:				
Listed on a recognised investment exchange	**146,354**	132,144	**146,354**	132,144
Unlisted	**17,041**	14,281	**17,041**	14,281
	163,395	146,425	**163,395**	146,425

Included within the debt securities analysis are debt securities that are pledged as collateral for derivative and other financial transactions. As at 31 December 2017, the Group and Society had pledged listed debt securities with a market value of £59,476,000 (2016: £59,177,000).

Also included within the debt securities analysis are debt securities with a market value of £24,546,000 (2016: £21,545,000) which have been sold subject to a commitment to repurchase them.

The Directors consider that all debt securities are available for sale and have therefore been treated as such in the Statement of Financial Position.

	GROUP 2017 £'000	GROUP 2016 £'000	SOCIETY 2017 £'000	SOCIETY 2016 £'000
Movements in the year on debt securities are analysed as follows:				
At 1 January	**146,425**	184,964	**146,425**	184,964
Additions	**125,537**	137,852	**125,537**	137,852
Disposals and maturities	**(106,535)**	(171,513)	**(106,535)**	(171,513)
Amortisation of premium	**(2,281)**	(2,750)	**(2,281)**	(2,750)
Change in fair value adjustment for hedged risk	**512**	(2,921)	**512**	(2,921)
Net (losses)/gains from changes in fair value recognised in other comprehensive income	**(263)**	793	**(263)**	793
At 31 December	**163,395**	146,425	**163,395**	146,425

14. DERIVATIVE FINANCIAL INSTRUMENTS

The fair value of derivative financial instruments held at 31 December 2017 are set out below.

	GROUP			SOCIETY		
	Notional principal amount	**Fair value – Assets**	**Fair value – Liabilities**	**Notional principal amount**	**Fair value – Assets**	**Fair value – Liabilities**
	£'000s	**£'000s**	**£'000s**	**£'000s**	**£'000s**	**£'000s**
At 31 December 2017						
Derivatives designated as fair value hedges						
Interest rate swaps	**731,552**	**1,459**	**(153,524)**	**731,552**	**1,459**	**(153,524)**
	731,552	**1,459**	**(153,524)**	**731,552**	**1,459**	**(153,524)**
Unhedged derivatives						
Interest rate swaps	**22,285**	**–**	**(45)**	**22,285**	**–**	**(45)**
Basis swaps	**355,000**	**72**	**(4)**	**355,000**	**72**	**(4)**
Embedded derivatives	**–**	**–**	**(5,635)**	**–**	**–**	**(2,342)**
	377,285	**72**	**(5,684)**	**377,285**	**72**	**(2,391)**
Total derivative assets/(liabilities)	**1,108,837**	**1,531**	**(159,208)**	**1,108,837**	**1,531**	**(155,915)**

	GROUP			SOCIETY		
	Notional principal amount	Fair value – Assets	Fair value – Liabilities	Notional principal amount	Fair value – Assets	Fair value – Liabilities
	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
At 31 December 2016						
Derivatives designated as fair value hedges						
Interest rate swaps	594,829	299	(161,790)	594,829	299	(161,790)
	594,829	299	(161,790)	594,829	299	(161,790)
Unhedged derivatives						
Interest rate swaps	7,000	–	(5)	7,000	–	(5)
Basis swaps	215,000	23	(4)	215,000	23	(4)
Embedded derivatives	–	–	(2,412)	–	–	(840)
	222,000	23	(2,421)	222,000	23	(849)
Total derivative assets/(liabilities)	816,829	322	(164,211)	816,829	322	(162,639)

As at 31 December 2017, £184,102,000 (2016:£192,871,000) of cash and securities was pledged as collateral against derivative financial instruments.

15. LOANS AND ADVANCES TO CUSTOMERS

		GROUP		SOCIETY	
		2017	2016	**2017**	2016
	Note	**£'000**	£'000	**£'000**	£'000
Loans and advances to customers net of provisions are analysed as follows:					
Loans fully secured on residential property		**1,409,211**	1,223,936	**1,320,690**	1,130,761
Other loans:					
Loans fully secured on land		**11,243**	17,593	**11,243**	17,593
Other loans		**–**	2	**–**	2
		1,420,454	1,241,531	**1,331,933**	1,148,356
Fair value adjustment for hedged risk		**144,804**	150,689	**114,737**	120,794
		1,565,258	1,392,220	**1,446,670**	1,269,150
Loans and advances to customers have remaining maturities from the Statement of Financial Position date as follows:					
Repayable on call and at short notice		**920**	1,080	**–**	383
In not more than three months		**974**	601	**971**	601
In more than three months but not more than one year		**6,358**	7,620	**5,205**	5,362
In more than one year but not more than five years		**100,573**	74,401	**95,025**	69,998
In more than five years		**1,313,040**	1,161,169	**1,233,255**	1,075,772
Effective interest rate adjustment		**130**	380	**(1,283)**	(1,222)
Fair value adjustment for hedged risk		**144,804**	150,689	**114,737**	120,794
Provision for impairment losses on loans and advances	10a	**(1,541)**	(3,720)	**(1,240)**	(2,538)
		1,565,258	1,392,220	**1,446,670**	1,269,150

This maturity analysis assumes that loans and advances run for their full agreed term or, in the case of equity release loans, for the actuarial life expectancy of the borrower. In practice, loans seldom continue to the maturity date and, therefore, the actual repayment profile of loans is likely to be significantly different from that disclosed above.

16. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

a) Movements in the year

	SOCIETY		
	Shares in subsidiary undertakings £'000	Loans to subsidiary undertakings £'000	Total £'000
At 1 January 2017	**25**	**120,421**	**120,446**
Movement in fair value hedge adjustment	-	**172**	**172**
Net repayment	-	**(4,193)**	**(4,193)**
At 31 December 2017	**25**	**116,400**	**116,425**

b) Subsidiary activities

	SOCIETY			
	Country of registration	Major activities	Class of share held	Society interest
The Society's subsidiary undertakings (which operate in the United Kingdom) are:				
National Counties Financial Services Ltd	**England**	**Dormant**	**Ordinary**	**100%**
Counties Home Loan Management Ltd	**England**	**Mortgage lending**	**Ordinary**	**100%**
National Counties Estate Agents Ltd	**England**	**Dormant**	**Ordinary**	**100%**

National Counties Estate Agents Limited was in the process of being dissolved at the 31 December 2017 and this process was completed on 23 January 2018.

17. PROPERTY, PLANT AND EQUIPMENT

	GROUP			SOCIETY		
	Freehold land and buildings	Equipment, fixtures & fittings and vehicles	Total	Freehold land and buildings	Equipment, fixtures & fittings and vehicles	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Cost						
At 1 January 2017	5,374	6,153	11,527	5,374	6,153	11,527
Additions	–	83	83	–	83	83
Disposals	–	(44)	(44)	–	(44)	(44)
At 31 December 2017	5,374	6,192	11,566	5,374	6,192	11,566
Depreciation						
At 1 January 2017	–	4,300	4,300	–	4,300	4,300
Charge for year	–	646	646	–	646	646
Eliminated on disposals	–	(28)	(28)	–	(28)	(28)
At 31 December 2017	–	4,918	4,918	–	4,918	4,918
Net book value						
At 31 December 2016	5,374	1,853	7,227	5,374	1,853	7,227
At 31 December 2017	5,374	1,274	6,648	5,374	1,274	6,648

The net book value of freehold land and buildings occupied for own activities at 31 December 2017 was for the Group and Society £4,923,000 (2016: £4,923,000).

The net book value of assets held under finance lease at 31 December 2017 was for the Group and Society £500,000 (2016 – £700,000).

18. INTANGIBLE ASSETS

	GROUP	SOCIETY
	Software	Software
	£'000	£'000
Cost		
At 1 January 2017	1,856	1,856
Additions	765	765
At 31 December 2017	2,621	2,621
Amortisation		
At 1 January 2017	1,075	1,075
Charge for year	363	363
At 31 December 2017	1,438	1,438
Net book value		
At 31 December 2016	781	781
At 31 December 2017	1,183	1,183

19. OTHER ASSETS

	Group 2017 £'000	Group 2016 £'000	Society 2017 £'000	Society 2016 £'000
Sundry debtors	**65**	29	**34**	29
Prepayments and accrued income	**645**	486	**645**	486
	710	515	**679**	515

20. SHARES

	Group 2017 £'000	Group 2016 £'000	Society 2017 £'000	Society 2016 £'000
Held by individuals				
Repayable from the date of the Statement of Financial Position in the ordinary course of business:				
Accrued interest	**6,408**	6,901	**6,408**	6,901
On demand	**346,376**	381,977	**346,376**	381,977
In not more than three months	**540,518**	513,758	**540,518**	513,758
In more than three months but not more than one year	**272,670**	175,098	**272,670**	175,098
In more than one year but not more than five years	**165,560**	209,101	**165,560**	209,101
	1,331,532	1,286,835	**1,331,532**	1,286,835

This maturity analysis assumes that balances are repayable at the earliest possible date of withdrawal without penalty. Some fixed rate products provide the facility for early access on payment of an interest penalty but, in practice, this facility is seldom utilised.

21. AMOUNTS OWED TO CREDIT INSTITUTIONS

	Group 2017 £'000	Group 2016 £'000	Society 2017 £'000	Society 2016 £'000
Repayable from the date of the Statement of Financial Position in the ordinary course of business:				
Accrued interest	**268**	159	**268**	159
In not more than three months	**54,063**	43,300	**54,063**	43,300
In more than three months but not more than one year	**14,203**	24,958	**14,203**	24,958
In more than one year but not more than five years	**144,789**	10,579	**144,789**	10,579
	213,323	78,996	**213,323**	78,996

22. AMOUNTS OWED TO OTHER CUSTOMERS

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
Repayable from the date of the Statement of Financial Position in the ordinary course of business:				
Accrued interest	**683**	969	**683**	969
On demand	**5,703**	6,481	**5,703**	6,481
In not more than three months	**114,106**	103,286	**114,106**	103,286
In more than three months but not more than one year	**65,536**	84,833	**65,536**	84,833
In more than one year but not more than five years	**5,504**	15,750	**5,504**	15,750
	191,532	211,319	**191,532**	211,319

23. OTHER LIABILITIES

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
Loans from subsidiary undertakings	**-**	-	**1,000**	100
Amounts due under finance leases	**416**	583	**416**	583
Other creditors	**48**	203	**48**	203
Accruals and deferred income	**1,998**	4,640	**1,925**	4,531
	2,462	5,426	**3,389**	5,417
Included in other liabilities is a finance lease repayable from the Statement of Financial Position date as follows:				
In not more than one year	**167**	167	**167**	167
In more than one year but not more than five years	**249**	416	**249**	416
	416	583	**416**	583

The Society has the option to purchase the equipment subject to the finance lease in 2020 on payment of a nominal fee.

24. RETIREMENT BENEFIT OBLIGATIONS

The Group operates the National Counties Building Society Pension and Life Assurance Scheme ("the Scheme"), a separate trustee-administered defined benefit pension scheme for staff. The Pension Benefit section of the Scheme was closed to new entrants with effect from 1 May 2007. A replacement Cash Benefit section was introduced from the same date. The Pension Benefit section provides a defined pension to the member, while the Cash Benefit section provides a cash amount which is utilised to provide a pension.

Further service accruals were ceased within the Pension Benefit section from 1 May 2013. At that point all Pension Benefit section members became eligible for the Cash Benefit section. The Cash Benefit section is now closed to new entrants. Employees who have joined the Society after 1 January 2015 are enrolled into a defined contribution scheme – Group Personal Pension Plan.

Under FRS 102, the Group is required to include the assets of any defined benefit scheme within the Statement of Financial Position together with the related liabilities. For the purposes of FRS 102, both sections of the Closed Scheme are considered to be defined benefit schemes and these disclosures therefore relate to both sections.

A number of employees of Hampshire Trust Plc were members of the Cash Benefit section of the Scheme until the company was sold in May 2014. It is not practical to separate FRS 102 disclosures between the Society and Hampshire Trust Plc. Disclosures are therefore made at the Group level. The Society, as principal employer, accepts ultimate responsibility for Scheme liabilities.

A full actuarial valuation is carried out by a qualified independent actuary every three years. The latest actuarial valuation was carried out as at 30 April 2017. These accounting disclosures are based on the preliminary results of that actuarial valuation rolled forward to the reporting date to take account of the passage of time, the accrual of new benefits for active members, membership movements, actual revaluation of deferred benefits, expected benefits paid out of the Scheme and changes in actuarial assumptions between 30 April 2017 and 31 December 2017.

The service cost has been calculated using the Projected Unit method.

	GROUP	
	2017	2016
The principal assumptions used by the actuary were as follows:		
Pension commitments discount rate	**2.5%**	2.5%
Pensionable salaries increase	**2.5%**	2.5%
Pensions in payment increasing in line with RPI or 5% p.a. if less, minimum 3% p.a.	**3.6%**	3.6%
Pensions in payment increasing in line with RPI or 5% p.a. if less	**3.1%**	3.1%
Pensions in payment increasing in line with RPI or 2.5% p.a. if less	**2.2%**	2.2%
Pensions in payment increasing in line with CPI or 2.5% p.a. if less	**1.8%**	1.8%
Retail Price Index increase	**3.2%**	3.2%
Consumer Price Index increase	**2.2%**	2.2%

The longevity assumptions for 31 December 2017 are based on 90% of the S2PA year of birth tables adjusted in line with the Continuous Mortality Investigation's 2015 model with a 1.25% long-term rate of improvement in mortality.

The number of years' life expectancy from age 65 is as follows:		
Male retiring in 2017	**22.9**	23.0
Female retiring in 2017	**24.7**	25.0
Male retiring in 2037	**24.3**	24.7
Female retiring in 2037	**26.2**	26.9

The Group contributed at the rate of 21% of pensionable salaries for the period to cessation of further service accruals in respect of the Defined Pension section of the scheme. As such no contributions were paid after 30 April 2013, and no further contributions are due to be paid under the current schedule.

The Group contributed at the rate of 14% (2016:14%) for the year in respect of the Cash Benefit section of the Scheme. Group contributions for the next financial year, based on contribution rates and membership at 31 December 2017 are estimated at £973,000.

	GROUP	
	2017	2016
	£'000	£'000
The amounts recognised in the Statement of Financial Position are determined as follows:		
Present value of defined benefit obligation	**(29.895)**	(28,148)
Fair value of scheme assets	**28,281**	26,895
Defined benefit liability in the Statement of Financial Position	**(1,614)**	(1,253)
Reconciliation of opening and closing balances of the defined benefit obligation:		
Defined benefit obligation at 1 January	**28,148**	21,220
Current service cost	**652**	556
Interest expense	**693**	767
Contributions by scheme participants	**161**	176
Actuarial gain	**1,296**	6,411
Benefits paid	**(1,055)**	(982)
Defined benefit obligation at 31 December	**29,895**	28,148
Reconciliation of opening and closing balances of the fair value of scheme assets:		
Fair value of scheme assets at 1 January	**26,895**	21,669
Interest income	**664**	791
Return on assets, excluding interest income	**1,365**	5,049
Contributions by the employer	**377**	361
Contributions by scheme participants	**161**	176
Benefits paid	**(1,055)**	(982)
Scheme administrative cost	**(126)**	(169)
Fair value of scheme assets at 31 December	**28,281**	26,895

The actual return on the Scheme assets over the period ending 31 December 2017 was £2,029,000.

	GROUP	
	2017	2016
	£'000	£'000
Analysis of amount charged in the Income Statement		
Current service cost and expenses	**778**	725
Total operating charge (included within administrative expenses)	**778**	725
Analysis of net return on scheme		
Net interest cost/(income)	**29**	(24)
Net interest cost/(income) being the pension scheme finance charge/(credit)	**29**	(24)
Analysis of amount recognised in the Statements of Comprehensive Income		
Return on assets, excluding interest income	**1,365**	5,049
Actuarial gains and losses arising on the scheme liabilities	**(1,296)**	(6,411)
Actuarial gain/(loss) recognised in other comprehensive income	**69**	(1,362)
Assets		
The fair value of the assets in the scheme at 31 December were as follows:		
UK and overseas equities	**10,227**	8,894
Diversified growth funds	**4,241**	4,064
Corporate bonds	**1,803**	1,740
Government bonds	**2,965**	2,899
Cash	**59**	100
Purchased annuity contracts	**8,986**	9,198
Total scheme assets	**28,281**	26,895

Purchased annuity contracts are included at the same value in both the assets and liabilities of the Scheme. These contracts are therefore neutral to the Scheme accounting position.

25. RESERVES – GENERAL RESERVES

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
At 1 January	**115,733**	113,965	**114,573**	112,726
Profit for the financial year	**4,873**	2,858	**5,840**	2,937
Other comprehensive income for the year	**56**	(1,090)	**56**	(1,090)
At 31 December	**120,662**	115,733	**120,469**	114,573

26. RESERVES – AVAILABLE-FOR-SALE RESERVE

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
At 1 January	**807**	195	**807**	195
Net (loss)/gain from changes in fair value	**(203)**	612	**(203)**	612
At 31 December	**604**	807	**604**	807

27. CASH AND CASH EQUIVALENTS

		GROUP		SOCIETY	
		2017	2016	**2017**	2016
	Note	**£'000**	£'000	**£'000**	£'000
Cash in hand and balances with the Bank of England	13a	**279,860**	313,378	**279,860**	313,378
Loans and advances to credit institutions	13b	**1,239**	2,036	**1,239**	2,036
		281,099	315,414	**281,099**	315,414

28. FINANCIAL COMMITMENTS

a) Financial Services Compensation Scheme (FSCS)

As a regulated UK deposit-taker, the Society, in common with all regulated UK deposit-takers, pays levies based on its share of deposits protected by the FSCS to enable the scheme to meet claims against it. There are two FSCS levies – a management expenses levy ("MEL") and a compensation costs levy ("CCL"). The MEL covers the running costs of the scheme and the CCL covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it.

In May 2013, the International Accounting Standards Board issued an interpretation to clarify the accounting treatment for levies in the financial statements of an entity subject to such levies. The interpretation explains that there is no obligation to recognise the liability for a levy until the activity that triggers payment occurs. Applying the interpretation to the FSCS levies, the liability should only be recognised after the trigger date of 1 April. As at the Statement of Financial Position date, the MEL liability accrued relates to the 12 month period to 31 March 2018 triggered at 1 April 2017. No liability for the levies is recognised for scheme years beyond March 2018.

The charge made in the Income Statement in 2017 for the CCL liability is £14,000 (2016: £287,000).

FSCS invoices totalling £194,000 have been paid by the Society during 2017 for its CCL liability (2016: £283,000) which, together with the above-mentioned provision charge, results in a FSCS CCL levy provision totalling £109,000 (2016: £289,000). This provision is included in the Income Statements within provisions for liabilities and in the Statements of Financial Position within provisions for liabilities (note 10b). The MEL costs for the Society are included within adminstrative expenses in the Income Statements.

b) It is the intention of the Society to continue to support fully its subsidiary undertakings.

c) Capital commitments at 31 December, for which no provision has been made in the Accounts, were as follows:	GROUP		SOCIETY	
	2017 £'000	2016 £'000	**2017 £'000**	2016 £'000
Capital expenditure contracted but not provided for:	**-**	-	**-**	-

d) Contingent liabilities

	Group 2017 £'000	Group 2016 £'000	Society 2017 £'000	Society 2016 £'000
Assets pledged as collateral security against derivative contracts at the year end	**184,102**	192,871	**184,102**	192,871

e) Commitments

	Group 2017 £'000	Group 2016 £'000	Society 2017 £'000	Society 2016 £'000
Irrevocable undrawn loan facilities to borrowers at year end	**7,799**	15,392	**7,799**	15,392
Commitment to repurchase assets sold under repo agreements	**24,546**	20,855	**24,546**	20,855
	32,345	36,247	**32,345**	36,247

29. FINANCIAL INSTRUMENTS

A financial instrument is a contract which gives rise to a financial asset of one entity and a financial liability of another entity. The Group is a retailer of financial instruments in the form of mortgage and savings products and uses wholesale financial instruments to invest in liquid asset balances, raise wholesale funding and manage risks arising from its operations. As a result of these operations, the Group is exposed to a variety of risks, the most significant being credit risk, liquidity risk and market risk which are described later in this note.

The Group has an established formal structure for managing risk, including setting risk appetite, risk limits, reporting lines, mandates, policies and other relevant control procedures. This structure is reviewed regularly by the Asset and Liability Committee ("ALCO"), which is charged with the responsibility for managing and controlling the Statement of Financial Position and the use of financial instruments for risk management purposes.

DERIVATIVES

Instruments used for risk management purposes include derivative financial instruments ("derivatives"), which are contracts or agreements whose current value at the reporting date is related to the change in the underlying price, rate or index inherent in the contract or agreement, such as interest rates.

Derivatives are only used by the Group to reduce the risk of loss arising from changes in interest rates or other market related factors and are not used in trading activity or for speculative purposes.

The table below describes the significant activities undertaken by the Group, the related risks associated with such activities and the type of derivatives which are typically used in managing such risks.

Activity	Risk	Managed by
Fixed rate mortgage lending	Increase in interest rates	Fixed interest rate swaps
Fixed rate savings products	Decrease in interest rates	Fixed interest rate swaps
Managing basis risk	Non-parallel interest rate shifts	Basis swaps
Fixed rate liquidity	Increase in interest rates	Fixed interest rate swaps

The most significant derivatives used by the Group in managing its risks are interest rate swaps which protect the Group from exposures to fixed rate mortgage lending and fixed rate savings products. An interest rate swap contract which is based on a notional principal amount, exchanges one set of interest rate cashflows for another for a set duration agreed between the parties at the commencement of the contract. Entering into these contracts allows the Group to manage the interest rate risk.

The Group also uses repos and reverse repos, which are effectively secured borrowing and lending, in its liquidity management operations.

Classification of financial assets and liabilities

Financial assets and liabilities are measured on an on-going basis at either fair value or amortised cost. The following tables show the classification of the Group's and Society's financial assets and liabilities:

	GROUP					
Carrying values as at 31 December 2017	**Held at amortised cost**		**Held at fair value**			
	Loans and receivables	**Other financial assets and liabilities at amortised cost**	**Available for sale**	**Derivatives designated as fair value hedges**	**Unmatched derivatives**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Assets						
Cash in hand and balances with the Bank of England	–	**279,860**	–	–	–	**279,860**
Loans and advances to credit institutions	**1,239**	–	–	–	–	**1,239**
Debt securities	–	–	**164,609**	–	–	**164,609**
Derivative financial instruments	–	–	–	**1,459**	**72**	**1,531**
Loans and advances to customers	**1,565,258**	–	–	–	–	**1,565,258**
Total financial assets	**1,566,497**	**279,860**	**164,609**	**1,459**	**72**	**2,012,497**
Non financial assets	–	**9,281**	–	–	–	**9,281**
Total Assets	**1,566,497**	**289,141**	**164,609**	**1,459**	**72**	**2,021,778**
Liabilities						
Shares	–	**1,331,532**	–	–	–	**1,331,532**
Amounts due to credit institutions	–	**213,323**	–	–	–	**213,323**
Amounts owed to other customers	–	**191,532**	–	–	–	**191,532**
Derivative financial instruments	–	–	–	**153,524**	**5,684**	**159,208**
Total financial liabilities	–	**1,736,387**	–	**153,524**	**5,684**	**1,895,595**
Non financial liabilities	–	**4,917**	–	–	–	**4,917**
Total Liabilities	–	**1,741,304**	–	**153,524**	**5,684**	**1,900,512**

Carrying values as at 31 December 2016	GROUP					
	Held at amortised cost		Held at fair value			
	Loans and receivables £'000	Other financial assets and liabilities at amortised cost £'000	Available for sale £'000	Derivatives designated as fair value hedges £'000	Unmatched derivatives £'000	Total £'000
Assets						
Cash in hand and balances with the Bank of England	–	313,378	–	–	–	313,378
Loans and advances to credit institutions	2,036	–	–	–	–	2,036
Debt securities	–	–	147,500	–	–	147,500
Derivative financial instruments	–	–	–	299	23	322
Loans and advances to customers	1,392,220	–	–	–	–	1,392,220
Total financial assets	1,394,256	313,378	147,500	299	23	1,855,456
Non financial assets	–	9,988	–	–	–	9,988
Total Assets	1,394,256	323,366	147,500	299	23	1,865,444
Liabilities						
Shares	–	1,286,835	–	–	–	1,286,835
Amounts due to credit institutions	–	78,996	–	–	–	78,996
Amounts owed to other customers	–	211,319	–	–	–	211,319
Derivative financial instruments	–	–	–	161,790	2,421	164,211
Total financial liabilities	–	1,577,150	–	161,790	2,421	1,741,361
Non financial liabilities	–	7,543	–	–	–	7,543
Total Liabilities	–	1,584,693	–	161,790	2,421	1,748,904

Carrying values as at 31 December 2017	SOCIETY					
	Held at amortised cost		Held at fair value			
	Loans and receivables	Other financial assets and liabilities at amortised cost	Available for sale	Derivatives designated as fair value hedges	Unmatched derivatives	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Assets						
Cash in hand and balances with the Bank of England	–	279,860	–	–	–	279,860
Loans and advances to credit institutions	1,239	–	–	–	–	1,239
Debt securities	–	–	164,609	–	–	164,609
Derivative financial instruments	–	–	–	1,459	72	1,531
Loans and advances to customers	1,446,670	–	–	–	–	1,446,670
Investment in subsidiary undertaking	–	116,425	–	–	–	116,425
Total financial assets	1,447,909	396,285	164,609	1,459	72	2,010,334
Non financial assets	–	9,111	–	–	–	9,111
Total Assets	1,447,909	405,396	164,609	1,459	72	2,019,445
Liabilities						
Shares	–	1,331,532	–	–	–	1,331,532
Amounts due to credit institutions	–	213,323	–	–	–	213,323
Amounts owed to other customers	–	191,532	–	–	–	191,532
Derivative financial instruments	–	–	–	153,524	2,391	155,915
Total financial liabilities	–	1,736,387	–	153,524	2,391	1,892,302
Non financial liabilities	–	6,070			–	6,070
Total Liabilities	–	1,742,457	–	153,524	2,391	1,898,372

Carrying values as at 31 December 2016	SOCIETY					
	Held at amortised cost		Held at fair value			
	Loans and receivables £'000	Other financial assets and liabilities at amortised cost £'000	Available for sale £'000	Derivatives designated as fair value hedges £'000	Unmatched derivatives £'000	Total £'000
Assets						
Cash in hand and balances with the Bank of England	–	313,378	–	–	–	313,378
Loans and advances to credit institutions	2,036	–	–	–	–	2,036
Debt securities	–	–	147,500	–	–	147,500
Derivative financial instruments	–	–	–	299	23	322
Loans and advances to customers	1,269,150	–	–	–	–	1,269,150
Investment in subsidiary undertaking	–	120,446	–	–	–	120,446
Total financial assets	1,271,186	433,824	147,500	299	23	1,852,832
Non financial assets	–	9,827	–	–	–	9,827
Total Assets	1,271,186	443,651	147,500	299	23	1,862,659
Liabilities						
Shares	–	1,286,835	–	–	–	1,286,835
Amounts due to credit institutions	–	78,996	–	–	–	78,996
Amounts owed to other customers	–	211,319	–	–	–	211,319
Derivative financial instruments	–	–	–	161,790	849	162,639
Total financial liabilities	–	1,577,150	–	161,790	849	1,739,789
Non financial liabilities	–	7,490	–	–	–	7,490
Total Liabilities	–	1,584,640	–	161,790	849	1,747,279

Fair values of financial assets and liabilities

The Group holds certain financial assets and liabilities at fair value, grouped into Levels 1 to 3 of the fair value hierarchy (see below).

Fair values are determined using the following fair value hierarchy that reflects the significance of the inputs in measuring fair value:

Level 1: The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.

Level 2: Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly.

Level 3: Inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

Fair values of financial assets and liabilities carried at fair value

The tables below show the fair values of the Group's and Society's financial assets and liabilities analysed according to the fair value hierarchy.

	GROUP				
As at 31 December 2017	**Carrying value £'000**	**Fair value Level 1 £'000**	**Fair value Level 2 £'000**	**Fair value Level 3 £'000**	**Fair value Total £'000**
Assets					
Debt securities	**164,609**	**164,609**	**–**	**–**	**164,609**
Derivative financial instruments	**1,531**	**–**	**1,531**	**–**	**1,531**
	166,140	**164,609**	**1,531**	**–**	**166,140**
Liabilities					
Derivative financial instruments	**159,208**	**–**	**7,201**	**152,007**	**159,208**
	159,208	**–**	**7,201**	**152,007**	**159,208**

	GROUP				
As at 31 December 2016	Carrying value £'000	Fair value Level 1 £'000	Fair value Level 2 £'000	Fair value Level 3 £'000	Fair value Total £'000
Assets					
Debt securities	147,500	147,500	–	–	147,500
Derivative financial instruments	322	–	322	–	322
	147,822	147,500	322	–	147,822
Liabilities					
Derivative financial instruments	164,211	–	10,630	153,581	164,211
	164,211	–	10,630	153,581	164,211

As at 31 December 2017	SOCIETY Carrying value £'000	Fair value Level 1 £'000	Fair value Level 2 £'000	Fair value Level 3 £'000	Fair value Total £'000
Assets					
Debt securities	**164,609**	**164,609**	**–**	**–**	**164,609**
Derivative financial instruments	**1,531**	**–**	**1,531**	**–**	**1,531**
	166,140	**164,609**	**1,531**	**–**	**166,140**
Liabilities					
Derivative financial instruments	**155,915**	**–**	**7,201**	**148,714**	**155,915**
	155,915	**–**	**7,201**	**148,714**	**155,915**

As at 31 December 2016	SOCIETY Carrying value £'000	Fair value Level 1 £'000	Fair value Level 2 £'000	Fair value Level 3 £'000	Fair value Total £'000
Assets					
Debt securities	147,500	147,500	–	–	147,500
Derivative financial instruments	322	–	322	–	322
	147,822	147,500	322	–	147,822
Liabilities					
Derivative financial instruments	162,639	–	10,630	152,009	162,639
	162,639	–	10,630	152,009	162,639

The main valuation techniques employed by the Group to establish the fair values of financial assets and liabilities are set out below:

Debt securities
Level 1: Market prices have been used to determine the fair value of listed debt securities.

Derivative financial instruments
Level 2: Interest rate swaps – the valuation of interest rate swaps is based on the 'present value' method. Expected interest cash flows are discounted using the prevailing SONIA yield curves. The SONIA yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the interest cash flows and maturities of the instruments. All swaps are collateralised and therefore no adjustment is required for credit risk in the fair value of derivatives.

Level 3: Lifetime Mortgage swap and NNEG embedded derivative – the fair value of these derivatives is calculated using internal models which include a valuation of the upper and lower boundary in the Lifetime Mortgage swap and take into account predictions of future drawings, interest rates, mortality/morbidity, early redemption, HPI growth and HPI volatility.

CREDIT RISK

Credit risk can be described as the risk of customers or counterparties being unable to meet their financial obligations to the Group as they become due.

The Group is exposed to this risk through its lending to:

- Individuals – residential mortgages, including Buy to Let
- Commercial lending
- Wholesale counterparties (including other financial institutions). This occurs within the treasury portfolio assets, where credit risk arises from the investments held by the Group in order to meet liquidity requirements and for general business purposes. It also arises from the use of derivatives and repos, but here collateralisation received reduces the risk substantially.

Changes in the credit quality and the recoverability of loans and amounts due from counterparties influence the Group's exposure to credit risk. Adverse changes in the credit quality of counterparties, collateral values or deterioration in the wider economy, including rising unemployment, worsening household finances and tightening in the UK property market, resulting in declining property values, could affect the recoverability and value of the Group's assets and influence its financial performance. A prolonged economic downturn and the possible continuation of falls in property values (either residential or commercial) could affect the level of impairment losses currently recognised.

The controlled management of credit risk is critical to the Group's overall strategy. The Group has therefore embedded a comprehensive and robust credit risk management framework with clear lines of accountability and oversight as part of its overall governance framework. The Group has effective policies and procedures to identify, monitor, control, mitigate and manage credit risk within the Group's risk appetite.

	GROUP		SOCIETY	
The Group's maximum credit risk exposure is detailed below:	**2017 £'000**	2016 £'000	**2017 £'000**	2016 £'000
Cash in hand and balances with the Bank of England	**279,852**	313,371	**279,852**	313,371
Loans and advances to credit institutions	**1,239**	2,036	**1,239**	2,036
Debt securities	**164,609**	147,500	**164,609**	147,500
Derivative financial instruments	**1,531**	322	**1,531**	322
Loans and advances to customers	**1,420,324**	1,241,151	**1,333,216**	1,149,578
Total Statement of Financial Position exposure	**1,867,555**	1,704,380	**1,780,447**	1,612,807
Statement of Financial Position exposure – mortgage commitments	**7,799**	15,392	**7,799**	15,392
Total	**1,875,354**	1,719,772	**1,788,246**	1,628,199

Loans and advances to customers				
Concentration by loan type				
Loans fully secured on residential property				
Owner Occupied and Buy to Let	**1,211,179**	1,017,196	**1,165,055**	967,361
Equity release	**199,042**	207,284	**157,757**	165,379
Other loans				
Loans fully secured on land – commercial	**11,644**	19,585	**11,644**	18,993
Other loans	**–**	806	**–**	383
Gross balances	**1,421,865**	1,244,871	**1,334,456**	1,152,116
Impairment provisions	**(1,541)**	(3,720)	**(1,240)**	(2,538)
Effective interest rate adjustment	**130**	380	**(1,283)**	(1,222)
Fair value adjustments	**144,804**	150,689	**114,737**	120,794
	1,565,258	1,392,220	**1,446,670**	1,269,150

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	%	%	**%**	%
Geographical analysis of gross mortgage balances				
North	**2**	3	**2**	3
North East	**5**	5	**4**	5
North West	**5**	5	**5**	5
East Midlands	**3**	4	**3**	4
West Midlands	**4**	4	**4**	4
East Anglia	**3**	4	**3**	4
South East	**65**	62	**66**	62
South West	**10**	10	**10**	10
Wales	**3**	3	**3**	3
	100	100	**100**	100
Indexed loan to value distribution of Owner Occupied and Buy to Let gross mortgage balances				
Greater than 95%	**–**	–	**–**	–
90%–95%	**–**	–	**–**	–
85%–90%	**–**	–	**–**	–
75%–85%	**2**	2	**2**	2
50%–75%	**34**	33	**34**	34
<50%	**64**	65	**64**	64
Total	**100**	100	**100**	100
Average loan to value of Owner Occupied and Buy to Let mortgage portfolio	**49**	47	**43**	38
Indexed loan to value distribution of lifetime gross mortgage balances				
Greater than 95%	**1**	1	**1**	1
90%–95%	**–**	–	**–**	–
85%–90%	**–**	–	**–**	–
75%–85%	**1**	–	**–**	–
50%–75%	**14**	9	**7**	9
<50%	**84**	90	**92**	90
Total	**100**	100	**100**	100
Average loan to value of Lifetime Mortgage portfolio	**45**	40	**38**	36

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	%	%	**%**	%
Indexed loan to value distribution of Commercial mortgage loan balances				
Greater than 95%	**–**	–	**–**	–
90%–95%	**–**	–	**–**	–
85%–90%	**–**	–	**–**	–
75%–85%	**12**	7	**12**	7
50%–75%	**17**	17	**17**	17
<50%	**71**	76	**71**	76
Total	**100**	100	**100**	100
Average loan to value of Commercial mortgage portfolio	**47**	45	**47**	45

The Group's average indexed loan to value at the year end date is 47% (2016: 44%).

The table below provides further information on the Group's residential loans and advances to customers by payment due status at the year end:

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
Loans neither past due or impaired	**1,388,786**	1,208,903	**1,303,671**	1,119,554
Past due but not impaired				
Past due to 3 months	**11,953**	7,924	**11,217**	7,184
Past due 3 to 6 months	**1,473**	1,039	**1,075**	682
Past due 6 to 12 months	**1,527**	650	**1,527**	650
Past due over 12 months	**2,078**	1,127	**2,078**	1,127
Possessions	**–**	–	**–**	–
Impaired				
Not past due	**2,751**	1,012	**2,164**	943
Past due to 3 months	**1,441**	3,298	**987**	2,408
Past due 3 to 6 months	**119**	527	**–**	192
Past due 6 to 12 months	**93**	–	**93**	–
Past due over 12 months	**–**	–	**–**	–
Possessions	**–**	–	**–**	–
	1,410,221	1,224,480	**1,322,812**	1,132,740

Loans that are past due are shown in the table above as not impaired where no impairment provision is required.

The following table indicates assets obtained by taking possession of collateral held against residential loans and advances to customers:

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
Residential property	–	–	–	–
	–	–	–	–

The table below provides further information on the Group's commercial loans and advances to customers by payment due status at the year end:

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
Loans neither past due or impaired	**10,725**	16,677	**10,725**	16,677
Past due but not impaired				
Past due to 3 months	–	–	–	–
Past due 3 to 6 months	–	–	–	–
Past due 6 to 12 months	–	–	–	–
Past due over 12 months	–	–	–	–
Possessions	–	–	–	–
Impaired				
Not past due	**919**	973	**919**	973
Past due to 3 months	–	–	–	–
Past due 3 to 6 months	–	–	–	–
Past due 6 to 12 months	–	988	–	988
Past due over 12 months	–	947	–	355
Possessions	–	–	–	–
	11,644	19,585	**11,644**	18,993

Loans that are past due are shown in the table above as not impaired where no impairment provision is required.

No commercial property was held at 31 December 2017 or 31 December 2016 as a result of taking possession of collateral held against commercial loans and advances to customers.

The collateral held consists of properties included within the above categories. The use of such collateral is in line with terms that are usual and customary to standard lending activities.

Forbearance strategies and restructured loans

A range of forbearance strategies are employed in order to work with our borrowers to control arrears and, wherever it is in the borrower's best interest, avoid repossession. The agreed strategy will reflect the customer's individual circumstances and will be used in line with industry guidance.

Our approach is based on criteria which, in the judgment of senior management, indicate that repayment is likely to continue. Forbearance arrangements include extended payment terms, a reduction in interest or principal repayments, and approved external debt management plans.

Interest is recorded on loans in forbearance on the basis of new contractual terms following restructure.

The tables below analyse balances of loans and advances to customers where forbearance measures have been applied as at the year end date:

	GROUP			SOCIETY		
As at 31 December 2017	**Number of accounts**	**Gross loans £'000**	**Provision £'000**	**Number of accounts**	**Gross loans £'000**	**Provision £'000**
Temporary arrangement – interest-only	**10**	**1,687**	**–**	**10**	**1,687**	**–**
Temporary arrangement – other	**24**	**2,846**	**9**	**15**	**1,669**	**2**
Concession	**4**	**367**	**–**	**4**	**367**	**–**
Extension of mortgage term	**21**	**2,537**	**1**	**21**	**2,537**	**1**
Interest-only conversion	**3**	**819**	**69**	**3**	**750**	**–**
	62	**8,256**	**79**	**53**	**7,010**	**3**

	GROUP			SOCIETY		
As at 31 December 2016	Number of accounts	Gross loans £'000	Provision £'000	Number of accounts	Gross loans £'000	Provision £'000
Temporary arrangement – interest-only	12	2,224	69	12	2,155	–
Temporary arrangement – other	44	6,398	26	35	5,208	7
Concession	5	386	–	5	386	–
Extension of mortgage term	6	460	–	6	460	–
Interest-only conversion	4	1,880	1,751	4	864	736
	71	11,348	1,846	62	9,073	743

Loans and advances to credit institutions and debt securities

The Group holds treasury investments in order to meet liquidity requirements and for general business purposes. The credit risk arising from these investments is monitored, managed and controlled closely by the Group.

The Group determines that a treasury asset is impaired when there has been a significant or prolonged decline in the fair value below its cost. The determination of 'significant or prolonged' requires judgment. In making this judgment, the Group evaluates, among other factors, the normal volatility in valuation, evidence of deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows. At 31 December 2017 and 31 December 2016 none of the Group's treasury investments were either past due or impaired and no impairment charges were required during the year.

The Group has no non-UK exposure in its liquidity portfolio other than to Multinational Development Banks. The tables below show the relative concentrations of the Group's treasury investment portfolio.

The ALCO is responsible for approving treasury counterparties for both derivatives and investment purposes. Limits are placed on the amount of risk accepted in relation to one counterparty, or group of counterparties, and to industry sectors. This is monitored daily by the society's Treasury team and reviewed monthly by ALCO.

The Group's policy permits lending to UK central government (which includes the Bank of England), Multinational Development Banks and banks and building societies approved by ALCO and the Board.

An analysis of the Group's treasury asset concentration is shown in the table below:

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£'000	£'000	**£'000**	£'000
Concentration by credit grading				
AAA	**17,142**	14,365	**17,142**	14,365
AA	**148,606**	135,070	**148,606**	135,070
A	**–**	101	**–**	101
BBB	**100**	–	**100**	–
Unrated	**–**	–	**–**	–
	165,848	149,536	**165,848**	149,536

	GROUP 2017 £'000	GROUP 2016 £'000	SOCIETY 2017 £'000	SOCIETY 2016 £'000
Concentration by industry sector				
Banks	**1,239**	2,036	**1,239**	2,036
Multinational Development Banks	**17,142**	14,365	**17,142**	14,365
UK Treasury	**147,467**	133,135	**147,467**	133,135
	165,848	149,536	**165,848**	149,536

	GROUP 2017 £'000	GROUP 2016 £'000	SOCIETY 2017 £'000	SOCIETY 2016 £'000
Concentration by geographic region				
UK	**148,706**	135,171	**148,706**	135,171
Multinational Development Banks	**17,142**	14,365	**17,142**	14,365
	165,848	149,536	**165,848**	149,536

LIQUIDITY RISK

The Society's principal purpose is to make loans secured by way of mortgage on residential property funded substantially by short-term savings from its members.

The contractual maturity of the mortgages is typically up to 25 years although loans are often repaid early due to borrowers moving house or remortgaging.

In contrast, the majority of members' savings are available on demand or at short notice. It is this inherent mismatch between the maturity profile of mortgage lending and the easy accessibility of savings that creates liquidity risk.

The Group's liquidity policy is to maintain sufficient assets in liquid form at all times to ensure that the Group can meet all its liabilities as they fall due and also meet all regulatory liquidity requirements.

The Group manages this risk on a continuous basis through the ALCO and by ensuring compliance with the Liquidity and Financial Risk Management Policies approved by the Board. In practice this results in the Group holding a significant amount of highly liquid assets, mainly UK Gilts, Treasury bills, Multilateral Development Bank securities and deposits with the Bank of England, which are eligible to meet its required liquidity buffer set by the regulator and for use as collateral with derivative counterparties. Day-to-day operational requirements are met from deposits placed on call or overnight with the Bank of England and major banks.

The Board undertakes a detailed review of its liquidity adequacy under the Individual Liquidity Adequacy Assessment proocess (ILAAP) and submits this to the PRA for supervisory review. The ILAAP specifies the daily processes that the Society will use to determine the amount of liquidity required to cover its potential cash flow needs under a range of stresses including three PRA standard scenarios 'name-specific', 'market-wide' and 'combined'.

There are many tests, limits and controls that the Group uses to monitor and manage its liquidity position. In particular these include:

- **Overall Liquidity Adequacy Requirement (OLAR)** – This includes a requirement to maintain sufficient liquid assets to survive a short-term stressed outflow and a longer term survival requirement including contingent liquidity.
- **Liquidity Coverage Ratio (LCR)** – The regulatory minimum percentage of buffer assets to net outflows.
- **Future funding period outflows** – Restrictions on the maximum wholesale and retail funding that can be taken in different future time periods to avoid concentrations of potential outflows in any period.

The tables below analyse the Group's assets and liabilities across maturity periods that reflect the residual maturity from the year end date to the contractual maturity date. Loans and advances to customers that have no specific maturity date have been included in the 'More than 5 years' category. The actual repayment profile of loans and advances is likely to be significantly different to that shown in the analysis:

	GROUP						
Residual maturity as at 31 December 2017	**On demand £'000**	**Not more than 3 months £'000**	**More than 3 months but not more than 1 year £'000**	**More than 1 year but not more than 5 years £'000**	**More than 5 years £'000**	**Non defined maturity £'000**	**Total £'000**
Financial assets							
Cash in hand and balances with the Bank of England	**279,860**	–	–	–	–	–	**279,860**
Loans and advances to credit institutions	**1,239**	–	–	–	–	–	**1,239**
Debt securities	–	**5,000**	**5,066**	**54,951**	**98,378**	**1,214**	**164,609**
Derivative financial instruments	–	**22**	**42**	**1,358**	**109**	–	**1,531**
Loans and advances to customers	**920**	**974**	**6,358**	**100,573**	**1,313,040**	**143,393**	**1,565,258**
Other assets	–	–	–	–	–	**9,281**	**9,281**
	282,019	**5,996**	**11,466**	**156,882**	**1,411,527**	**153,888**	**2,021,778**

Financial liabilities and reserves							
Shares	**346,376**	**540,518**	**272,670**	**165,560**	–	**6,408**	**1,331,532**
Amounts owed to credit institutions	–	**54,063**	**14,203**	**144,789**	–	**268**	**213,323**
Amounts owed to other customers	**5,703**	**114,106**	**65,536**	**5,504**	–	**683**	**191,532**
Derivative financial instruments	–	**40**	**571**	**1,917**	**156,680**	–	**159,208**
Other liabilities	–	**42**	**125**	**249**	–	**4,501**	**4,917**
Reserves	–	–	–	–	–	**121,266**	**121,266**
	352,079	**708,769**	**353,105**	**318,019**	**156,680**	**133,126**	**2,021,778**

Residual maturity as at 31 December 2016	GROUP On demand £'000	Not more than 3 months £'000	More than 3 months but not more than 1 year £'000	More than 1 year but not more than 5 years £'000	More than 5 years £'000	Non defined maturity £'000	Total £'000
Financial assets							
Cash in hand and balances with the Bank of England	313,378	–	–	–	–	–	313,378
Loans and advances to credit institutions	2,036	–	–	–	–	–	2,036
Debt securities	–	–	10,212	40,256	95,957	1,075	147,500
Derivative financial instruments	–	–	23	295	4	–	322
Loans and advances to customers	1,080	601	7,620	74,401	1,161,169	147,349	1,392,220
Other assets	–	–	–	–	–	9,988	9,988
	316,494	601	17,855	114,952	1,257,130	158,412	1,865,444
Financial liabilities and reserves							
Shares	381,977	513,758	175,098	209,101	–	6,901	1,286,835
Amounts owed to credit institutions	–	43,300	24,958	10,579	–	159	78,996
Amounts owed to other customers	6,481	103,286	84,833	15,750	–	969	211,319
Derivative financial instruments	–	8	602	4,151	159,450	–	164,211
Other liabilities	–	42	125	417	–	6,959	7,543
Reserves	–	–	–	–	–	116,540	116,540
	388,458	660,394	285,616	239,998	159,450	131,528	1,865,444

There is no material difference between the maturity profile for the Group and that for the Society.

The following is an analysis of gross contractual cash flows payable under financial liabilities.

	GROUP					
31 December 2017	**Repayable on demand £'000**	**Not more than 3 months £'000**	**More than 3 months but not more than 1 year £'000**	**More than 1 year but not more than 5 years £'000**	**More than 5 years £'000**	**Total £'000**
Shares	**508,026**	**383,531**	**277,346**	**172,287**	–	**1,341,190**
Amounts owed to credit institutions	–	**54,387**	**14,269**	**147,068**	–	**215,724**
Amounts owed to other customers	**6,632**	**113,723**	**66,176**	**5,602**	–	**192,133**
Derivative financial instruments	–	**2,990**	**8,454**	**42,174**	**141,373**	**194,991**
Total liabilities	**514,658**	**554,631**	**366,245**	**367,131**	**141,373**	**1,944,038**
31 December 2016						
Shares	497,321	403,738	178,018	218,314	–	1,297,391
Amounts owed to credit institutions	–	43,499	25,102	10,899	–	79,500
Amounts owed to other customers	7,220	103,223	85,876	16,105	–	212,424
Derivative financial instruments	–	3,256	7,591	42,747	167,335	220,929
Total liabilities	504,541	553,716	296,587	288,065	167,335	1,810,244

The analysis of gross contractual cash flows differs from the analysis of residual maturity due to the inclusion of accrued interest at current rates, for the average period until maturity on the amounts outstanding at the Statement of Financial Position date.

MARKET RISK

The Group is exposed to interest rate risk through a number of potential mismatches. The Group manages this exposure on a continuous basis through the ALCO, within limits set by the Board and using a combination of financial instruments. These mismatches are primarily: interest rate basis risk, where instruments with similar re-pricing characteristics reprice differently e.g. LIBOR rates increase more quickly than mortgage rates; yield curve risks, causing assets and liabilities to reprice differently; and repricing mismatches e.g. where there is a mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates. The latter interest rate sensitivity exposure for the Group, after taking into account derivative hedge contracts entered into by the Society to manage this risk, was as follows:

	GROUP						
	Not more than 3 months	More than 3 months but less than 6 months	More than 6 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Non-interest bearing	Total
At 31 December 2017	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Assets							
Cash in hand and balances with the Bank of England	278,428	–	–	–	–	1,432	279,860
Loans and advances to credit institutions	1,239	–	–	–	–	–	1,239
Debt securities	5,001	–	5,055	54,872	93,781	5,900	164,609
Derivative financial instruments	–	–	–	–	–	1,531	1,531
Loans and advances to customers	554,275	28,089	99,806	500,986	238,710	143,392	1,565,258
Other assets	–	–	–	–	–	9,281	9,281
Total assets	**838,943**	**28,089**	**104,861**	**555,858**	**332,491**	**161,536**	**2,021,778**
Liabilities							
Shares	881,176	104,254	216,111	123,583	–	6,408	1,331,532
Amounts owed to credit institutions	200,538	3,500	2,500	6,518	–	267	213,323
Amounts owed to other customers	119,845	38,600	26,936	5,504	–	647	191,532
Derivative financial instruments	–	–	–	–	–	159,208	159,208
Other liabilities	–	–	–	–	–	4,917	4,917
Reserves	–	–	–	–	–	121,266	121,266
Total liabilities	**1,201,559**	**146,354**	**245,547**	**135,605**	**–**	**292,713**	**2,021,778**
Impact of derivative financial instruments	736,552	(31,300)	(73,550)	(356,169)	(275,533)	–	–
Interest rate sensitivity gap	373,936	(149,565)	(214,236)	64,084	56,958	(131,177)	–
Sensitivity to profit and reserves							
Parallel shift of 1%	(467)	560	1,601	(1,892)	(5,178)	–	(5,376)
Parallel shift of 2%	(934)	1,120	3,202	(3,784)	(10,356)	–	(10,752)

	GROUP						
	Not more than 3 months	More than 3 months but less than 6 months	More than 6 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Non–interest bearing	Total
At 31 December 2016	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Assets							
Cash in hand and balances with the Bank of England	312,216	–	–	–	–	1,162	313,378
Loans and advances to credit institutions	2,036	–	–	–	–	–	2,036
Debt securities	–	–	10,139	39,547	91,277	6,537	147,500
Derivative financial instruments	–	–	–	–	–	322	322
Loans and advances to customers	516,686	9,892	83,620	391,468	243,204	147,350	1,392,220
Other assets	–	–	–	–	–	9,988	9,988
Total assets	830,938	9,892	93,759	431,015	334,481	165,359	1,865,444
Liabilities							
Shares	917,403	75,153	107,299	180,079	–	6,901	1,286,835
Amounts owed to credit institutions	56,782	7,700	8,838	5,518	–	158	78,996
Amounts owed to other customers	109,824	45,400	39,433	15,750	–	912	211,319
Derivative financial instruments	–	–	–	–	–	164,211	164,211
Other liabilities	–	–	–	–	–	7,543	7,543
Reserves	–	–	–	–	–	116,540	116,540
Total liabilities	1,084,009	128,253	155,570	201,347	–	296,265	1,865,444
Impact of derivative financial instruments	598,829	(7,750)	(70,460)	(246,187)	(274,432)	–	–
Interest rate sensitivity gap	345,758	(126,111)	(132,271)	(16,519)	60,049	(130,906)	–
Sensitivity to profit and reserves							
Parallel shift of 1%	(432)	473	991	492	(5,513)	–	(3,989)
Parallel shift of 2%	(864)	946	1,982	984	(11,026)	–	(7,978)

There is no material difference between the interest rate risk profile for the Group and that for the Society.

30. SEGMENTAL ANALYSIS

The Group operates only in the United Kingdom and all its transactions are denominated in Pounds Sterling.

The Group operates as one business and therefore no segmental analysis is relevant.

31. CAPITAL MANAGEMENT

Requirements for the quality and quantity of capital to be held by the Group are set out in the Capital Requirements Directive IV, an EU legislative package covering prudential rules for banks, building societies and investment firms. The capital requirements of the Group are monitored quarterly with the results reported to the Board. Capital is ultimately held for the protection of depositors. The internal level of capital is set with the aim of ensuring that the business has sufficient levels of capital for current and projected future activities, to withstand downturn stresses, and to ensure that the minimum regulatory requirement is always met.

The Society conducts an Internal Capital Adequacy Assessment Process (ICAAP) covering all risks. This is used to assess the Society's capital adequacy and determine the levels of capital required going forward to support the current and future risks in the business.

Throughout the year the Group complied with, and maintained surplus capital above, the externally imposed capital requirements.

The following table shows the composition of the Group's regulatory capital:

	GROUP	
	2017	2016
	£'000	£'000
Common Equity Tier 1 capital		
General reserves	**120,662**	115,733
Available-for-sale reserve	**604**	807
Common Equity Tier 1 capital prior to regulatory adjustments	**121,266**	116,540
Deductions from capital	**(1,183)**	(781)
Common Equity Tier 1 capital	**120,083**	115,759
Tier 2 capital		
Collective provision	**536**	512
Total capital	**120,619**	116,271

32. COUNTRY-BY-COUNTRY REPORTING

Article 89 of the Capital Requirements Directive IV requires credit institutions and investments firms in the EU to disclose annually, specifying by Member State and third country in which it has an establishment, the following information on a consolidated basis for the year: name, nature of activities, geographical location, turnover, number of employees, profit before tax, corporation tax paid and public subsidies received.

The principal activities of National Counties Building Society are the provision of residential mortgages and retail savings products.

National Counties Building Society and its subsidiaries operate mainly in the United Kingdom. During 2017 the Society commenced lending to borrowers in Guernsey, but this business is not yet material. Details of the Society's trading subsidiaries are disclosed in Note 16.

Average employee numbers are disclosed in Note 8.

	GROUP	
	2017	2016
	£'000	£'000
Turnover	**21,580**	20,046
Profit before tax	**6,047**	3,582
Corporation tax paid	**245**	173

Turnover consists of net interest income, net fees and commissions received or paid and other income.

No public subsidies were received by the Group.

ANNUAL BUSINESS STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2017

The Annual Business Statement sets out certain information and explanations prescribed by regulations made under the Building Societies Act 1986 in respect of the Group's business for the year.

1. STATUTORY PERCENTAGES

	%	Statutory limit %
a) Lending limit		
Proportion of business assets other than in the form of loans fully secured on residential property	**0.95**	25
b) Funding limit		
Proportion of shares and other borrowings other than in the form of shares held by individuals	**23.32**	50

The statutory percentages demonstrate that the Group complies with the principal purpose of a building society, namely the making of loans which are secured on residential property and funded substantially by its members.

The above percentages are derived directly from the Group Statement of Financial Position.

Business assets are the total assets of the Group plus provisions for impairment losses less tangible and intangible fixed assets and liquid assets.

Loans fully secured on residential property comprises the amount of those loans shown in the Group Statement of Financial Position plus provisions for impairment losses on those loans.

2. OTHER PERCENTAGES

	2017 %	2016 %
As a percentage of shares and borrowings:		
Gross capital	**6.98**	7.39
Free capital	**6.56**	6.91
Liquid assets	**25.67**	29.35
As a percentage of mean assets:		
Profit after taxation	**0.25**	0.17
Management expenses – Group	**0.78**	0.79
Management expenses – Society	**0.77**	0.79

The above percentages have been compiled directly from the Group Accounts.

Gross capital represents general reserves and available-for-sale reserves.

Free capital represents the aggregate of gross capital and collective provision for impairment losses less tangible and intangible fixed assets.

Mean total assets represents the average of the aggregate of total assets at the beginning and end of the year.

Profit after taxation is described as profit for the financial year in the Income Statement.

Management expenses are the aggregate of administrative expenses and depreciation and amortisation.

3. INFORMATION RELATING TO DIRECTORS AND OTHER OFFICERS

DIRECTORS AT 31 DECEMBER 2017

OTHER DIRECTORSHIPS:

Rodger Grant Hughes *MA, FCA* (Chairman)
Born: August 1948
Appointed: July 2013
Business Occupation: Non-executive Director

Other directorships:
Counties Home Loan Management Ltd*

John Henry Howard *BSc* (Vice Chairman)
Born: February 1951
Appointed: May 2008
Business Occupation: Company Director

Other directorships:
Quayviews Ltd
Consumer Insights Ltd

Mark Alexander Bogard *MA*
Born: January 1962
Appointed: May 2012
Business Occupation: Building Society Chief Executive

Other directorships:
Alexander Hall Associates Ltd
Goodeffect Ltd

Christopher Rendell Croft *LLB*
Born: September 1951
Appointed: May 2014
Business Occupation: Building Society Company Secretary

Other directorships:
Counties Home Loan Management Ltd*
National Counties Financial Services Ltd*
National Counties Estate Agents Ltd *

Christopher James Fry *BA, ACA*
Born: June 1957
Appointed: April 2010
Business Occupation: Building Society Finance Director

Other directorships:
Counties Home Loan Management Ltd*
Woodlands 2000 Ltd

Fiona Mary Crisp *MSc, DIC, FCT*
Born: October 1957
Appointed: March 2015
Business Occupation: Treasury Consultant

Other directorships:
ACT 2013 Ltd
The Association of Corporate Treasurers
Crisp Consultants Ltd
ACT (Administration) Ltd

Patrick Harry Muir
Born: May 1965
Appointed: March 2015
Business Occupation: Marketing Consultant

Other directorships:
Egg Money Ltd
Swan Marketing Services Ltd

Simon Wainwright *BSc, MA, FCIB*
Born: April 1963
Appointed: March 2015
Business Occupation: Managing Director

Other directorships:
RGA Holdings Ltd
RGA UK Services Ltd
RGA Capital Ltd
RGA RE UK Ltd

OFFICERS AT 31 DECEMBER 2017	DIRECTORSHIPS:
Keith Andrew Barber *DMS, ACIB, DipPFS* **Business Occupation:** Director of Business Development	National Counties Financial Services Ltd*
Malcolm John Clays *BSocSc, ACA* **Business Occupation:** Director of Finance	None
Andrew Richard Deeley *MCICM* **Business Occupation:** Director of Lending	None
Stephen Christopher Drury **Business Occupation:** Chief Operating Officer	None
Michael James Feather **Business Occupation:** Director of Business Change	None
Nick Hodges *BSc, AMCT, ACMA* **Business Occupation:** Director of Treasury	None
David Horsman *LLM, FCCA* **Business Occupation:** Director of Finance Development	None
Kathryn Elizabeth Mendoza *LLB* **Business Occupation:** Director of Legal and Compliance	None
Vicki Ela Webb *BSc, MCIPD* **Business Occupation:** Director of HR and Training	None
Mark Andrew Willis *MA (Oxon), FCA, FCT* **Business Occupation:** Director of Risk	Mawsley Management Ltd

*Companies within the National Counties Group

Details of Directors' service contracts are provided in the Report on Directors' Remuneration.

Details of membership of and attendances at main Board Committees are given in the Report on Corporate Governance.

Fiona Crisp (Chairman), Christopher Croft (employer-nominated) and Mark Willis (member-nominated) are trustees of National Counties Building Society Pension and Life Assurance Scheme.

Rodger Hughes is also a Non-executive member of the Board of Simmons & Simmons LLP.

The address for service of documents for each director is Addleshaw Goddard (GAB), Sovereign House, PO Box 8, Sovereign Street, Leeds LS1 1HQ.

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