Annual Report and Accounts

Year ended 31 March 2016

the West Brom

Annual Report and Accounts
Year ended 31 March 2016

Contents

Key highlights of the 2015/16 financial year include:

- A substantial increase in gross residential mortgage lending to £673m representing 51% growth (2014/15: £446m).
- Net residential lending of £351m (2014/15: £196m).
- Savings balances grew by 10% to £4.4bn (2014/15: £4.0bn), driven by strong growth in ISA and web-based products.
- A 9% growth in pre-tax profits to £13.5m (2014/15: £12.4m).
- Growth in total assets to £5.8bn (2014/15: £5.6bn), with the increase in the residential mortgage book more than offsetting the reduction in non-core commercial loan balances.
- An increase in the Group's strong Common Equity Tier 1 capital ratio to 14.6% (2014/15: 14.4%).
- Successful relocation to new, purpose-built head office premises at Providence Place in West Bromwich town centre, ensuring capacity for future growth.

"Sustained growth in residential lending."

Chairman's Statement

I am proud to report another successful year, with continued sound profit performance. We have re-established ourselves as a leading traditional building society with gross new residential mortgage lending increasing this year by 51% to £673m and retail savings balances increasing by £0.4bn to £4.4bn. Full details of the year's performance are covered in the Chief Executive's Review and the Strategic Report.

Economic update

Whilst there has been deterioration in the global economic outlook, the UK economy continues to make progress notwithstanding that the forthcoming referendum on EU membership has created considerable uncertainty.

GDP continues to grow, unemployment levels continue to fall and inflation remains exceptionally low. Against this background the Bank of England has held its historical low level Bank Rate.

The exception to the slow but steady progress in the UK economy has been house prices, with the Halifax house price index showing a rise of 10% in the year to 31 March 2016. This has contributed to strong growth in the mortgage market with UK lending up 15% in the year to 31 March 2016.

Regulatory environment and industry developments

The pace of regulatory intervention continues with a number of changes being introduced. In March the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) jointly implemented a new framework ensuring that key managers have greater accountability for their actions and the Society has successfully implemented all the resulting requirements.

This March was also the month which saw the implementation of the requirements of the European Mortgage Credit Directive. Again, the Society successfully enhanced its processes and controls to meet these new requirements; the most significant piece being the introduction of the European Standard Information Sheet (ESIS) designed to provide prospective mortgage customers with all the information they need to make an informed decision.

Although we are not required, under the Remuneration Code, to implement a 'clawback' arrangement in respect of the variable remuneration of executives, the Society has decided to adopt such an arrangement effective from the 2016/17 financial year, reflecting our desire to be at the forefront of good corporate governance.

And last, but not least, in June this year we will be implementing the FCA's changes to the Complaints Handling Regime, enabling our front line staff to have more time to respond to customer dissatisfaction and thereby providing a much more customer centric approach.

A strong team

Following the robust recruitment process detailed within our Governance Report, I am pleased to welcome Julie Hopes, a new non-executive director, to the Board. She brings a wealth of experience in customer operations and change management, and will broaden our expertise in these important areas.

Looking to the future

The continuing low interest rate environment, whilst good for borrowers, will remain challenging for savers. We will strive to strike a balance that benefits all our members' long term interests.

We will continue to invest in our core systems in order to maintain a high level of service for both our borrowing and savings members.

Finally, on behalf of the Board, I would like to thank all the staff and the Executive team for their professionalism, hard work and dedication. I would also like to thank our members for their continued loyalty and support.

Mark Nicholls
Chairman
25 May 2016

Chief Executive's Review

Jonathan Westhoff

I am pleased to report another year of progress in every respect; a strong growth in new mortgages advanced to home owners, an increase in savings balances that funded the growth in total mortgage balances and an increasing level of profitability which supported a further strengthening of our capital position.

The West Brom is now positioned as a well capitalised, efficient and modern Society, built on the traditional principles of supporting homeowners, providing a safe home for savers and delivering excellent customer service and satisfaction.

Performance overview

Profit before tax was 9% ahead of last year at £13.5m (2014/15: £12.4m), a sound and sustainable performance.

Gross prime residential mortgage lending increased by 51% to £673m (2014/15: £446m) and residential lending balances increased by £213m (2014/15: £73m). This growth was funded entirely by an increase in retail savings deposits which increased by £397m (2014/15: £248m reduction). This meant that the Society's total assets grew from £5.6bn to £5.8bn, the first increase since 2008 when the Society undertook a strategic repositioning with a focus on reducing its non-core activities, primarily commercial lending. For the year to 31 March 2016 we have seen a strong residential lending performance resulting in an increase in loan balances which outstrips the reduction in commercial loans.

Importantly, this does not mean that progress is slowing on our carefully managed run down of the non-core commercial property loans. Total balances outstanding reduced a further 19% in the year to £0.68bn. However, although these exposures have more than halved since our exit from this form of lending, our long term strategy for managing the remaining loans could lead to some further bad debts being incurred, given that many of the properties that are security for the loans have tenants that are in sectors which remain vulnerable in the current economic environment.

It is also satisfying to report that whilst delivering growth, the Society has continued to improve its Common Equity Tier 1 capital ratio, the key measure of capital strength, to 14.6% (2014/15: 14.4%).

Serving our members

The core, traditional building society principle of mutuality remains our cornerstone. As a mutual organisation, the delivery of long-term member value informs all of our decision making.

The West Brom looks after the interests of its members by offering prime residential mortgages for homeowners, competitive retail savings and a range of ancillary products and services designed to meet individual financial needs.

There has been increasing competition in the mortgage market, but we have been able to offer competitive mortgage ranges for borrowers, whether they are purchasing a home or remortgaging their current property. We have also supported first time buyers, who accounted for over 20% of our total lending by value.

Whilst we are happy to see homeowner borrowers benefit from our lowest ever rates, we have, as previously advised, taken action to seek to rebalance the rate charged on certain buy to let mortgages, which averages only 2.3%, and is not considered to reflect the funding, capital and operational costs associated with these mortgages.

As I have previously reported, a rate adjustment has been applied to these loans to address this. A group of borrowers has challenged our right to invoke the relevant mortgage condition allowing us to do this. Following our successful defence of this challenge in the High Court an appeal was heard in April 2016, the outcome of which is not yet known.

The continuation of the low rate environment is generally good news for homeowner borrowers but conversely, it is not such good news for our savers.

In 2015/16, we offered our savings members a range of products, many of which have featured regularly in the Best Buy tables. These are available through a variety of channels – branch, post and online – to suit the individual customer's preference.

We continue to offer members a personal one-to-one advice service through our partnership with Wren Sterling – a leading national independent financial advisory business. This gives members the opportunity to seek independent financial advice, should they wish, and as Wren Sterling are independent, they are able to search the entire financial market to tailor their recommendations to individual circumstances.

Listening to our members

The West Brom is run in the interests of its members and so it is important we provide opportunities for people to share their views and opinions.

A regular feature in the calendar are our Members' ViewPoint feedback events, which we host in venues located around the Society's branch network and use to capture suggestions for how we can improve our products and services. They also enable members to spend time with representatives from the senior management team in an informal environment and raise any queries or concerns.

To help monitor satisfaction levels we carry out occasional surveys and invite members to rate our service after a transaction in a branch or a telephone enquiry. Branches also now include feedback facilities, where members can conveniently access a web-based facility via their smartphone or mobile device.

The West Brom's Customer Panel continues to grow, with more than 2,000 registered users. During the year we have used the Panel to gauge members' opinions on a variety of important topics, including taking out a mortgage and children's savings accounts. It is input such as this that helps us to design products which are properly in tune with members' needs.

Part of the community

The West Brom is committed to playing active roles in the communities we serve, offering something back in line with our mutual ethos. This may be a financial contribution, such as money raised by our staff and customers in support of a nominated charity, or through volunteering by our staff, supported by the Society.

Most of our fundraising this year was carried out in support of Edward's Trust, a Birmingham-based bereavement charity with a particular focus on helping children at this most traumatic of times, dealing with the loss of a family member. Through a range of sponsored activities and fundraising events, we have collected more than £22,000 to assist the charity's vital work.

Other beneficiaries include Birmingham Children's Hospital, a long-standing partner of the Society's thanks to our Red Balloon Appeal Account. This affinity savings product has ensured an annual contribution of £73,000, which has helped to replace outdated x-ray equipment in the radiology department.

We also supported the hospital's public art project in the summer of 2015, the Big Hoot, by sponsoring an owl statue in Sutton Coldfield town centre next to our local branch. West Brom staff regularly volunteer at Birmingham Children's Hospital, delivering art and craft sessions with patients and helping to decorate the wards at Christmas.

Smaller grants are issued regularly to local charities and good causes through the Mercian Community Trust. Among the organisations receiving contributions this year were Fisher House, the 'home from home' facility for the families of injured military personnel being treated at the Queen Elizabeth Hospital Birmingham, and the Heulwen Trust, which provides daytrips for disabled children in Wales.

Community outreach work from our branch network has focused primarily on financial education, with several branch managers spending time in local schools delivering interactive workshops themed around money management.

Strategic investment

In the Spring of 2016 our Head Office and central operations relocated to Providence Place in West Bromwich. The Society's former High Street premises served as our home for nearly 40 years, but had neither the physical space nor facilities to support our aspirations for growth. Our new Head Office is considerably larger, modern, well-equipped and has an open plan layout that supports collaborative working between key departments, thereby improving our operational efficiency. It represents an exciting new era for the Society and, together with continued investment in core infrastructure, enables us to provide members with the level of service they deserve.

Our people

At the West Brom, the way we do things for our customer is just as important as what we do. Our people now have a bright, modern workplace that provides them with the environment they need to deliver their best endeavours for our customers.

We have maintained the Investors in People Gold Award, which is seen as a measure of a high calibre employer. This underlines the values of the Society and helps attract the very best talent, who then enjoy the support and development opportunities the Society offers.

We are continuing to invest in our talent management programme 'Evolve'. This innovative, high profile leadership programme, sponsored by the Executive and run in partnership with The Leadership Trust, is a key mechanism in driving a high performance culture. It gives the participants the opportunity to develop their leadership skills and enable them to realise their potential by applying their learning in practice.

Conclusion and Outlook

The Society has grown both its mortgage lending and total assets in the year. This growth has been on the back of a sound profit performance and increased capital, underpinning our financial strength.

This means that we are well placed in 2016/17 to continue with our programme of investment and lending activity.

Looking forward, Mark Gibbard our Group Finance & Operations Director has informed the Board of his intention to retire at the end of the 2016/17 financial year. The recruitment of his successor has commenced.

The progress that the Society has made in 2015/16 also means that we can be optimistic, notwithstanding the continued challenge of the low interest rate environment and political uncertainties.

The progress we have made could not have been achieved without the hard work and commitment of all our colleagues for which I thank them. Most importantly I would also like to thank all of our members for their continuing loyalty.

Jonathan Westhoff
Chief Executive
25 May 2016

Strategic Report

Our Strategy

Our strategy is built on the simple premise of delivering our core purpose – providing a safe place for savings and enabling home ownership.

In delivering our savings and investments offering we aim to provide security, simplicity and value to our members. We strive to meet the needs of our members with a competitive range of products that offers transparency and clarity, delivering sound returns.

The provision of residential mortgages is at the very heart of the mutual model. In returning the West Brom to a traditional building society over recent years, we have significantly increased residential mortgage lending. Over the medium term horizon, our focus will be on providing finance for home ownership rather than property investment.

Whilst we have made significant progress with our strategy over the last few years, we still have to manage down our non-core activities, in particular commercial lending. We will continue to pursue this run-off in the best economic terms for the Society.

The business model employed to deliver the strategy is detailed below.

Primary Activities

Savings and Investments

Mortgages and Protection

Strategic Priorities

Security

- We will generate and maintain sufficient capital and liquidity to enable us to deliver our business plans.
- We will exit our legacy positions whilst balancing speed with the economic cost.
- We will have a clear, transparent approach to risk management.

Members

- We will make decisions that are in the interests of our current and future membership as a whole.
- We will consider the impact of our decisions on customer experience, customer outcomes and all other stakeholders.

Efficiency

- Cost efficiency will underpin all components of our operating model.
- Existing resources will be leveraged to deliver acceptable returns.
- We will seek to exploit technology at every stage of the operating model to reduce the cost of service delivery.

Our Business Model

The Society's strategic aims have resulted in a business model split between core and non-core activities. Our emphasis on the core activities of retail savings, investments and prime residential lending means that we are continuing to make a concerted effort to manage the orderly run-off of non-core activities.

The Group is organised into three main business segments:

Retail – residential lending, delivered through branch, direct and intermediary channels supported by retail savings products offered to customers through branch, internet and direct. Investments, general insurance and protection are sold directly in our branches and in partnership with Wren Sterling. This segment also includes non-core second charge lending which is in run-off;

Commercial – the provision of finance for commercial real estate investment. This activity is considered non-core and inconsistent with the traditional building society model and is, therefore, being managed down; and

Property – a portfolio of residential properties held to generate rental income. During 2008, the Board concluded that it would not add any further investments and would, over time, respond to opportunities to dispose of properties where it was economically advantageous to do so. The portfolio is managed by Andrews Property Services, a well-respected property management company.

All of the above are supported by central functions which provide Finance, HR, IT, Compliance and Risk Management capabilities. Funding is reviewed on a Group-wide level with the Treasury and Finance functions managing the day to day cash flows of the business, along with providing wholesale funding and ensuring the effective allocation of capital and liquidity.

Key performance indicators

The Society monitors its progress against strategic objectives using a wide range of financial and non-financial key performance indicators (KPIs). The following sections of the Strategic Report clearly define these KPIs and describe the Society's performance against each.

Review of 2015/16

Profit before tax – for the year ended 31 March 2016 was £13.5m up 9% on the previous year (2014/15: £12.4m).

Net interest margin – Net interest margin fell to 1.06% from 1.15% in 2014/15. This latter figure was boosted by the recognition of previously suspended default interest on several impaired commercial accounts. Current margins are also being impacted by competition in the mortgage market.

Lending – Gross new residential lending was £673m, this was a 51% increase on last year (2014/15: £446m).

Commercial mortgages – Balances reduced by 19% during the year to £680m as we continue to run-off this non-core area of the business.

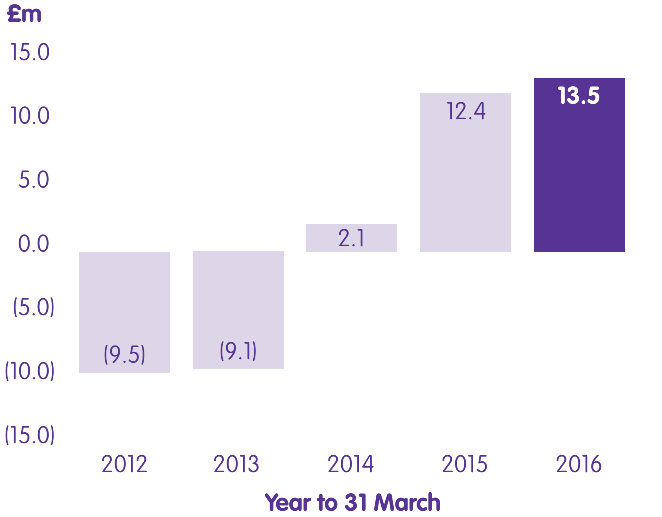
Capital – Capital management and stable profitability have delivered an improvement in capital ratios for the 6th consecutive year with the Group's Common Equity Tier 1 ratio, up to 14.6% from 14.4% the previous year.

Performance overview

Key performance indicators
The statutory result before tax is used to monitor the performance of the Group. The statutory result before tax is the most commonly used measure of profitability.

The Board assesses the Society's performance using the result before tax at both a total Group and individual business division level as this presents a more transparent view of the performance of the core and non-core elements of the Society.

Profit before tax



Profitability, up 9% from the previous year, reflects a stable underlying position.

Overview by business division

At 31 March Profit by division

	2016 £m	2015 £m
Retail	**11.6**	13.2
Commercial	**(4.3)**	(5.6)
Property	**6.5**	5.9
Intercompany adjustments	**(0.3)**	(1.1)
Total Group profit before tax	**13.5**	12.4

Retail

The Retail segment's principal activities are residential mortgage lending and retail savings.

Retail has seen benefits from the growth in new mortgage lending, which at £673m was 51% higher than the previous year's level (2014/15: £446m).

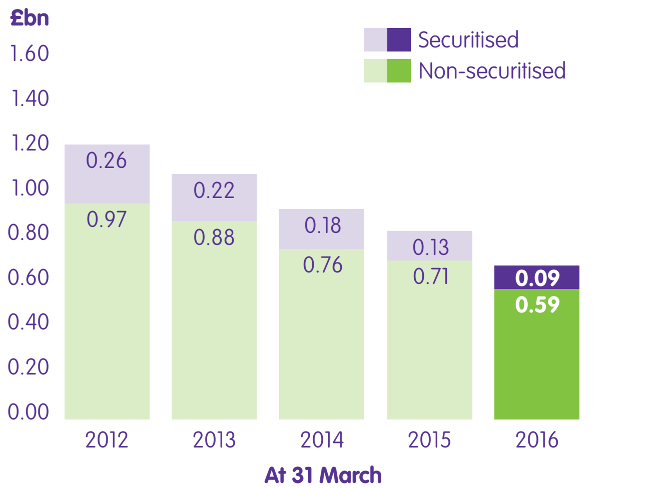
Credit management remains a priority and just 1.43% of residential mortgage accounts were in arrears by three months or more at the end of the year compared with 1.63% in 2015. Impairment charges were down to £0.2m from £0.7m in the previous year.

Commercial

We continue to experience bad debt charges on the commercial book as, whilst the commercial market has improved, we are exposed to certain sectors which are more volatile.

The Society has a clear strategy for the run-off of the commercial lending book. This involves holding loans for a longer period in order to optimise returns rather than looking to dispose of quickly, which would necessitate sale at a discount and incur losses. Capital requirements and exposure to future volatility are also assessed. We believe this to be a value maximising strategy for our members. The level of exposure to commercial mortgages has reduced year on year, from £1.7bn in 2007/8 to £0.68bn at the end of 2015/16, of which £0.09bn (2014/15: £0.13bn) is securitised.

Commercial lending balances*



*Commercial lending balances secured on commercial and residential property

Property

The Property division, which is considered a non-core activity, contributes to the results of the Group in two ways: rental income from the residential properties and an increase in the value of these properties due to the increase in house prices.

The increase in UK property prices resulted in a revaluation gain of £5.5m on the West Bromwich Homes residential property portfolio, the same increase as the previous year. This portfolio is valued at £123.7m at 31 March 2016 (2014/15: £118.6m). 4 properties were sold during the year achieving their book value of £0.4m. Trading profit from the investment properties was £1.0m (2014/15: £0.4m).

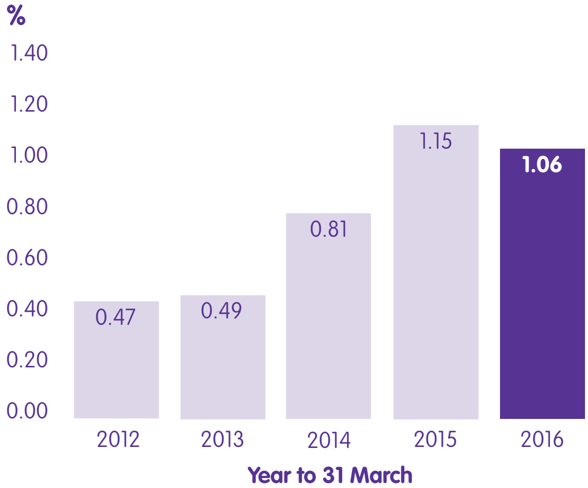
Financial performance – Group

Net interest margin

Key performance indicators
Net interest margin is calculated as net interest income expressed as a percentage of mean total assets.

The key drivers of this measure are the level of return received from the assets held by the Group and the interest paid on its borrowings. As the primary constituents of this measure are member related, being mortgages to borrowers and savings from retail customers, the Board's goal is not to maximise this ratio but to maintain a measured level that balances continued security with long-term value for the members.

Net interest margin



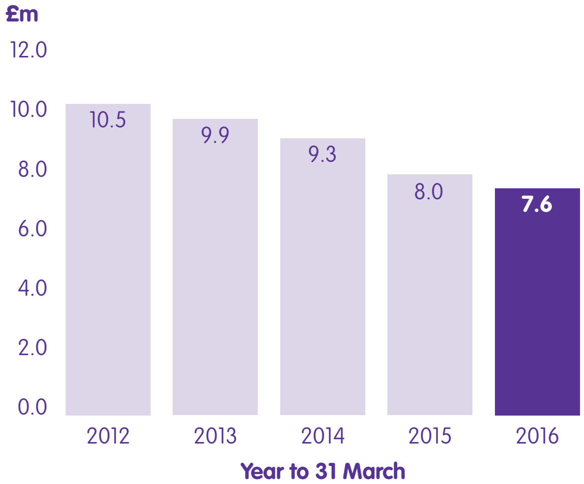
During 2015/16 the net interest margin reduced to 1.06% (2014/15: 1.15%) due to the combination of:

- A one-off credit in interest received in the financial year to 31 March 2015 which accounted for 0.12% of the reduction. This was due to previously suspended interest on commercial loans being collected, reflecting a better than expected outcome due to the management of the property assets in question; and
- The reduction in new mortgage lending margins due to increased competition. This was in part offset by lower funding costs as market retail savings rates continue to be subdued by the availability of funding provided by the Bank of England.

Other income

Key performance indicators
The Board monitors other income in absolute terms. Other income primarily represents income earned from the sale of non-margin related products. These include commission on the sale of insurance (in particular home and contents) and investment related products, together with fees earned on lending and property rental activity.

Other income



Other income of £7.6m (2014/15: £8.0m) has shown another reduction, which is in line with expectations and a reflection of the focus on mortgage and savings activity rather than ancillary financial services sales.

Rental income which is generated from the Society's own portfolio of residential properties let for rental through the subsidiary West Brom Homes increased modestly to £4.1m (2014/15: £4.0m). This accounts for slightly more than half of other income.

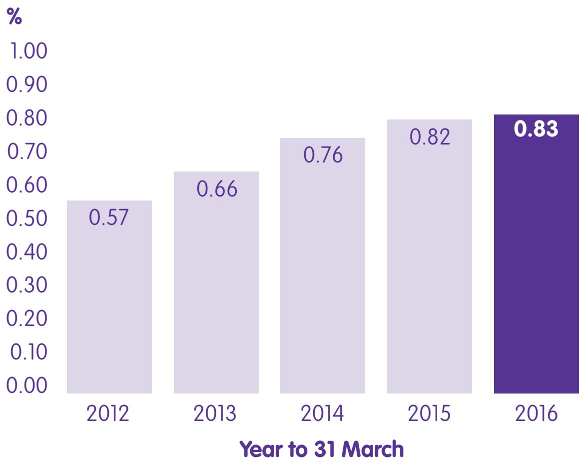
Administrative expenses

Key performance indicators
The management expenses ratio is a measure of cost efficiency, reflecting costs as a proportion of total assets managed. It is calculated as total management expenses (including depreciation and amortisation) as a percentage of mean total assets.

The Board reviews this measure at both the statutory and underlying level. The underlying management expenses ratio is calculated by stripping out all costs that are considered to be one-off and not reflective of the ongoing costs of the Group.

The key drivers in this ratio are the underlying costs of the Group and its asset base.

Administrative expenses ratio



Administrative expenses have been impacted by the considerable investment in change undertaken by the Society, with a large number of regulatory and technical projects in progress, in addition to the completion of the new Head Office in February 2016. The latter meant that there was a period of incurring the cost of operating two head office sites during the transition phase.

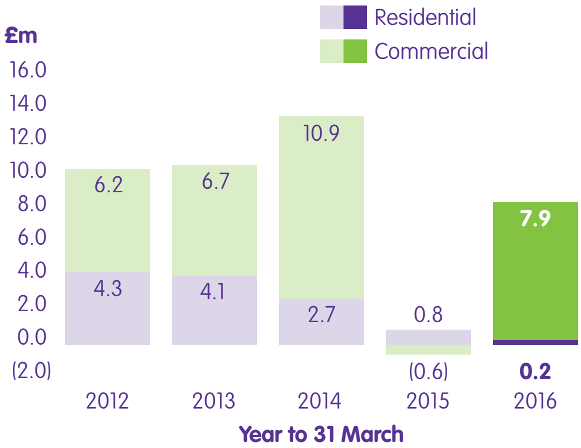
As a consequence, and despite a slight reduction in the depreciation charge for 2015/16 at £5.1m (2014/15: £5.4m) administrative expenses increased to £42.0m (2014/15: £40.6m) and the management expense ratio increased to 0.83% (2014/15: 0.82%).

Impairment provisions on loans and advances

Key performance indicators
The Board monitors the underlying level of impairment provisions, calculated as the absolute charge less offsetting fair value movements on derivatives used to hedge the impaired loans. The indicator measures the credit risk performance of the assets (i.e. the lower the credit performance of the assets, the higher the losses). Provisions include the losses incurred or those losses expected to be incurred (based upon events that have already happened) and are calculated both individually and collectively on groups of assets with the same credit characteristics.

The key drivers of the quantum of losses incurred include unemployment, interest rates, movements in property prices, tenant defaults on commercial property and the availability of funding in the market.

Charge for impairment losses on loans and advances



There was only a small impairment charge on residential loans of £0.2m (2014/15: £0.8m) reflecting the quality of the lending we have advanced since returning to the market and the increased seasoning of the older balances. At the year end the Group had £20.8m balance sheet impairment provisions against residential mortgages (2014/15: £23.7m).

The commercial loan impairment charge was £7.9m. Last year there was a small credit of £0.6m, however this did not include the cost of the adverse fair value movements of the derivatives hedging interest rate risks in the non-performing commercial mortgages. Taking this into account, the underlying cost for commercial non-performing loans last year was around £10m, with a comparable figure of £7.3m this year including £0.6m of positive fair value movements on derivatives.

At the end of the period, the Group had £43.9m (2014/15: £46.0m) set aside for losses from exposures to the commercial lending portfolio, equivalent to 6.5% of the current loan book (2014/15: 5.7%). The commercial property sector is considered particularly vulnerable to any unforeseen setbacks in the UK economic recovery. As such, the Board is committed to maintaining an appropriate level of cover against these non-core commercial assets.

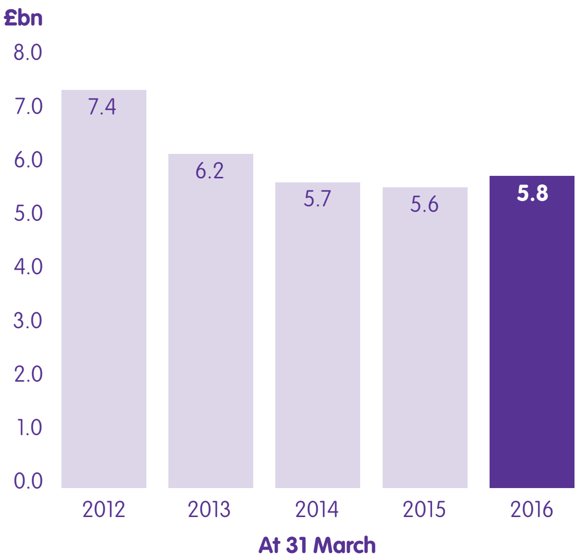
A key strategy in mitigating the losses incurred on commercial loans is identifying circumstances where the Society taking control of the underlying security (to manage better the future cashflows), results in an improved outcome from a recovery perspective. In accordance with this approach, £316m of commercial mortgage assets were managed through a Law of Property Act Receiver at the end of the year (2014/15: £332m).

Financial position

The capital ratio for the year shows an increase, benefitting from the profit for the year and the continued de-risking of the balance sheet. The detailed breakdown of capital movements is given on page 13.

Total assets at the end of the year grew to £5.8bn (2014/15: £5.6bn) despite the run-off of non-core assets.

Group total assets



Loans and advances to customers

The Society increased its new prime residential mortgage lending by 51% in 2016 to £673m (2014/15: £446m) which, net of redemptions, increased residential mortgage balances by £213m (2014/15: £73m).

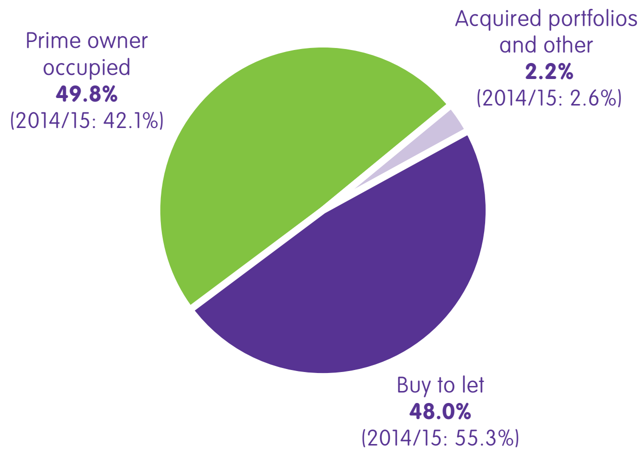
Throughout the year the West Brom has offered a range of competitive products available via branch, direct and intermediary channels and has had 16 Best Buy mortgage products.

Residential lending

Although the Society's new lending has all been to owner occupiers the residential mortgage book does also include buy to let, made through the Society's branches and intermediary channels, and mortgage portfolios originally acquired through the Society's subsidiary company, West Bromwich Mortgage Company Limited. No portfolios have been acquired since 2005.

At the end of the period, the residential mortgage portfolio was divided 49.8% prime owner occupied (2014/15: 42.1%), 48.0% buy to let (2014/15: 55.3%) and 2.2% non-prime (2014/15: 2.6%). The Society's new lending will see the mix of prime owner occupied balances steadily grow as we rebalance our mortgage portfolio.

Analysis by lending type at 31 March 2016



The residential lending portfolio is geographically diverse, with the highest concentrations being in the South East, West Midlands and Greater London, reflecting higher property prices in the South and London and higher lending activity in the Society's heartland.

At 31 March Residential loans analysis by region

	2016 £m	2015 £m
East Anglia	**110.7**	99.9
East Midlands	**380.7**	344.6
Greater London	**591.2**	616.5
Northern Ireland	**5.8**	6.2
North	**147.7**	127.3
North West	**460.8**	419.7
Scotland	**126.8**	140.2
South East	**742.1**	707.4
South West	**336.5**	301.6
Wales	**194.7**	188.2
West Midlands	**713.1**	687.5
Yorkshire	**301.1**	259.5
Total	**4,111.2**	3,898.6

Key performance indicators

The Board reviews the credit performance of the Group's loans and receivables using a variety of measures that report on different characteristics and behaviours of both the loan and the customer. This is to ensure that all indicators of potential problems are identified as early as possible.

The principal industry standard and Board measure is the number of cases where the borrower has missed more than three monthly payments. With a contracting book, the percentage arrears figures can increase without any significant increase in the absolute number of accounts in arrears.

At 31 March 2016 Group arrears

	Total balances £m	3 months+ %
Prime - owner occupied	**1,935.2**	**0.85**
Buy to let	**1,901.6**	**0.80**
Acquired portfolios and other	**252.3**	**4.71**
Core residential	**4,089.1**	**1.07**
Second charge lending	**22.1**	**8.58**
Total	**4,111.2**	**1.43**

At 31 March 2015 Group arrears

	Total balances £m	3 months+ %
Prime - owner occupied	1,641.2	1.44
Buy to let	2,156.5	0.98
Acquired portfolios and other	74.5	8.88
Core residential	3,872.2	1.34
Second charge lending	26.4	10.34
Total	3,898.6	1.63

At 1.43% (2014/15: 1.63%), the total residential mortgage arrears are in line with expectation given the sustained improvement in the UK economy, the continued low interest rate environment, low unemployment rates and the high quality of our new lending.

The residential arrears figure excluding second charge is 1.07% (2014/15: 1.34%).

The Society actively seeks to support those borrowers who are experiencing genuine financial hardship, so enabling them to remain in their homes if this is believed to be in their best interests (i.e. where the loss to the customer is not likely to increase over time). Forbearance measures take a number of forms depending on individual customer circumstances. Short-term solutions focus on temporary reductions to contractual payments. For customers with longer term financial difficulties, term extensions may be offered, which may also include interest rate concessions. The Society's approach to forbearance is described in more detail in note 32 to the Accounts.

The Society's comprehensive pricing models and strict affordability criteria ensure all new lending is undertaken within the Board's credit risk appetite.

The quality of mortgages advanced during the year is high, with no accounts three months or more in arrears at 31 March 2016.

Commercial

The Society is managing a controlled run-off of its commercial portfolio, which is held in its subsidiary West Bromwich Commercial Limited. Exposure has been reduced by £1.0bn since its peak of £1.7bn in 2008/9.

During the year, balances secured on commercial assets were reduced by 19% to £680m (2014/15: £835m). Of the remaining commercial balances, £91m is securitised (2014/15: £130m) with full provision made for the residual risk to the Society.

The sector split of the commercial loan portfolio is shown in the table below.

At 31 March Commercial Loans

	2016 £m	2015 £m
Healthcare and leisure	**167.0**	186.4
Industrial and warehouse	**23.1**	34.9
Office	**48.7**	117.6
Retail	**350.2**	395.7
Residential property	**20.2**	22.9
Other	**21.4**	23.0
Fair value adjustments	**49.0**	54.6
Total	**679.6**	835.1

Funding

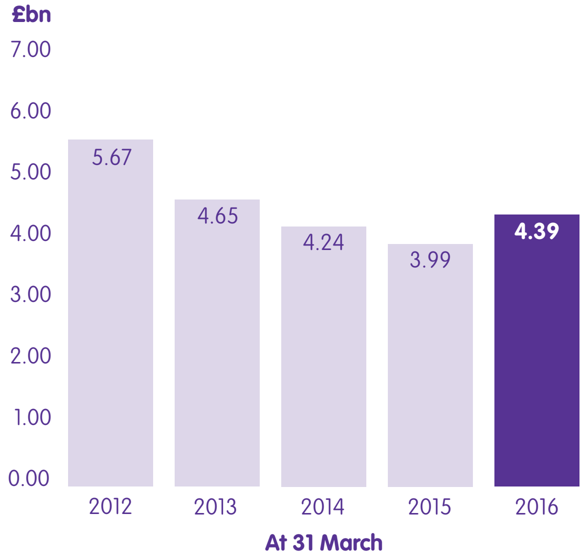
Key performance indicators

The key funding measure that the Board uses to assess the risk in its funding base is the wholesale funding ratio. The wholesale funding ratio measures the proportion of total Society shares and borrowings (including non-recourse finance) not in the form of retail savings products. It assesses the Society's relative exposure to the wholesale funding markets and it is the Board's aim to maintain this ratio at a stable low level.

Retail

The Society is primarily funded by retail savings balances, with residential mortgage assets funded 1.06 times (2014/15: 1.01 times) by these deposits.

Retail balances



Retail savings balances increased during the year to £4.39bn (2014/15: £3.99bn).

Whereas we do wish to see a steady growth in our retail savings balances, we also do not want to generate more retail savings balances than is needed to fund mortgage growth, as the returns we can generate from any surplus funding is limited to that available by re-investing in the wholesale markets, which is often less than our savings rates. Consequently surplus funding is costly to us.

The Society is very conscious that these are difficult times for savers and seeks to maintain competitive rates. This has to be balanced with the Society's funding requirements and the rates available in the market; otherwise we attract more funding than we need, which is expensive if this is simply held as surplus cash.

Wholesale

At the end of the year the wholesale funding ratio was 15.2% (2014/15: 20.3%).

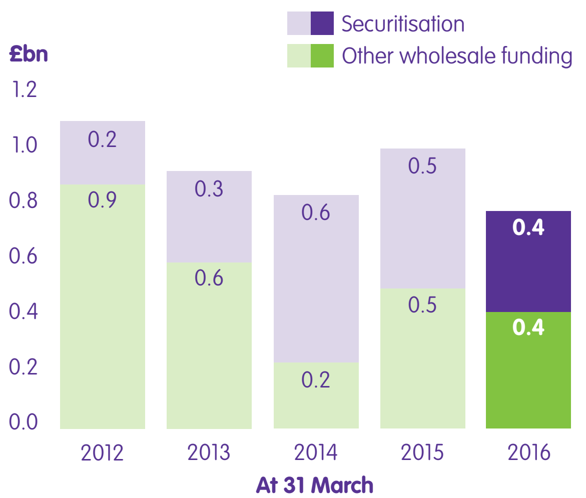
Whilst predominantly funded by retail deposits, the wholesale markets may still provide a useful source of funding which the Society will continue to access where it is economically effective to do so.

The table below analyses the Society's wholesale funding portfolio.

At 31 March Wholesale funding sources

	2016 £m	2015 £m
Deposits	**416.0**	545.7
Securitisation	**368.6**	467.1
Total	**784.6**	1,012.8

Wholesale funding balances



Liquidity

Key performance indicators

The Society's liquidity position is monitored in a number of different ways, including reviewing the components of our funding and liquidity portfolios, testing liquidity by selling into the market and monitoring the impact under a number of stressed scenarios. However, the key measures that the Board uses to monitor its liquidity position are:

- *Liquidity ratio - liquid assets as a proportion of shares and borrowings;*
- *'Buffer liquidity' - the most liquid and secure form of holding, comprising gilts, treasury bills, supranational bonds and reserves with the Bank of England. Buffer liquidity is assessed against limits set by the PRA.*

Effective liquidity management is central to the Society's objectives of providing customers with a secure home for their savings. At all times during the year, proactive liquidity management processes kept available liquidity above regulatory limits and at levels sufficient to cover lending commitments and other cash outflows.

Owing to their low-risk nature, liquid assets provide very modest returns relative to the cost of generating funds. It is therefore disadvantageous to hold excess liquidity and beneficial to closely monitor holdings such that the Board's risk appetite and regulatory requirements are met, with minimum detrimental impact to margins.

Liquidity holdings consist solely of high quality liquid assets with 100% of treasury investments rated single A or better or classified as a Global Systemically Important Counterparty (GSIC) (2014/15: 100%). The Group has no exposure to those markets where concerns have been expressed, including non-UK sovereign debt or to any mortgage market outside the UK. No treasury assets were impaired at 31 March 2016 (2014/15: nil).

An analysis of the Group's liquidity position is shown below.

At 31 March 2016 Liquidity portfolio

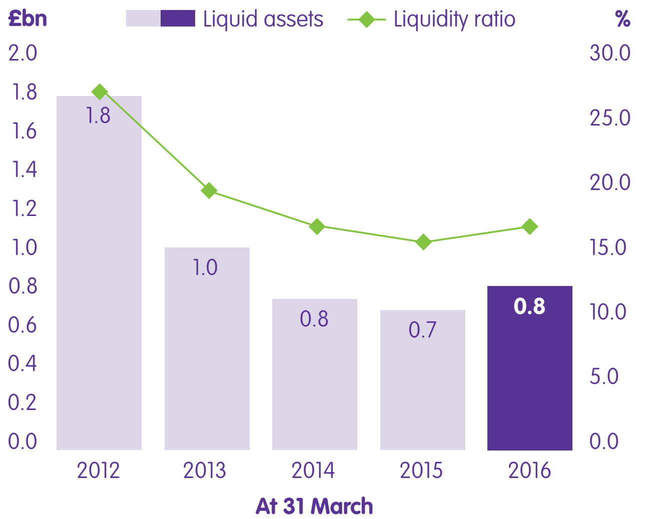
	£m	%
Extremely High Quality Liquidity Assets		
- Cash and balances with the Bank of England	**208.7**	**25.2**
- Supranationals	**53.5**	**6.4**
- Covered Bonds	**124.0**	**14.9**
- Mortgage Backed Securities	**109.4**	**13.2**
Total Extremely High Quality Liquidity Assets	**495.6**	**59.7**
Other securities - rated single A or better	**123.2**	**14.9**
Subsidiary/other liquidity	**210.7**	**25.4**
Total liquidity	**829.5**	**100.0**

At 31 March 2015 Liquidity portfolio

	£m	%
Extremely High Quality Liquidity Assets		
- Cash and balances with the Bank of England	253.6	35.1
- Supranationals	45.2	6.3
- Covered Bonds	66.8	9.3
- Mortgage Backed Securities	81.9	11.4
Total Extremely High Quality Liquidity Assets	447.5	62.1
Other securities - rated single A or better	80.4	11.1
Subsidiary/other liquidity	193.7	26.8
Total liquidity	721.6	100.0

In addition to the above Extremely High Quality Liquidity Assets (EHQLA), the Society also holds £137m of FLS T-Bills (2014/15: £207m) that it includes as EHQLA in its regulatory calculations, which are not included in Group Liquidity.

Liquid assets and liquidity ratio



The Society's liquidity ratio increased to 17.3% (2014/15: 15.9%). Our focus continues to be on maintaining adequate levels of high quality, highly liquid assets.

In October 2015, as part of the CRD IV package of regulatory reforms, the Prudential Regulation Authority (PRA) introduced two new liquidity measures: the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The LCR became a regulatory requirement from 1 October 2015 and the PRA has set a minimum requirement of 80% from that date, rising to 100% from 1 January 2018. As at 31 March 2016 the Society's LCR ratio was in excess of 100%.

The requirements for the NSFR, a measure of stable funding, are not expected to be implemented until 2018. The Society monitors its position relative to the anticipated requirement of the NSFR and holds sufficient stable funding to meet this. A final European NSFR standard is expected in 2016.

Capital

Capital is held as the ultimate protection for depositors. The Board sets the internal level of capital with the aim of ensuring capital levels are always above minimum regulatory requirements.

Key performance indicators

The primary indicator used to monitor capital is the amount of Common Equity Tier 1 (CET1), being the strongest form of capital for any financial institution.

The CET1 ratio, being the amount of CET1 capital divided by risk weighted assets is considered to be the key ratio. In addition CRD IV has introduced a simpler non-risk based leverage ratio as a supplementary indicator. The leverage ratio is calculated as Tier 1 capital divided by total leverage ratio exposure. The relative simplicity of this measure is both a strength and a weakness. It removes the subjectivity associated with determining the risk weighting to be applied to each asset class, which can involve particularly complex models for the larger banks. In doing so, it effectively applies the same risk weighting to all asset classes when clearly the risks are not the same.

The table that follows includes both the Society's CET1 and leverage ratios. Figures have been quoted applying the current CRD IV transitional rules and also showing the full impact of CRD IV without the transitional rules.

At 31 March

	Notes	Transitional CRD IV rules 2016 £m	Full implementation of CRD IV 2016 £m	Transitional CRD IV rules 2015 £m	Full implementation of CRD IV 2015 £m
Common Equity Tier 1 capital					
General reserves		**239.3**	**239.3**	233.1	233.1
Revaluation reserve		**3.4**	**3.4**	3.4	3.4
Available for sale reserve (AFS)		**0.9**	**0.9**	3.5	3.5
Cash flow hedging reserve		**(0.3)**	**(0.3)**	(0.1)	(0.1)
Profit participating deferred shares		**179.5**	**179.5**	177.1	177.1
Common Equity Tier 1 prior to regulatory adjustments		**422.8**	**422.8**	417.0	417.0
Regulatory adjustments:					
Defined benefit pension fund asset	1	**(0.8)**	**(0.8)**	-	-
Cash flow hedging reserve	2	**0.3**	**0.3**	0.1	0.1
Intangible assets and goodwill	3	**(8.2)**	**(8.2)**	(7.0)	(7.0)
Deferred tax asset relating to operating losses	4	**(14.7)**	**(14.7)**	(15.7)	(15.7)
Other deductions		**(2.4)**	**(2.4)**	(4.1)	(4.1)
Common Equity Tier 1 capital		**397.0**	**397.0**	390.3	390.3
Additional Tier 1 capital					
Permanent interest bearing shares (PIBS)		**74.9**	**74.9**	74.9	74.9
Regulatory adjustments:					
Amortisation of PIBS under transitional rules	5	**(30.0)**	**(74.9)**	(22.5)	(74.9)
Total Tier 1 capital		**441.9**	**397.0**	442.7	390.3
Tier 2 capital					
Collective provision		**18.1**	**18.1**	16.1	16.1
Total capital		**460.0**	**415.1**	458.8	406.4
Risk weighted assets (RWA)					
Retail mortgages		**1,570.5**	**1,570.5**	1,521.5	1,521.5
Commercial loans		**727.8**	**727.8**	838.8	838.8
Treasury		**120.7**	**120.7**	90.9	90.9
Other		**175.9**	**175.9**	164.0	164.0
Market and counterparty credit risk		**30.2**	**30.2**	19.5	19.5
Operational risk		**95.2**	**95.2**	84.0	84.0
Total risk weighted assets		**2,720.3**	**2,720.3**	2,718.7	2,718.7
Total exposure for leverage ratio		**5,705.1**	**5,705.1**	5,540.8	5,540.8

		%	**%**	%	%
Common Equity Tier 1 (as a percentage of RWA)		**14.6**	**14.6**	14.4	14.4
Tier 1 (as a percentage of RWA)		**16.2**	**14.6**	16.3	14.4
Total capital (as a percentage of RWA)		**16.9**	**15.3**	16.9	14.9
Leverage ratio		**7.7**	**7.0**	8.0	7.0
Reconciliation of total assets as disclosed in the Statement of Financial Position to the leverage ratio exposures					
Total assets		**5,767.1**	**5,767.1**	5,600.4	5,600.4
Mortgage pipeline and committed facilities	6	**79.7**	**79.7**	49.3	49.3
Structured entities with significant risk transfer	7	**(84.1)**	**(84.1)**	(125.5)	(125.5)
Common Equity adjustments relating to assets	8	**(26.1)**	**(26.1)**	(26.8)	(26.8)
Netted derivative adjustment		**(70.0)**	**(70.0)**	(22.3)	(22.3)
Repurchase agreements and Potential Future Credit Exposure for swaps	9,10	**38.5**	**38.5**	65.7	65.7
Leverage ratio exposure		**5,705.1**	**5,705.1**	5,540.8	5,540.8

Notes

1. A full deduction is made from CET1 for the defined benefit pension fund asset.
2. The cash flow hedging reserve is not included in capital.
3. A full deduction is made from CET1 for intangible assets and goodwill.
4. Under the rules of CRD IV (transitional and on full implementation) deferred tax assets relating to previous operating losses are deducted from capital.
5. Under the transitional rules applicable to the current year, 40% of the value of PIBS is deducted from Tier 1 capital. Under the transitional rules the amortisation deduction is increased by 10% p.a. every 1 January through to 2021, with the final 10% deducted on 5 April 2021, the earliest call date for the PIBS.
6. A 50% weighting is applied to mortgage pipeline and committed facilities assuming that in practice these retail commitments will not be cancelled.
7. The reserves generated by the structured entities with significant risk transfer are excluded from regulatory capital therefore the assets relating to these entities are also excluded from the total assets used to calculate the leverage ratio.
8. The regulatory adjustments above include deductions relating to other assets which are also deducted from the total assets in the leverage calculation.
9. Repurchase agreements represent the extent to which collateral provided on repurchase agreements exceeds the amount borrowed.
10. The denominator for the leverage ratio is total assets from the annual report and accounts, with a relatively small number of adjustments. In 2016 an adjustment for the additional exposure relating to repurchase agreements and potential future credit exposure has been included. As a consequence the leverage ratios for 2015 have been restated to also include this adjustment. This has reduced the transitional and full implementation leverage ratios for 2015 by 0.1%.

Each of the Society's capital ratios exceeds regulatory requirements. The Society's CET1 ratio at 14.6% under CRD IV transitional rules (2014/15: 14.4%), shows the Society to be a strong and financially resilient institution. The year on year improvement in the ratio reflects the ongoing programme of de-risking that the Society has been following in its Back to Basics principles and has also benefited from the inclusion of revaluation and fair value gains which, under CRD IV, were included as part of the Society's capital from 1 January 2015.

The Society's leverage ratio of 7.7% (2014/15: 8.0%) is particularly strong, nearly double that now targeted for the large banks. However, whilst this measure may have some value in benchmarking, it is not adjusted for risk and is only a very high level indicator.

Member engagement

At the West Brom we constantly look at how we can improve our products and services. One of the ways we do this is through customer research, which helps us to understand our members' needs and expectations. In addition to financial and performance indicators, the Board monitors the feedback from our customer research to assess how well we are meeting the financial needs and interests of our members, as well as improvements we can make to deliver high quality products and services.

Key performance indicators

The Board reviews a range of customer research programmes, with the key ones being:

- *Mystery Shopper – conducted across our branch network. Mystery shoppers record their experience on a scorecard against the standards that we expect our customers to receive;*
- *Real-time survey – a survey within Customer Services and our Direct Mortgage Team where members are asked to score our service at the end of their call and give us reasons for that score. The survey has now been expanded to include our branch network;*
- *Members' ViewPoint – events which seek face-to-face feedback from members on our products and services. Two of these events have been held during the past year;*
- *Postal and email surveys – we send our members short surveys by mail/email on a range of subjects e.g. a recent product purchase; and*
- *Customer Panel – more than 2,000 of our mortgage and savings customers have signed up to the Customer Panel and regularly give us feedback about our products and services.*

Our Mystery Shopper programme is an ongoing quarterly measure of how our branches are performing against agreed standards. These standards have been devised to ensure we deliver the high level of service that our members expect to receive. These mystery shops are audio recorded which provides a valuable coaching tool to our Branch Managers.

The real-time survey within Customer Services and our Direct Mortgage Team is a short recorded survey, offered to both existing and potential customers at the end of a phone call, which captures both a score and comments regarding a customer's satisfaction with the West Brom. This is important in being able to gain immediate feedback within a few minutes of the service being provided. Customer feedback is a valuable motivational tool for staff but it also provides us with the opportunity to bring about customer improvements throughout the entire organisation. Of course, if an issue is raised via the feedback, the real-time nature of the survey allows us to resolve it straight away with the customer. We have since rolled this out to our branch network where customers are able to rate the service they have received.

The popular Members' ViewPoint events provide an opportunity for members to openly convey their impressions of the Society to the Chief Executive and other senior executives. This year we have held two Members' ViewPoint events at different locations across our branch network. Feedback from the events has been very positive with members relishing the opportunity to share their thoughts and opinions about the Society with the Chief Executive.

Introduced in 2013, we have continued to survey our new mortgage customers to find out about their experience, with questions about the application process through to completion. This year an online response option was introduced so customers can now complete their survey on paper or online. Overall, satisfaction increased in 2015/16 to 4.3 out of 5 (2014/15: 4.1 out of 5), which is a very pleasing result.

Last year we introduced a Customer Panel, which is made up of over 2,000 customers, who are consulted regularly about our products and services and act as a sounding board for decision making. Panel members have made valuable contributions to new product development plans.

The Board also reviews a number of measures in relation to customer complaints. One key indicator is the Financial Ombudsman Service (FOS) 'complaint overturn' rates. This shows the percentage of instances where the FOS has overturned, in the customer's favour, outcomes where firms originally found against the customer.

During the last 12 months, FOS has ruled in our favour in 84% of cases, which continues to compare positively with the current industry standard of 47% (source: FOS Resolved Complaints Data 1 - 01 July to 31 December 2015).

Corporate and Social Responsibility

Social and community impact

Supporting the local community has been an abiding principle of the Society since its foundation more than 165 years ago. Our people seek to make meaningful contributions to those who are facing hardship and disadvantage through a variety of initiatives and approaches:

- **Financial aid**
  The Society operates a grant-giving scheme called the Mercian Community Trust, which is funded through our Community Account and administered in partnership with the Diocese of Lichfield. Contributions from the Mercian Community Trust range from a few hundred pounds to several thousand. They are targeted at charitable causes associated with issues such as ill health, social wellbeing, disability, vulnerable children, bereavement and domestic violence. We issued more than 50 grants during the year to charities including Birmingham St Mary's Hospice, Autism West Midlands, Variety, the Gap Centre in Sandwell and British Blind Sport.

- **Fundraising**
  Our staff always rise to the challenge when it comes to collecting money for good causes and are invited to help select a nominated charity every year to benefit from the contributions we receive. This year we chose Edward's Trust, a Birmingham based charity supporting children and families who are facing loss and surviving bereavement. Established 25 years ago by a family trying to come to terms with loss of their own son, Edward's Trust has captured the imagination of West Brom staff and customers alike and more than £22,000 has been raised through a wide range of events.

- **Affinity partnerships**
  The Society has links to a number of affinity partners, using special savings accounts to amass an annual contribution that can be used to support their various activities. For Birmingham Children's Hospital our Red Balloon Appeal Account helps to fund essential life-saving equipment or improve patient treatment, rest and play areas. Affinity partnerships with sporting clubs such as Walsall FC and Shrewsbury Town are putting money into supporting youth development and access to sport.

- **Volunteering programme**
  We encourage colleagues to participate in regular volunteering sessions with local community organisations. Our volunteering policy ensures every employee can spend up to two working days carrying out voluntary work and approximately 70 individuals have taken up the opportunity to do so this year. Among the projects supported were painting and decorating communal areas at women's refuge The Haven. Groups of volunteers have visited local hospitals to decorate the wards ready for Christmas and at Birmingham Children's Hospital we have delivered art and craft sessions with patients waiting for appointments. An increasing number of our Branch Managers are giving up their time to visit local schools, delivering money management workshops with the children and sharing important messages about the dangers of debt.

Employee diversity

The West Brom is located in one of the most ethnically diverse regions in the country, a feature reflected in the composition of the staff profile with just over a quarter (26%) drawn from ethnic minority communities. This representation is invaluable in those branches serving a mixed ethnic population, particularly where English is not necessarily the first language of many customers.

The Society has a staff directory that lists a broad spread of language skills, extending from a rudimentary level to those individuals who are fluent in a language other than English, for example Punjabi, Urdu, Polish or Chinese. In addition, in liaison with Sandwell Deaf Association, the Society has offered staff a basic course in British Sign Language (BSL) which allows for a more sensitive and welcoming service for people with a hearing impairment.

With a total staff number of 760 as at 31 March 2016, female colleagues amount to 471, some 62% of the overall figure. 67% of Branch Managers are female and, at a senior managerial level, the proportion is 35 male managers to 11 female managers (24%). One of the eight Board members was female, with a second joining on 1 April 2016. The Society works to recruit people of the highest calibre, irrespective of gender while conscious of the importance of creating opportunities and reducing barriers to a more equal distribution of staff.

Taxation

The statutory reported tax charge for the year is £4.1m (2014/15: £3.2m). This represents an effective tax rate of 30% (2014/15: 26%), which is higher than the statutory rate in the UK of 20% (2014/15: 21%). The higher rate is due mainly to allowing for future changes in corporation tax rates (which reduce to 18% by 2021). This reduces the benefit that may be obtained in the future from utilising brought forward tax losses.

Total tax contribution

During 2015/16 the Group incurred taxes of £9.5m (2014/15: £7.1m) including £7.4m (2014/15: £5.2m) of irrecoverable VAT, which represents a cost to the Group charged to profit before tax as part of administrative expenses and depreciation.

Year to 31 March	2016 £m	2015 £m
Taxes paid		
Indirect taxes (irrecoverable VAT)	**7.4**	5.2
Employment taxes (Employer's NI)	**2.1**	1.9
Total	**9.5**	7.1

In addition, the Group collected and remitted on behalf of HM Revenue & Customs a further £14.5m (2014/15: £16.9m).

Year to 31 March	2016 £m	2015 £m
Taxes collected and remitted		
Taxes withheld at source (on savings accounts)	**6.9**	9.2
Payroll taxes (PAYE and Employees' NI)	**7.5**	7.6
Indirect taxes (Insurance Premium Tax and VAT)	**0.1**	0.1
Total	**14.5**	16.9

Principal risks and uncertainties

Effective risk management is integral to the Society's operations.

The separate Risk Management Report on pages 17 to 20 identifies the principal risks and uncertainties faced by the Society and describes, in detail, the West Brom's approach to risk management.

Outlook for 2016/17

The Society has achieved significant progress in 2015/16, with a return to Balance Sheet growth, despite the run-off of legacy, non-core portfolios.

Whilst there is increasing competition in both the mortgage and savings markets, the Society plans to grow its net residential prime lending further in 2016/17, funded by growing its investing members' balances.

The Society's investment programme will continue into 2017 and beyond, delivering efficiencies and enhanced customer service.

The Society continues to strengthen its capital position and improve its profitability, giving its members confidence in its financial strength.

Mark Gibbard
Group Finance & Operations Director
25 May 2016

Risk Management

Overview

Effective management of risks and opportunities is essential to achieving the Society's corporate objectives. The Board aims to manage effectively all the risks that arise from its activities and believes that its approach to risk management reflects an understanding of actual and potential risk exposures, the quantification of the impact of such exposures and the development and implementation of controls that manage exposures within the Board's agreed risk appetite.

Risk management framework

The Society's activities are governed by its constitution, principles and values. The Directors have also agreed a set of statements which describe the Board's risk appetite in terms of a number of principal key risk categories: business, capital, credit, liquidity, market, basis, operational, retail conduct, and pension liability (the Society's Risk Appetite Statements).

These Risk Appetite Statements drive corporate planning activity, including capital and liquidity planning, as well as providing the basis for key risk measures.

The final element of the framework is the formal structure for managing risk across the Group. This is based on the 'Three Lines of Defence' model which is illustrated below.

	Activity	Responsibility	Governance
1st	Business Operations	Line Management	Line Management Oversight
2nd	Policy, Controls, Measure, Monitor	Control Functions	Management and Board Committees
3rd	Assurance	Internal Audit	Audit Committee

Governance structure

During the year risk governance was provided by a structure consisting of eight key risk management committees:

Risk Committee (RC) – This Committee is chaired by a Non-Executive Director and is responsible for the oversight and management of the principal and key strategic risks identified by the Board.

Executive Risk Committee (ERC) – This Committee is chaired by the Chief Financial Risk Officer and is responsible for providing the Executive and the Risk Committee with an enterprise wide view of the risk profile of the Society, including current and potential risks. The ERC is also accountable for driving the detailed implementation of the Society's Risk Management Framework.

Assets & Liabilities Committee (ALCo) – This Committee is chaired by the Group Finance & Operations Director and is responsible for overseeing the assets and liabilities risk including the assessment of exposure to Treasury counterparty credit, market, liquidity, basis and interest rate risk.

Residential Credit Committee (RCC) – This Committee is chaired by the Chief Financial Risk Officer and is responsible for monitoring the Society's residential lending activity and its exposure to credit risks in the retail loan books.

Commercial Loans Risk Committee (CLRC) – This Committee is chaired by the Chief Financial Risk Officer and is responsible for monitoring the Society's exposure to credit risks in the commercial loan book.

Operational and Conduct Risk Committee (OCRC) – This Committee is chaired by the Group Secretary and is responsible for the oversight of the management of operational and retail conduct risks arising from the Society's business activities.

Group Capital Committee (GCC) – This Committee is chaired by the Group Finance & Operations Director and is responsible for reviewing the Group's capital requirements.

Audit Committee (AC) – Comprising four Non-Executive Directors, the Audit Committee provides the Board with assurance regarding the integrity of the financial statements and the adequacy and effectiveness of the Society's risk management frameworks.

Independent assurance is provided by the Internal Audit function which has a direct reporting line into the Audit Committee (AC).

Risk categories

The Board has identified nine principal risk categories, which together define its overall risk universe. These are defined below:

Business risk

The risk of the Society failing to meet its business objectives through the inappropriate selection or implementation of strategic plans.

Credit risk

The risk that losses may arise as a result of the Society's borrowers, debtors or market counterparties failing to meet their obligations to repay.

Capital risk

The risk that the Society has insufficient capital to cover stressed losses or to meet regulatory requirements.

Liquidity risk

The risk that the Society either does not have sufficient financial resources to enable it to meet its obligations as they fall due or can secure such resources only at excessive cost.

Market risk

The risk of changes in the value of, or income arising from, the Society's assets and liabilities as a result of unexpected changes in financial prices, primarily interest rates, property prices, bond yields and inflation.

Basis risk

The risk that assets and liabilities re-price at different times and/or by varying amounts, adversely affecting the net interest margin.

Operational risk

The risk of loss and/or negative impact to the Society resulting from inadequate or failed internal processes or systems from external events or human error.

Retail conduct risk

The risk that inappropriate behaviours by the Society result in adverse outcomes to retail consumers.

Pension liability risk

The risk that there will be a shortfall in the value of the Society's pension fund assets over and above the guaranteed liability to its employees under the defined benefit pension scheme. This may result from a number of sources including investment strategy, investment performance, market factors and mortality rates.

For each risk category the Board has agreed an appetite statement and key metrics which, together, define the level of risk the Board is prepared to accept or tolerate. In addition, key threats and the corresponding Society responses or mitigants, as well as opportunities, have been identified. The mitigating controls and the effectiveness of the controls are monitored by line management, with control functions providing a Second Line of Defence. Internal Audit, through an approved assurance programme, provides the Third Line of Defence.

The Risk Committee meets at least quarterly to review the Society's exposure to the risk categories. During this financial year, the Committee met on eight occasions.

Business conditions and the economic environment

The economic environment in the UK continued to improve in 2015. The Bank of England maintained interest rates at historically low levels and maintained the policy of quantitative easing that has injected money into the economy. UK inflation remained at record lows, driven by a collapse in oil and energy prices and ongoing supermarket price wars. This aligned to growth in real earnings has a positive impact on continued customer affordability. The cost of retail mortgages remains low and with the government's Help to Buy schemes being extended, increased consumer confidence has continued to stimulate the housing market.

The growth in the buy to let market will potentially be abated by the Chancellor's moves to increase taxation by reducing tax relief for higher rate tax payers and also applying a 3% surcharge for buy to let and second properties.

The West Brom is exclusively focused in the UK and, therefore, the general UK macro-economic environment is key to its success. The external factors that impact the Society include:

- Interest rates (Bank Rate and LIBOR);
- Inflation;
- Unemployment; and
- The housing and commercial property markets.

Day-to-day management of key risks

Primary responsibility for risk management, including the design and operation of effective controls, rests with the management of each business function – the 'First Line of Defence'. Support and challenge is provided through specialist risk functions – Credit Risk, Operational Risk, Conduct Risk and Assets & Liabilities Management – the 'Second Line of Defence'. These functions develop and review policies, monitor and support compliance with those policies, and support the business functions to manage risk.

Governance and oversight is provided through a number of management and executive committees as detailed on page 17.

Credit risk

Credit risk refers to the risk that a customer or counterparty to a contract will not be able to meet their obligations as they fall due. For the purposes of the Society, this normally means the risk that a borrower will not repay their mortgage loan, or that a financial institution will not repay funds invested by the Society in that institution.

During the year the Society's lending was in accordance with the approved credit policy, which is consistent with the risk appetite established by the Board. Currently, no new non-conforming property lending (i.e. commercial, buy to let, sub-prime or self-certified) is being undertaken.

The Society's exposure to residential and commercial credit risk is managed by a specialist Credit Risk team which is responsible for setting the Credit Risk Management Framework and associated limits. It also provides regular reports to the Risk Committee, which is chaired by a Non-Executive Director and includes all other Non-Executive Directors as members.

Additionally, credit risk can arise within treasury transactions (used to meet liquidity requirements and those hedging instruments used for interest rate risk purposes). This type of credit risk is managed by the Treasury Middle Office team. On a daily basis, this team monitors exposures to counterparties and countries, and ensures operations remain within Board approved limits. ALCo and the Board review the Treasury Policy and limits, with reports presented to ALCo on a monthly basis confirming compliance with such policy limits.

Throughout the last financial year, a conservative approach to liquidity management has been maintained, investing for short periods with selected financial institutions. The Society has also maintained a position of holding a significant proportion of liquidity in UK government guaranteed and supranational financial institution assets, which are considered to be both highly liquid and secure. Treasury operates a strict control framework and exposures are monitored on a daily basis.

Market risk

Market risk refers to the possible changes in the value of, or income arising from, the Society's assets and liabilities as a result of changes in interest/exchange rates, property prices or equities. Market risk exposures are managed through the Treasury department which is responsible for managing exposure to all aspects of market risk within parameters set by the Board.

ALCo reviews the Treasury Policy, recommending changes to the Board as appropriate, and ensures that regular reports on all aspects of market risk are assessed and reported to the Board. The key market risk is interest rate risk, which arises as a result of differences in the timing of interest rate re-pricing of assets and liabilities. To mitigate this, Treasury uses natural balance sheet hedging (e.g. matching 2 year fixed rate mortgages with 2 year fixed rate saving bonds) and derivative instruments. The use of derivatives is only permitted in accordance with the provisions of the Building Societies Act 1986, which focus on their use to reduce risk.

The maximum level of interest rate risk is governed by the Board approved Treasury Policy in line with the Board's risk appetite.

In line with regulatory requirements and best practice, the impact of a parallel shift in interest rates in both directions, is considered. In addition, the impact of alternative non-parallel scenarios upon income and market value is also considered.

Interest rate sensitivity also arises from the potential for different interest rates to move in different ways, e.g. Bank Rate mortgages are funded by LIBOR-linked liabilities. The impact of these mismatches (Basis risk) is monitored by Treasury and reported to ALCo.

The Society's main exposure to equities is through the defined benefit pension scheme. While the Society does attract funds through index-linked savings products, all exposures to equity indices are fully hedged. There is no exposure to foreign exchange rates.

The Society has invested in property through its subsidiary West Bromwich Homes Limited and offers residential property for rent. This non-core business exposes the Society to movements in house prices. The Board's strategy is to exit from this business when market conditions are opportune.

Liquidity risk

The Society's primary purpose is to make loans secured by way of mortgage on residential property. It funds these loans substantially from short term deposits provided by its saving 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.

Savers' deposits, whilst accessible predominantly on demand, at short notice or for fixed periods, nevertheless tend to remain with the Society for longer periods. A substantial proportion of savers have long established relationships with the Society.

This difference in the nature of borrowers' and savers' relationships causes a structural mismatch between the speed at which the Group can generate cash from its business assets and the demand for funds to meet its liabilities. To mitigate this risk, the Group holds sufficient liquid resources to meet the normal day-to-day operations of the business and, in addition, maintains a buffer of high quality assets which can be converted quickly into cash to cover outflows in severely stressed conditions. Processes are in place to ensure that the quantity, quality and availability of these liquid resources is adequate at all times.

The Board undertakes a detailed review of its liquidity adequacy under the Individual Liquidity Adequacy Assessment Process (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 'idiosyncratic', 'market-wide' and 'combined'.

The supervisory review also informs the PRA's view of the amount of 'buffer' or highest quality liquid assets that the Society should hold to meet the three standard regulatory stress scenarios and the maximum allowable gap between maturing wholesale assets and wholesale liabilities (wholesale refinancing gap). The PRA replaced the Individual Liquidity Guidance with the Liquidity Coverage Ratio (LCR), which was a Basel III requirement to be adopted universally. Treasury maintains liquid resources at the greater of the LCR requirement or the internal assessment of liquidity adequacy.

The Board has established a Liquidity Risk Policy which lays down a rigorous framework of limits to control the Society's liquidity risk. The governance process surrounding liquidity risk management activities is as follows:

- The Board has delegated authority for the governance of Liquidity Risk Management to the Assets & Liabilities Committee (ALCo) which meets monthly;
- Operational management of liquidity risk is further delegated to the Liquidity Management Committee (LMC) which meets weekly. LMC looks at liquidity stresses over a horizon of up to three months and plans cash flows over a rolling 12 month planning period;
- Treasury is responsible for day-to-day management and maintenance of adequate liquid resources under delegated authority from ALCo; and
- The Risk Committee monitors independently the overall liquidity adequacy process, including the activities of ALCo, LMC and Treasury.

The Society is responsible for the liquidity and cash flow requirements of wholly owned subsidiaries.

Capital risk

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. This analysis is collated into an Individual Capital Adequacy Assessment (ICAA) that is approved by the Board. The ICAA incorporates expected future capital requirements from changes in business volumes, mix of assets and activities within the context of current and anticipated future risks, and multiple, stressed scenarios. The ICAA is used by the PRA to set the Society's capital requirements as Individual Capital Guidance (ICG).

Society capital requirements are reviewed on a monthly basis and the results of this monitoring are reported to the Group Capital Committee, Risk Committee and the Board.

The detailed breakdown of the Society's capital position can be found on page 13.

Operational risk

Each business function has a clearly articulated responsibility for identifying, monitoring and controlling its operational risks. The business function receives support and guidance from the Operational Risk team, which co-ordinates regular reviews with the function managers and collates the output for review by executive management, the Operational and Conduct Risk Committee and the Risk Committee.

The Legal and Operational Risk team also provides independent input and challenge to the business functions, both through the regular review of operational risks and day-to-day business initiatives.

Retail conduct risk

The regulatory focus on retail conduct risk has increased with the separation of the Financial Services Authority into the Prudential Regulation Authority and Financial Conduct Authority. The Society has formally mirrored this separation by recognising a specific risk category – retail conduct risk.

Principal risks and uncertainties

Set out in the table overleaf are the principal external threats which have been identified by the Risk Committee, along with the Society's response and mitigants in place.

Risk Category	Principal External Threats	Society Response and Mitigants
Business risk	Adverse changes to the operating environment arising from: • A reduction in interest rates from the current historical low, or a series of rapid and large increases in interest rates. • Demand for retail funds. • House price movements. • Low or flat economic growth. • Increasing regulatory costs. • Loss of buy to let legal case.	Business plans continue to model the impact of a range of scenarios and stress testing to provide comfort that the Society can tolerate the consequences financially and reputationally. Income projections are reviewed regularly to identify mitigation actions.
Credit risk	Higher unemployment and/or an increase in Bank Rate (leading to increased arrears and losses).	The Society's provisioning and stress testing models assume a range of unemployment levels and varying interest rate scenarios. Should an increase occur, the Society would expand its credit management resource.
	Reduction in property prices (leading to a higher incidence of voluntary possessions).	The Society is committed to work with its borrowers to avoid possession wherever possible. In the event that possessions were to increase the Society has provided and regularly reviews its impairment provisions.
	Low or flat economic growth (leading to further tenant failures).	The Society has a well-resourced and highly experienced team dealing with commercial property mortgages and, as has been the case throughout the year, works with borrowers to lessen the impact.
Capital risk	Rules for calculating capital (amount required and/or amount held) are changed.	Maintain regular dialogue with the Regulator and ensure full understanding of the relevant rules.
Liquidity risk	Intensification of competition for retail funding.	The Society continues to attract new retail savers despite intense competition.
Market risk/ Basis risk	Reduction in returns from residential tracker mortgage assets whose rate is linked to Bank Rate with no floor.	The Society does not originate any new residential tracker mortgages.
	Falling HPI, leading to a reduction in the book value of West Bromwich Homes Limited properties.	No new homes are being added to the portfolio and active steps are being taken to reduce the Society's exposure.
Operational risk	Insurance arrangements do not sufficiently cover an event (requiring the Society to pick up the cost).	The annual review of insurance arrangements is based on advice from brokers and an annual benchmarking exercise.
	A significant business continuity event.	Detailed business plans are in place, which are regularly tested.
	One or more of the Society's IT systems are attacked for the purposes of financial gain, theft of data or to cause the Society disruption or negative exposure.	External specialist advice has been received and actions implemented on system design, security policies, firewalls, anti-virus, security patching, email filtering, internet access limitations, system lockdown design, system access controls, network access control, penetration testing, dedicated security monitoring and alerting tools and resources. The Society has plans in place to manage the impact of a cyber attack.
Pension liability risk	Increased longevity and/or poor investment returns (requiring the Society to contribute more to the scheme).	The defined benefit scheme is closed to new members and existing members are no longer accruing service benefits. The Trustees take extensive advice (actuarial, investment etc.) to minimise the impact of the risks identified.
Retail conduct risk	Actions of third party suppliers leading to adverse customer outcomes.	A robust supplier framework is in place to oversee the activities of key suppliers.

The Society has a Recovery Plan in place that captures inter alia management actions for a range of adverse scenarios that may impact any of the above risks either individually or collectively.

Richard Sommers
Chairman of the Risk Committee
25 May 2016

Board of Directors

Mark Gibbard BSc, FCA, MCT
Age 54 / Group Finance & Operations Director Appointed February 2011
Mark has worked in financial services for nearly 30 years, including 7 years as Finance Director on the Board of Cheltenham & Gloucester plc. Prior to joining the West Brom, he was Divisional Director Risk Management at Nationwide Building Society. Mark chairs the Society's Assets & Liabilities Committee.

Claire Hafner MA, ACA
Age 56 / Non-Executive Director Appointed September 2011
Claire has recently retired from her role as Chief Financial Officer for VocaLink, a specialist provider of transaction services to banks, their corporate customers and to the public sector. She was previously Finance Director for law firm Eversheds, heading a team of finance professionals across the UK and overseas. Claire is a member of the Audit, Risk and Remuneration committees.

Julie Hopes MBA, ACIB
Age 48 / Non-Executive Director Appointed April 2016
Julie has many years of experience in retail financial services, with a particular focus on general insurance. An Associate of the Chartered Institute of Bankers, she has non-executive director roles with Co-operative Insurance and the Police Mutual Assurance Society. Julie is a member of the Risk Committee.

Mark Nicholls MA (Cantab), MBA
Age 67 / Chairman Appointed January 2010
Mark has considerable knowledge of financial services having been a Director of SG Warburg Group Plc and Managing Director of the private equity group of the Royal Bank of Scotland. Mark has held Non-Executive Directorships at Portman and Nationwide building societies and is currently Chairman of Rathbone Brothers Plc. Mark chairs the Nominations Committee and is a member of the Remuneration Committee.

Mark Preston BA (Hons), ACIB
Age 56 / Non-Executive Director Appointed May 2011
Mark is currently Chief Executive Officer at Exotix Partners and has been involved in financial markets for nearly 30 years. He was previously Chief Executive Officer for the Products and Markets Division of Lloyds TSB and Co-Head of the Bank's Corporate Markets. Mark is a member of the Risk and Remuneration committees.

Martin Ritchley FCA, FCIB, Hon DBA (Coventry)
Age 69 / Deputy Chairman and Senior Independent Director Appointed September 2009
Martin is a former Chief Executive of Coventry Building Society and former Chairman of the Building Societies Association. He chairs the Remuneration Committee and is a member of the Audit, Nominations and Risk committees.

Richard Sommers MA (Oxon), ACIB
Age 59 / Non-Executive Director Appointed October 2009
Richard has recently retired from his role as Treasurer of Lady Margaret Hall, a college in the University of Oxford. He is highly experienced in retail and commercial banking and held senior positions with the Barclays Group, including Chief Financial Officer for Barclaycard and Risk Director of Retail Financial Services. Richard chairs the Risk Committee and is a member of the Audit and Nominations committees.

Colin Walklin BSc, FCA
Age 62 / Non-Executive Director Appointed July 2011
Colin is Group Chief Operating Officer of Standard Life Plc with responsibility for operations, technology and change management throughout the Group. A qualified Chartered Accountant, Colin chairs the Audit Committee and is a member of the Risk Committee.

Jonathan Westhoff BA (Hons) Financial Services, FCMA, CGMA, ACIB
Age 51 / Chief Executive Appointed May 2009
Formerly the Society's Group Finance Director and Deputy Chief Executive, Jonathan was appointed as Chief Executive in May 2011. After 17 years with Barclays Bank, he moved into the mutual sector in 2000, serving as Finance Director at Portman and Newcastle building societies. Jonathan is currently Chairman of the Midlands and West Association of Building Societies, a Council Member of the Building Societies Association and a Councillor on the CBI West Midlands Council. He chairs the Executive Committee and is a member of the Society's Assets & Liabilities Committee.

Directors' Report

The Directors are pleased to present their Annual Report, together with the audited Accounts, for the financial year ended 31 March 2016.

Business objectives

The main purpose of the Society and its subsidiaries (the Group) is to work together to meet the prime financial needs of our members. This entails provision of a diverse range of personal financial services, offering competitive pricing and excellent service.

Business review

The Group's business and future plans are referred to in the Chairman's Statement on page 2, the Chief Executive's Review on pages 3 to 4 and the Strategic Report on pages 5 to 16.

Key performance indicators

The Board measures performance against its strategic aims by reference to a number of key performance indicators which are described in the Strategic Report on pages 5 to 16.

Profit and capital

The Group's profit before tax (on continuing operations) amounted to £13.5m (2014/15: £12.4m). The total profit after tax transferred to reserves was £9.4m (2014/15: £9.2m).

The total Group reserves at 31 March 2016 were £243.3m (2014/15: £239.9m) after taking into account a revaluation reserve of £3.4m (2014/15: £3.4m), a cash flow hedging reserve of £(0.3)m (2014/15: £(0.1)m) and an available for sale reserve of £0.9m (2014/15: £3.5m).

Gross capital at 31 March 2016 was £497.7m (2014/15: £491.9m) including £179.5m of profit participating deferred shares (2014/15: £177.1m) and £74.9m (2014/15: £74.9m) of subscribed capital.

The main Group ratios were as follows: gross capital ratio; 10.37% (2014/15: 10.85%), free capital ratio; 7.29% (2014/15: 7.78%) and liquidity ratio; 17.28% (2014/15: 15.92%). For further details see page 103.

Detailed Pillar 3 capital disclosures for the current year will be available on the Society's website.

Country-by-Country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the Capital Requirements Directive (CRD IV).

The principal activities of the Society are set out under the business objectives earlier in this report and for each of the Society's subsidiaries in note 15 to the accounts. All of the activities of the Group are carried out in the United Kingdom and therefore 100% of the total income, profit before tax and tax shown in the Income Statement as well as employee figures shown in note 7 are related to the United Kingdom. The Society and its subsidiaries have not received any public subsidies (2015: nil).

Risk management

As the Society operates in a very competitive environment, the management of risk and development of a suitable strategy are critical activities in achieving business success.

The Board and the Board Committees ensure that risk management and strategic direction are considered regularly and that appropriate actions are implemented. These considerations are detailed in the Society's Internal Capital Adequacy Assessment Process (ICAAP) document.

The principal risks inherent to our business and details of how these risks are managed are set out in the Risk Management Report on pages 17 to 20.

In addition to these principal risks there are, as a result of the economic environment for banks and building societies, ongoing actions under the PRA's supervisory review process, which include extensive stress testing exercises. The Directors are aware, in arriving at their judgements, that the Society will be subject, in the same way as others within the sector, to these ongoing tests of capital and recognise the uncertainty inherent in the process as factors within each test change.

Financial risk management objectives and policies

The Board's objective is to minimise the impact of financial risk upon the Society's performance. Financial risks faced by the Society include interest rate, credit, liquidity and currency risks. The Board manages these risks through a risk management framework, Board policies and its Treasury and Credit Risk functions. Governance and oversight is provided through the Risk and Assets & Liabilities Committees. Details of the Society's financial instruments, hedging activity and risk mitigation can be found in note 12 and notes 31 to 34 to the Accounts.

Mortgage arrears

At 31 March 2016 there were 73 (2014/15: 82) residential and commercial mortgage accounts where payments were 12 months or more in arrears based on current monthly repayments. The total amount outstanding on these accounts was £74.1m (2014/15: £82.0m), representing 1.57% (2014/15: 1.76%) of mortgage balances, and the amount of arrears was £13.9m (2014/15: £12.5m). Appropriate provisions were made for potential losses on mortgages in accordance with the provisioning policy set out in note 1 to the Accounts.

Directors

The following served as Directors of the Society during the year:

Mark Gibbard*
Claire Hafner
Mark Nicholls (Chairman)
Mark Preston
Martin Ritchley
Richard Sommers
Colin Walklin
Jonathan Westhoff*

* Executive Directors.

All Directors are members of the Society. None of the Directors have, at any time in the year or as at the year end, any beneficial interest in shares or debentures of any associated body of the Society.

Supplier payment policy

The Society's policy is to agree the terms of payment before trading with the supplier and to pay in accordance with its contractual and other legal obligations. At 31 March 2016, the creditor days figure was 21 days (2014/15: 18 days). This conforms with the aim of paying creditors promptly.

Charitable donations

During the year the Society donated £18,600 (2014/15: £2,950) to a local charitable organisation. The Society also raised significant sums through its community programme, affinity accounts and voluntary staff initiatives. These are outlined on pages 15 to 16 of the Strategic Report.

No donations were made for political purposes. While encouraging any employees who wish to take part in community affairs, the Group does not support any employees in the pursuit of political activity.

Employees

The Society is an equal opportunities employer and gives proper consideration to all applications for employment with regard to vacancies that arise and to the applicant's own aptitude and abilities, regardless of race, creed, gender, sexual orientation, marital status, age, physical or mental disability. If current staff members become disabled, every effort is made to enable them to maintain their present position or to receive relevant retraining.

The Society has systems that provide information to employees, permitting them to participate in the operation and development of the business. The Society consults with the West Bromwich Building Society Staff Union and assesses the results of annual staff satisfaction surveys to ensure that staff conditions and workload are maintained at an acceptable level. Additionally, details of meetings, team briefings, circulars and information updates are placed on the Society's intranet to ensure that employees are aware of the Society's objectives and performance and conscious of the wider financial and commercial environment in which the Society functions.

Health and safety

The Society sets high standards to maintain the health and safety of all staff, customers and those affected by any of its operations.

The Society is committed to ensuring that all employees receive adequate training in health and safety to make them aware of their individual responsibilities to enable them to carry out their work tasks without injury or damage to the health of themselves or others affected by their work. All employees, on commencing employment with any business area, receive induction training which is reinforced through annual refresher training. Additional training is delivered when a need has been identified, such as Manager Training, Stress Awareness, Manual Handling, Fire Warden, First Aid etc.

The Society recognises the need to consult with its employees on health and safety issues and the rights of individuals and Trade Unions in respect of this. Accredited safety representatives are afforded every opportunity to effect this consultation and to receive training as appropriate from their Trade Union. A Health and Safety Committee is in place with representatives from across the business which meets quarterly to review health and safety.

Health and safety issues are brought to the attention of all employees through business specific communication channels. Employees are similarly encouraged to raise issues through their line management.

During the reporting year no enforcement notices were issued against the organisation by any of the enforcing authorities and no proceedings were instigated against the Society for breaches of health and safety regulations within the reporting period.

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

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

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

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

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

A copy of the Annual Accounts is placed on the Society's website.

Directors' statement pursuant to the Disclosure and Transparency Rules

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware:

- the financial statements, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and result of the Group; and
- the management reports in pages 5 to 16 include a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Directors' responsibilities for accounting records and internal control

The Directors are responsible for ensuring that the Group:

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

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

Directors' responsibilities in respect of going concern

In preparing the financial statements the Directors must satisfy themselves that it is reasonable for them to conclude it is appropriate to adopt the going concern basis. The Group meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business.

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's Review on pages 3 to 4 and the Strategic Report on pages 5 to 16. The financial position of the Group, its capital structure and risk management and control processes for managing exposure to credit, market, liquidity and operational risk are described in the Strategic Report on pages 5 to 16 and the Risk Management Report on pages 17 to 20.

In addition, notes 32 to 34 to the Accounts include further information on the Group's objectives, policies and processes for managing its exposure to liquidity, credit and interest rate risk, details of its financial instruments and hedging activities.

The Group's forecasts and projections, taking account of possible changes in trading performance and funding retention, and including stress testing and scenario analysis, show that the Group will be able to operate at adequate levels of both liquidity and capital for the foreseeable future. Furthermore, the Group's capital is in excess of the PRA requirement.

After making enquiries the Directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future and that, therefore, it is appropriate to adopt the going concern basis in preparing the Annual Accounts.

Auditor

The auditor, KPMG LLP, has expressed their willingness to continue in office. In accordance with Section 77 of the Building Societies Act 1986, a resolution for their re-appointment will be proposed at the Annual General Meeting.

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Society's auditor is unaware; and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

By order of the Board

Mark Nicholls
Chairman
25 May 2016

Directors' Report on Corporate Governance

The Board is committed to high standards of corporate governance and believes they are central to the Society's culture and values.

The widely accepted articulation of good practice is the 2014 UK Code on Corporate Governance (the Code).

The Society is not required to and does not comply with the Code and is not required to do so, as it applies to publicly listed companies, but where it is considered relevant, the Society does comply with its principles. This Report details the Society's approach to corporate governance and, where different to relevant Code principles, explains why that is the case.

The Code's Main Principles	What the Society does to meet the Principles
A1 The Role of the Board Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.	The principal functions of the Society's Board include: • Providing entrepreneurial leadership; • Setting the Society's strategic aims and risk appetite; • Implementing and maintaining a framework of prudent and effective controls, which enables risk to be assessed and managed; • Ensuring the necessary financial and human resources are in place for the Society to meet its objectives; and • Reviewing management performance. The Board meets as often as is necessary to fulfil its responsibilities. During the last financial year the Board met on 10 occasions. Details of Director attendance at Board and Committee meetings can be found in the table at the end of this Report. The minutes of Board and Committee meetings record all material discussion and challenge and are circulated to all Directors. The Chair of each Committee reports to the subsequent Board meeting the key matters discussed. A schedule of matters reserved to the Board is maintained and kept under regular review. The Board is supported by a number of Committees each with Board approved terms of reference. Details of the membership of those Committees and their key activities are reported elsewhere in this Report and Accounts. The Society has arranged appropriate insurance cover in respect of legal action against its Directors.
A2 Division of Responsibilities 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.	The positions of Chairman and Chief Executive are held by different people. The role of the Chairman includes establishing and developing an effective Board to provide support and constructive challenge to the management team. Further details of the Chairman's main responsibilities are set out in the commentary relating to Code Principle A3. The Chief Executive has overall responsibility for managing the Society and implementing Board agreed strategy.
A3 Chairman The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.	The main responsibilities of the Chairman are: • Establish and develop an effective Board, including succession planning, recruitment and appraisal of Non-Executive Directors (NEDs); • Lead the Board as a team; • Ensure that the Board has agreed clear values and guiding principles; • Plan and manage the Board's business, including ensuring that appropriate committees are established with the right objectives and membership and that the Board has the right agenda and information; • Ensure that the Board has established key priorities; • Maintain and develop a productive and open relationship with the Chief Executive, agree the Chief Executive's objectives and carry out regular appraisals. The Chairman is responsible for leading the appointment process for the Chief Executive; • Ensure there are appropriate arrangements for the evaluation and remuneration of senior executives; • Act as an accountability focus for the Society, including chairing the Annual General Meeting; • Represent the Society with Regulators and ensure that there is an open and trustworthy relationship; and • Ensure that the Board and its Committees periodically evaluate their own performance. The Board has satisfied itself that both at the time of his appointment, and currently, the Chairman is independent in character and judgement and meets the independence criteria set out in the Code.
A4 Non-Executive Directors As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.	NEDs are involved in all key decisions and receive detailed management information and reports to ensure they have a firm grasp of the Society's business and external operating environment. NEDs are responsible for all appointment, termination and remuneration decisions relating to the Society's Executive Directors. Martin Ritchley has been appointed as the Board's Senior Independent Director (he is also Deputy Chairman). As Senior Independent Director he leads the annual review of the Chairman's performance. The NEDs meet formally and informally without Executive Directors present.

The Code's Main Principles	What the Society does to meet the Principles
B1 The Composition of the Board 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.	Board and Committee composition is kept under regular review by the Chairman and the Nominations Committee, to ensure that it is of appropriate size, mix of Executive and Non-Executive Directors and has the right skills and experience to oversee the Society's business activities. The Board believes that all NEDs should meet the Code's independence criteria on appointment and throughout their term of office and has determined that each of the current Directors is independent in character and judgement and that there are no potential conflicts of interest which would affect their judgement.
B2 Appointments to the Board There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.	During the course of the last financial year, no new appointments were made to the Board. During the latter part of the financial year the search began for an additional NED to join the Board. The process involved the support of a specialist recruitment firm in the search and interview process. In addition, an advert was placed in the national press (online). This was to ensure that as many individuals that might be interested in the role had the opportunity to apply. Initially, all applications received as a result of the advertisement as well as all individuals identified by the recruitment firm, were reviewed by the recruitment firm with the results then reviewed with members of the Board to identify a shortlist of potential candidates to interview. One of the shortlist of candidates had applied through our advert. These candidates were then interviewed by the recruitment firm before being interviewed by members of the Board. The potential successful candidate then met with the remaining Board members and Group Secretary. Finally, the Nominations Committee recommended to the Board that the potential candidate be offered the role of NED. The process concluded with the appointment of Mrs Julie Hopes who joined the Board on the 1 April 2016. The terms of reference of the Nominations Committee, which is made up of NEDs, is available on request from the Group Secretary.
B3 Commitment All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.	The standard letter of appointment for NEDs sets out the expected time commitment and explains what is required if there is any material change to their commitments.
B4 Development All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.	The Society has a range of induction activities and material for NED appointments which is tailored to their individual experience. These include site visits, meetings with senior management and reports/information concerning the Group's operations. Internally organised events on topics of particular relevance to the Society are used to aid development. NEDs are also encouraged to attend appropriate externally organised events. A development log records relevant development activities undertaken by individual Directors.
B5 Information and Support 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.	Board papers, including a management information pack are issued to Directors prior to Board meetings. Board agendas are agreed in advance of each meeting and focus on strategic matters, as well as ensuring that Directors are kept informed of key business activities and regulatory developments. Minutes of Board Committee meetings held since the last Board meeting are included in the papers. Where appropriate, papers are presented by the relevant member of the management team. The Board and its Committees are served by the Group Secretary who advises on governance matters and procedures. Directors have access to independent professional advice should that be required.
B6 Evaluation The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.	The most recent formal evaluation of Board and individual Director performance concluded in the latter part of the 2015/16 financial year. The evaluations were initiated by a questionnaire and were reviewed by the Chairman and the general output discussed with the whole Board. Specific points were fed back to individual Directors by the Chairman. Evaluation of the Chairman was led by the Deputy Chairman and took the form of a meeting to review the effectiveness of the Chairman and Board and Committee provisions. The conclusions were shared with the Chairman.
B7 Re-election All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.	All new Directors are required by the Society's Rules to stand for election at the first Annual General Meeting following their appointment to the Board. The Code's Main Principle relating to re-election of Directors requires that they be submitted for re-election at regular intervals. One of the Supporting Provisions is that all Directors of FTSE 350 companies should be subject to annual election. Although the Society is not a FTSE 350 company, the Board would normally adopt Code Provisions which apply to such firms. Having carefully reviewed the Provision, the Board has concluded that, although very unlikely, there could be circumstances where requiring all Directors to stand for election could have an adverse outcome for the stability of the Society and that this would not be in the best interests of members. The Society's Rules require that those Directors who are due for election or who have not been re-elected in the last three years must stand for election/re-election. Julie Hopes, appointed on 1 April 2016, will stand for election in July 2016. All of the other Directors were re-elected in 2012, 2013, 2014 or 2015 and are therefore not required by the Rules to stand for re-election in 2016. However, recognising the new Code Provision, the Board believes that it would be appropriate to bring forward the re-election (as permitted by the Rules) of four Directors so that half of the Board is standing for re-election in 2016. The Rules also state that any Director reaching the age of 70 should stand for re-election. Martin Ritchley reaches the age of 70 on 1 July 2016 and therefore has been put forward for re-election this year. The Board has agreed to keep the arrangements under review and will explain any variation to the Code in future Corporate Governance Reports.
C1 Financial and Business Reporting The board should present a fair, balanced and understandable assessment of the company's position and prospects.	The Directors' Report on pages 22 to 24 includes statements detailing the Directors' responsibilities. The Chief Executive's Review on pages 3 to 4, the Strategic Report on pages 5 to 16 and the Risk Management Report on pages 17 to 20, give an extensive report on the Society's performance, financial position and the key risks that will impact performance and risk management going forward.

The Code's Main Principles	What the Society does to meet the Principles
C2 Risk Management and Internal Control The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.	The Society's Board is responsible for the development of strategies relating to risk management and internal control. Operational responsibility rests with the Executive Directors and senior managers. The risk management systems and internal controls are designed to allow the Society to achieve its corporate objectives in a controlled manner and remain within defined risk appetite statements. These systems and controls are designed to manage rather than eliminate risk. The Board reviews the effectiveness of the risk management systems and internal controls in a number of ways, including: • Board review and approval of Risk Appetite Statements at least annually, with monthly reporting relating to those statements; • A formal committee structure, including an Audit Committee (see below for more detail) and a Risk Committee. The minutes of the meetings of these Committees are reviewed by the full Board, the relevant Committee Chairman highlighting any key issues; • Regular reports and presentations to the Board by the Executive Directors; and • Monthly Board report on key business performance. The Society's Internal Audit function, with a dual reporting line to the Chief Executive and Chair of Audit Committee, provides independent assurance regarding the adequacy and effectiveness of internal controls across all Group activities.
C3 Audit Committee and Auditors 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 auditor.	The Board has an Audit Committee comprising four NEDs, all of whom are considered independent according to the criteria contained in the Code. The Board is satisfied that at least one member of the Committee has recent and relevant financial experience. The Chairman of the Audit Committee receives additional fees in recognition of his added responsibilities. The terms of reference of the Committee is available from the Group Secretary on request. The Society has a policy on the engagement of external auditors to supply non-audit services, which is operated across the Group and in tandem with the external auditor's own internal policy on providing non-audit services. The Society has a well established 'Open Door' Policy to enable staff to raise concerns in confidence about possible improprieties in matters of financial reporting or other issues. This policy has taken account of the Public Interest Disclosure Act 1998. During the year, the Committee received a report summarising all of the reports made under this Policy. There have been four meetings of the Committee during the financial year 2015/16. Executive Directors and other members of senior management (by invitation only) attended the meetings. Those employees who regularly attend include the Chief Executive, Group Finance & Operations Director, Group Secretary, Chief Financial Risk Officer and Divisional Director Internal Audit. The Board receives regular reports on Committee meetings and also receives copies of the minutes of these meetings. During the last financial year, the Audit Committee: • Validated the integrity of the Group's financial statements (including formal announcements relating to such statements); • Reviewed and approved significant financial reporting issues and accounting policies/issues; • Reviewed the Group's internal controls; • Monitored and reviewed the effectiveness of the Group's Internal Audit function; • Recommended the appointment of the external auditor (following a review of the external auditor's independence and objectivity and the effectiveness of the audit process), the remuneration and terms of engagement; • Confirmed that the Internal Audit function was appropriately resourced; and • Met privately with the Divisional Director Internal Audit and the external auditor.
D1 Level and Components of Remuneration Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance. **D2 Procedure** There should be 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.	The Board has established a Remuneration Committee, comprising four NEDs, which considers and makes recommendations to the Board on key remuneration decisions relating to Society staff who have been identified in the FCA's Remuneration Code as Code Staff. The Directors' Remuneration Report on pages 32 to 38 explains how the Society, through the Remuneration Committee and Board, approaches the remuneration of Directors and other executives. The Society is subject to the FCA's Remuneration Code, requiring the Society to have a remuneration policy which promotes effective risk management, supports business strategy, objectives and values and is in the long-term interests of the Society. During the last financial year, the Remuneration Committee: • Reviewed the Society's Remuneration Policy; • Recommended to the Board the Performance-Related Pay Scheme and awards under that Scheme; • Reviewed employee benefits arrangements; • Made recommendations to the Board in respect of the annual salary review; • Reviewed the employee benefits package and sales incentive schemes; and • Reviewed the terms of appointment and benefits of Code Staff.

The Code's Main Principles	What the Society does to meet the Principles
E1 Dialogue with Stakeholders There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility of ensuring that a satisfactory dialogue with shareholders takes place.	As a mutual, the Society is owned by its members; the Society seeks feedback from members in a number of ways, including: • Regular Members' ViewPoint events held around the branch network; • Assessing enquiries from the Society's contact centre and website; • Analysing the quantity and nature of customer complaints; • Customer research on specific topics; • Customer satisfaction surveys and Mystery Shopper programme; and • Members' Panel to canvass views on products and services and give feedback on how we can improve the way we operate.
E2 Constructive Use of the AGM The board should use the AGM to communicate with investors and to encourage their participation.	All members who are eligible to vote are sent a Summary Financial Statement and details of the Annual General Meeting (AGM) at least 21 days before the date of the meeting. Proxy forms are also included in the AGM mailing to allow those members who do not attend the meeting to cast their vote. Members are also able to submit their proxy form electronically. The Society uses independent scrutineers to count proxy votes received through the post and via the internet. All Board members are expected to be present at the AGM each year (except in the case of unavoidable absence). The Chairmen of the Audit, Remuneration, Risk and Nominations Committees are available to answer questions at the AGM.

Meetings of the Nominations Committee

The Nominations Committee which is chaired by the Society's Chairman, met on 3 occasions in the last financial year. The key matters considered by the Committee were:

- Membership of Board committees;
- Board performance evaluation arrangements;
- NEDs reaching the end of their three year term of office;
- NED development; and
- Board Succession Planning.

The terms of reference of the Committee, which is made up of NEDs, is available on request from the Group Secretary.

The attendance of individual Directors during the year, with the number of meetings each was eligible to attend shown in brackets, is set out below.

Attendance Records – Board and Board Committee Meetings

	Board	Nominations	Audit	Risk	Remuneration
Mark Nicholls	10 (10)	3 (3)			5 (5)
Mark Gibbard	10 (10)			3 (3)*	
Claire Hafner	9 (10)		4 (4)	5 (5)**	5 (5)
Mark Preston	10 (10)			8 (8)	5 (5)
Martin Ritchley	10 (10)	3 (3)	4 (4)	8 (8)	5 (5)
Richard Sommers	9 (10)	3 (3)	3 (4)	8 (8)	
Colin Walklin	10 (10)		4 (4)	8 (8)	
Jonathan Westhoff	10 (10)			3 (3)*	

* Jonathan Westhoff and Mark Gibbard resigned from the Committee in July 2015 to comply with external governance and best practice.

** Claire Hafner joined the Committee in September 2015.

Mark Nicholls
Chairman
25 May 2016

Audit Committee Report

Membership and attendees

The Audit Committee is appointed by the Board and comprises four Non-Executive Directors;

- Colin Walklin (Chairman);
- Claire Hafner;
- Martin Ritchley; and,
- Richard Sommers.

The Chairman, Chief Executive, Group Finance & Operations Director, Chief Financial Risk Officer, Group Secretary, Divisional Director Treasury and Finance, the external auditor and Divisional Director Internal Audit also attend by invitation.

The Board is satisfied that the Committee has members with recent and appropriate financial experience.

The Committee met four times during the year, with attendance as detailed on page 28. In addition, the Committee met privately with the external auditor and the Divisional Director Internal Audit.

Roles and responsibilities

The roles and responsibilities of the Committee are in line with the provisions of the Financial Reporting Council (FRC) Guidance on Audit Committees (the 'Smith Guidance') which was updated in September 2012 and applied for financial years beginning on or after 1 October 2012.

The main function of the Committee is to assist the Board in fulfilling its oversight responsibilities in relation to:

- the provision of assurance to the Board regarding the integrity of the financial statements of the Society, including its annual and any interim reports, reviewing significant financial reporting issues and judgements which they contain. The Committee also review summary financial statements and significant financial returns to regulators;
- assessing the adequacy and effectiveness of the Society's internal controls and risk management systems (including Conduct Risk);
- reviewing and approving the statements to be included in the Annual Report concerning internal controls and risk management;
- reviewing the Society's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The Committee shall ensure that these arrangements follow proportionate and independent investigation of such matters and appropriate follow up action;
- monitoring and reviewing the effectiveness of the Society's Internal Audit function in the context of the Society's overall risk management system;
- approving the appointment and removal of the Divisional Director Internal Audit, and making recommendations regarding performance objectives and remuneration to the Society's Remuneration Committee as required;
- considering and approving the remit of the Internal Audit function and ensuring it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The Committee shall also ensure the function has adequate standing and is free from management or other restrictions;
- reviewing and assessing the Internal Audit plan;
- considering and making recommendations to the Board, to be put to members for approval at the AGM, in relation to the appointment, reappointment and removal of the Society's external auditor. The Committee shall oversee the selection process for new auditors and if an auditor resigns, the Committee shall investigate the issues leading to this and decide whether any action is required;
- monitoring the effectiveness of the Society's external auditor, including (but not limited to):
    - approval of their remuneration, whether fees for audit or non-audit services, and ensuring that the level of fees is appropriate to enable an adequate audit to be conducted;
    - approval of their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;
    - assessing annually their independence and objectivity taking into account relevant UK professional and regulatory requirements and the relationship with the auditor as a whole, including the provision of any non-audit services; and
    - reviewing and approving in accordance with policy, any proposed employment of employees or former employees of the Society's auditor.

The minutes of the Audit Committee are distributed to the Board, and the Committee Chairman provides a verbal report to the Board meeting immediately following Committee meetings. A copy of the Audit Committee terms of reference can be obtained from the Group Secretary, on request.

Areas of focus for the Committee in the year

The Committee has an annual schedule, developed from its terms of reference, with standing items that it considers at each meeting in addition to any specific matters upon which the Committee has decided to focus. The work of the Audit Committee falls under three main areas as follows:

a) Financial reporting issues and judgements

The Committee considers the financial information published in the Society's annual and half year financial statements and considers the accounting policies adopted by the Society, presentation and disclosure of the financial information and, in particular, the key judgements made by management in preparing the financial statements. The Committee pays particular attention to matters it considers to be important by virtue of their impact on the Society's results, and particularly those which involve a high level of complexity, judgement or estimation by management.

The Committee also take note of the work of the external auditor, KPMG LLP, to help ensure that suitable accounting policies have been implemented and appropriate judgements have been made by management.

Since the previous year end, there have been no changes in the Group's accounting policies. The key matters of note that the Committee considered in reviewing the 2015/16 financial statements were:

- Review and confirmation of the approach adopted in calculating the residential and commercial loan loss provisions including an assessment of the appropriateness of the assumptions. The Committee was satisfied with the overall approach and quantum of impairment provisions along with the applicable disclosures included in the Annual Accounts.
- Since December 2013 an interest rate increase has been applied to certain buy to let loans held in West Bromwich Mortgage Company Limited (the Company). An action group has challenged the decision. The Committee is satisfied that the actions taken by management are legally permitted, appropriate and in the best interests of the membership as a whole. Judgement has been received at Court which has upheld the Society's view. Legal proceedings have been ongoing and following our successful defence of this challenge in the High Court an appeal was heard in April 2016, the outcome of which is not yet known. The Committee is satisfied that no provision is required but a contingent liability disclosure is appropriate (see note 25 to the Accounts).
- The Group continues to hold a significant investment property portfolio where it has adopted the fair value model of measurement. The Committee has reviewed and confirmed the appropriateness of the process and assumptions applied in calculating the fair value of the property portfolio at the end of the financial year. It is satisfied that the valuation reflects all assumptions that market participants would use when pricing the investment properties under the current market.
- The Group holds a deferred tax asset on its balance sheet, predominantly arising from losses incurred over the period 2008/9 to 2012/13. The recoverability of this asset, therefore, is largely dependent upon future profits. The Committee has reviewed detailed forecasts included with the Group's Medium Term Plan and is confident that the deferred tax asset will be realised in the future.
- The Committee has again reviewed the adoption of the going concern assumption for the interim and year end accounts, adopting the same, thorough approach for both reporting periods. This involves a rigorous consideration of the sufficiency of our current and projected capital and liquidity positions together with the principal risks which could impact these positions. The Committee also reviews the viability of the business model in terms of recurring level of profitability, support from the regulator and ability to continue to trade. Based on this review, the Committee concluded that the adoption of the going concern assumption to prepare the accounts remains appropriate.
- The Committee considered matters raised during the statutory external audit and has concluded that there were no adjustments required which were material to the financial statements.

b) Risk and internal control

The Society recognises the importance of effective risk management and strong systems of internal control in the achievement of its objectives and the safeguarding of its assets, and also facilitates the effectiveness and efficiency of operations, which help to ensure the reliability of internal and external reporting and assist in compliance with applicable laws and regulations. The Society operates in a dynamic business environment and, as a result, the risks it faces change continually. Management are responsible for designing the internal control framework to ensure thorough and regular evaluation of the nature and extent of risk and the Society's ability to react accordingly. Management are also responsible for implementing the Board's policies on risk and control, noting that all employees are responsible for internal control as part of their individual objectives.

Further details of actual risk management practices are provided in the Risk Management Report on pages 17 to 20. Through the Committee, the Society's Internal Audit function provide independent assurance to the Board on the effectiveness of the internal control framework. The information received and considered by the Committee during the 2015/16 financial year provided reasonable assurance that there were no material breaches of control and that, overall, the Society maintained an adequate internal control framework that met the principles of the Code.

Internal Audit utilise the services of external specialists for support in providing assurance in technical areas, primarily, Information Technology, Treasury and Credit Risk. The Divisional Director Internal Audit reports to the Chairman of the Committee, and the Committee is responsible for agreeing the annual budget for Internal Audit, in addition to ensuring that the function retains adequate skills and resource levels that are sufficient to provide the level of assurance required.

The Audit Committee approves the Internal Audit plan of work, including subsequent amendments, which is prepared on a risk based approach by Internal Audit and reflects input from management and the Committee. The Committee reviews the work of, and output from, Internal Audit, in addition to progress against the agreed plan of work. Internal Audit provides the Committee with reports on material findings and recommendations and updates on the progress made by management in addressing those findings.

The Committee also reviews periodically the use of the confidential reporting channel in the Society. Awareness of 'whistle blowing' arrangements is maintained through internal communication and is covered as part of employees' induction and ongoing development.

As part of the external audit process, our external auditor provides us with internal control reports. During the year, KPMG LLP did not highlight any material control weaknesses.

The Committee requires an external 'effectiveness review' of Internal Audit every three years. A review was carried out during the 2014/15 financial year by an external firm appointed by the Committee. In performing their review, information was gathered from a variety of sources including interviews with key business stakeholders, workshops with the Internal Audit team, and a review of key documentation covering all aspects of the Internal Audit function (including file reviews). An external assessment of Internal Audit's readiness to comply with the Chartered Institute of Internal Auditors recommendations on 'Effective Internal Audit in the Financial Services sector', issued in July 2013, was also included.

The review concluded that the Internal Audit function is operating effectively in providing assurance to the Committee and a wide range of key stakeholders.

c) External auditor

KPMG, as KPMG Audit Plc, and since 29 July 2014 as KPMG LLP, has been the Society's auditor since 1993.

The Committee regularly monitors the Society's relationship with the external auditor and has adopted a framework for ensuring auditor independence and objectivity, which defines unacceptable non-audit assignments, pre-approval of acceptable non-audit assignments and procedures for approval of other non-audit assignments across the Society.

Details of the fees paid to the external auditor for audit and non-audit services are set out in note 6 to the Accounts. The Committee has also agreed a policy for the employment, by the Society, of former employees of the external auditor which is designed to further maintain the auditor's independence.

The Committee assesses the effectiveness of the external auditor annually, immediately after the completion of their year-end audit, the results of which are reported to and discussed at the next appropriate Committee meeting. This assessment is facilitated by the Group Secretary and is discussed, initially, without the presence of the auditor in the meeting. The Committee considers that the relationship with the auditor is working well and is satisfied with their effectiveness and independence.

Audit Committee effectiveness

The effectiveness of the Committee was assessed by an external firm in July 2013. The scope of this review considered time management and composition, Committee processes and support, the work of the Committee and future priorities. This review concluded that the Committee operated effectively, being highly rated in each of the areas reviewed.

Committee members are expected to undertake relevant training as part of their ongoing development and, periodically, the Committee as a whole receives training on current topics.

On behalf of the Board

Colin Walklin
Chairman of Audit Committee
25 May 2016

Directors' Remuneration Report

Annual Statement by the Chairman of the Remuneration Committee

I am pleased to present the Directors' Remuneration Report which sets out details of pay, benefits and performance-related pay for Directors.

The Remuneration Committee has decided to adopt voluntarily the relevant requirements of the UK Corporate Governance Code, in so far as they are considered appropriate for a building society. The tables marked 'audited' in this report are requirements of the Building Societies Act 1986. The report also complies with the third EU Capital Requirements Directive and the detailed requirements of the Financial Conduct Authority's (FCA's) Remuneration Code (the Code). Details of the Code can be found at www.fca.org.uk.

Under the Code, the Society is required to identify those staff who are considered to have a material impact on the Society's risk profile (Code Staff). This includes all Executive and Non-Executive Directors and all members of the Society's Executive Committee (ExCo).

This report is presented in two sections:

- The Remuneration Policy – setting out the Remuneration Committee's forward looking policy with regard to pay and benefits. This policy was put to an advisory vote at the 2014 Annual General Meeting (AGM). It received an 89% positive vote. The Remuneration Policy, if unchanged, is voted on every three years. There have been no changes in the policy since the last vote. The next policy vote is proposed for 2017.
- The Annual Remuneration Report – detailing the amounts earned by Directors in respect of the financial year ended 31 March 2016 and how the policy will operate for the year ending 31 March 2017.

All eligible members receive a copy of this Report and are entitled to participate in an advisory vote on the Annual Remuneration Report at the 2016 AGM.

As outlined in the Chief Executive's Review, the Society has enjoyed a successful year and has seen its pre-tax profit rise to £13.5m. Alongside this achievement, the Society grew its new residential lending by more than 50% and continued to reduce its exposure to riskier commercial lending.

The payments to Executive Directors and the Society's senior managers were reviewed in this context. Following a review benchmarking the Executive Directors' remuneration commissioned from Deloitte LLP increases in basic salary were awarded to them from 1 April 2015. These were the first increases in basic pay awarded to the Chief Executive and Group Finance & Operations Director since 2011. For the financial year 2016/17 both Executive Directors received a pay increase of 2%, the general staff population also received a 2% increase on 1 April 2016.

The Executive Director Performance-Related Pay Scheme generated awards of between 41.40% and 41.65% of salary. These payments reflect the delivery of financial measures, the management of risk, both credit risk and operational risk, customer and people measures and new and enhanced operational capabilities.

Deferred Performance-Related payments in relation to 2012/13, 2013/14 and 2014/15 for Executive Directors have been approved for payment since the end of the 2015/16 financial year.

Fees for the Chairman and other NEDs were reviewed for the 2015/16 financial year and no increases were applied. A further review for the 2016/17 financial year also resulted in no increase in fees for the Chairman or any NED.

Martin Ritchley
Chairman of Remuneration Committee
25 May 2016

Remuneration Committee membership and responsibilities

Membership

The members of the Remuneration Committee during the financial year 2015/16 were: Martin Ritchley, Mark Nicholls, Claire Hafner and Mark Preston.

All members of the Committee are Non-Executive Directors. Under the Committee's terms of reference, at least one member of the Committee must also be a member of either the Risk Committee or Audit Committee. The current composition of the Committee complies with this requirement.

The Society's Chief Executive, Group Secretary and Divisional Director Human Resources attend meetings by invitation.

Responsibilities

The Committee is responsible for setting the policy on remuneration, overseeing its implementation and making recommendations to the Board in respect of remuneration arrangements for Executive Directors and other Code Staff.

Following each meeting, the Chairman of the Committee reports to the Board on all substantive issues discussed.

The Committee is required to meet at least twice a year. During the year there were five meetings.

The Committee considered the following matters during the year:

- Determining the pay and benefits of Executive Directors, the Chairman, Code Staff and other senior managers and recommending to the Board for approval;
- Determining the pay and benefits for the general staff population;
- Determining the level of performance-related pay in relation to the 2014/15 financial year and deferred awards due during the year for Code Staff and recommending to the Board for approval;
- Recommending to the Board the Society and individual performance-related pay objectives for Code Staff in relation to the 2016/17 financial year;
- Considering the approach to be adopted in respect of disclosure requirements in relation to this report; and
- Forthcoming Gender Pay Regulations.

The Committee receives an annual report, prepared jointly by the Group Secretary, Chief Financial Risk Officer and the Divisional Director Internal Audit. This report provides information on whether any activity or behaviour by any individual has been identified or observed which should affect their eligibility to participate in performance-related pay arrangements. No such behaviours were reported.

No member, or invitee, is present when their own remuneration is discussed.

The Terms of Reference for the Committee were last updated in March 2016. The Terms of Reference are available on request from the Group Secretary.

Advisors

Last year the Committee appointed Deloitte LLP ("Deloitte") to provide independent advice on executive remuneration. Deloitte is a founding member of the Remuneration Consulting Group and as such voluntarily operating under the Code of Conduct in relation to the executive remuneration consulting.

Section 1 – The Remuneration Policy

Background

The Remuneration Policy (the Policy) provides the framework for the Committee to make remuneration decisions in relation to Executive Directors and other Code Staff.

The Policy is designed to promote appropriate behaviours and is aligned with the Society's risk appetite.

The approach of the Remuneration Committee is to ensure that Executive Directors' remuneration is designed to promote the long term success of the Society, with full consideration of other stakeholders such as members and regulators.

Remuneration decisions are made on the basis of total compensation comprising salary, performance-related pay and benefits, ensuring an appropriate balance between the fixed and variable components of remuneration. The variable element of the remuneration package creates flexibility to allow for changes in current and future performance.

The Society's remuneration principles are as follows:

- The Policy is in line with the strategy, objectives and values of the Society, thereby aligning it with both short and long-term interests;
- The policies, procedures, remuneration practices and performance-related payment schemes are consistent with the promotion of good and effective risk management and are structured in such a way as to discourage risk taking which is outside the Society's risk appetite;
- All remuneration packages are designed such that the Society can attract and retain high calibre individuals;
- Performance measures for individuals are challenging and robust and measured on a consistent basis; and
- Performance-related pay is performance dependent, an element of which is deferred over a three year period, to allow the Remuneration Committee to review whether the payment remains appropriate, and providing the ability to reduce or cancel the payment.

The Policy follows, as a minimum, regulatory requirements and good corporate governance practices.

Remuneration Policy and Practice

Components of remuneration

The table below describes the Society's policy with respect to each element of pay for Executive Directors:

Component	Purpose	Operation	Performance Metrics	Opportunity
Basic Salary	Fixed remuneration set to attract and retain Executives of sufficient calibre through the payment of competitive rates.	Reviewed annually (or more frequently if required).	Influencing factors include: • Role and experience • Personal performance • Benchmarking comparisons • Salary increases awarded across the Society.	Set at a level considered appropriate, taking into account the relevant factors tabled. The Committee considers very carefully any pay awards which do not reflect the wider increases across the Society and will only make them where there is a clear commercial rationale for doing so.
Performance-Related Pay	Linked to the delivery of Society and personal objectives. Used to reward Executive Directors within the context of achieving the Society's goals and objectives.	40% of the Performance-Related Pay earned (maximum 20% of basic salary) is deferred over a three year period. Deferred payments are made in equal instalments over the following three years, are subject to annual review and recommendation by the Committee and require approval by the Non-Executive members of the Board. The deferred element can be reduced or cancelled by the Non-Executive members of the Board. All awards are non-pensionable.	Based on a number of measures, including: • Financial • Customer • People • Risk • New and enhanced operational capabilities. Reviewed by the Committee annually to ensure that the measures are appropriate.	Maximum annual opportunity is 50% of basic salary.
Pension or Pension Allowance	A part of fixed remuneration intended to attract and retain Executive Directors of sufficient calibre.	Executive Directors are invited to join the Society's stakeholder pension plan or, as an alternative, be provided with a cash allowance.	Not applicable.	A cash allowance of 25% of salary for the Chief Executive and 20% for the Group Finance & Operations Director in lieu of receiving a pension.
Benefits	A part of fixed remuneration intended to attract and retain Executive Directors of sufficient calibre.	Executive Directors receive benefits in line with market practice, which include a fully expensed car, private medical care for themselves and their family, and life assurance. Other benefits may be provided in individual circumstances.	Not applicable.	Set at a level considered appropriate by the Committee.

The table below shows the policy for Non-Executive Directors:

Component	Purpose	Operation	Measure/Factors Considered	Application
Fees	To attract and retain Non-Executive Directors of the right calibre for the Society.	Fees are reviewed annually for Non-Executive Directors by the Chairman and Executive Directors. Fees for the Chairman are recommended by the Remuneration Committee and approved by the Board. The Chairman is not present when his fees are discussed or approved.	Not applicable.	Fees are set at a level to attract individuals with the appropriate knowledge and experience and to reflect the responsibilities and time commitment for Board and Board Committees, taking into account market practice.
Performance-Related Pay, Pension and Other Benefits	Non-Executive Directors are not eligible to receive any performance-related pay, pension or other benefits.		Whilst Non-Executive Directors do not participate in any performance-related pay scheme, their overall performance is reviewed annually by the Chairman.	

Recruitment Policy for Executive Directors

The appointment of an Executive Director could be either an internal or external appointment. In principle, the Society would look to provide no additional benefits to a new Director than those provided to an existing Director.

The Committee's approach is to offer a package that is sufficient to recruit an individual of sufficient calibre, but to pay no more than is necessary to attract the appropriate candidate.

Component	Application
Salary	A Director would receive an amount commensurate with their experience and responsibilities.
Benefits	A Director would receive comparable benefits to existing Directors, although if required to attract the right candidate these may be widened to include additional benefits, such as a relocation allowance.
Performance-Related Pay	The maximum performance-related award would be in line with current policy, unless the market rate required to recruit the individual supported a higher amount. In any event, this would be no more than what is considered commercially justifiable.
Pension	A Director would have the option to join the Society's stakeholder pension scheme or to receive a cash allowance of up to 25% of salary.
Recruitment Awards	The Society does not anticipate making any 'sign-on' payments. However, this may be considered if the new Director was required to forfeit an arrangement from their previous employer. In such instances the award would be no more in the terms of amount than the award due to be forfeited. The timing and vesting requirements of any payment would be replicated as far as possible.

The Committee has discretion within the Policy to make remuneration decisions where it considers it necessary to do so. In setting remuneration arrangements for new hires, the Committee will consider the value of the package on offer compared to similar positions in the market, the structure of the remuneration and the experience of the candidate, to ensure that arrangements are in the best interests of both the Society and its members, without paying in excess of what is deemed necessary to recruit a Director of the required calibre.

Recruitment Policy for Non-Executive Directors

As with Executive Directors, the Committee's approach is to offer a package that is sufficient to recruit an individual of sufficient calibre, but to pay no more than is necessary to attract the appropriate candidate.

Component	Application
Fees	A new Non-Executive Director would receive fees. The level of fees would be set at a level commensurate with their experience and responsibilities and with due regard to the fees of other Non-Executive Directors.

Service contracts

The terms and conditions of employment for Executive Directors are detailed in their service contracts. The contract is terminable with twelve months' notice if given by the Society or six months' notice if given by the Director.

Non-Executive Directors do not have service contracts and instead have letters of engagement which set out their time commitments and responsibilities.

Policy on payment for loss of office

The Committee's approach is to pay no more than is necessary in such circumstances. Since 2012, the Society's policy is for new contracts to require Executive Directors to mitigate their loss in the event of receiving a 'loss of office' payment.

Component	Application
Salary and Benefits	A termination payment would be on the basis of the relevant notice period. There would be no payment in the event of misconduct or poor performance.
Performance-Related Pay	Any performance-related pay awards would be made solely at the discretion of the Committee. Any deferred awards would remain payable in future years subject to the normal rules of the Scheme, including possible reduction or cancellation.

Section 1 – The Remuneration Policy (continued)

Employment conditions elsewhere in the Society

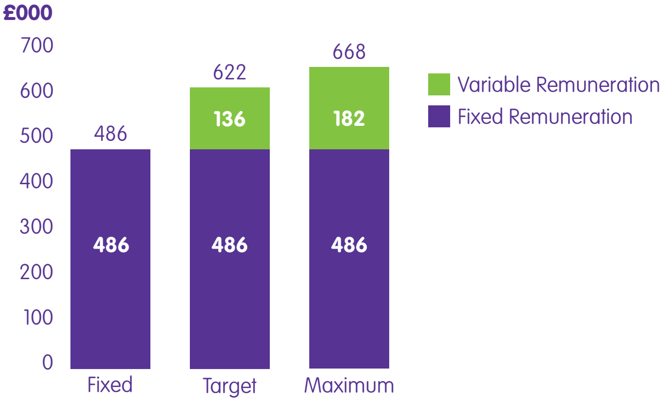
The pay and benefits of the general staff population are considered annually by the Committee, which also determines the amount of general performance-related pay. The Society, subject to eligibility, offers a comprehensive range of benefits to staff, including pension, life assurance, health care and performance-related pay.

Remuneration scenarios

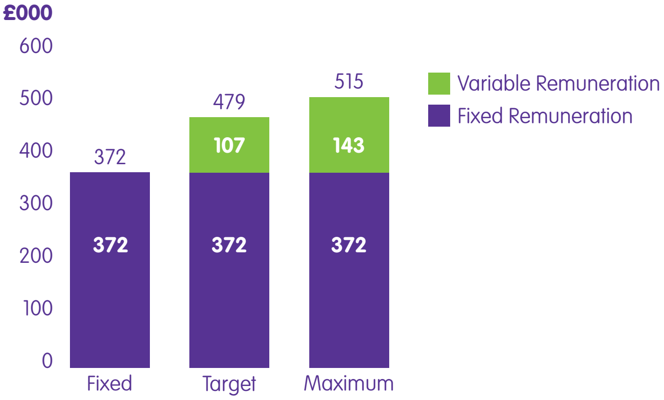
The following charts show the breakdown of the component parts of the remuneration package for Executive Directors for 2015/16 on the following basis:

- Fixed Remuneration – comprising of salary and benefits.
- Target Remuneration – the anticipated annual remuneration incorporating a performance-related award.
- Maximum Remuneration – the maximum remuneration that could be awarded.

Chief Executive 2015/16



Group Finance & Operations Director 2015/16



When developing the scenarios, the following assumptions were made:

- Fixed remuneration includes salary, pension and benefits only;
- Target remuneration is based on a performance-related award of 37.5% of basic salary; and
- Maximum award is based on a performance-related award of the maximum achievable which is 50% of salary.

Section 2 – Annual Report on Remuneration

Non-Executive Director Fees (Audited)

Non-Executive Director		**Date Appointed**	**2015/16 £000**	2014/15 £000
Mark Nicholls	(Society Chairman)	01/01/10	**120**	120
John Ainley	(Remuneration Committee Chairman up to 17 May 2014)	18/05/11	**-**	6
Claire Hafner		01/09/11	**50**	50
Mark Preston		18/05/11	**50**	50
Martin Ritchley	(Deputy Chairman & Remuneration Committee Chairman from 17 May 2014)	01/09/09	**70**	70
Richard Sommers	(Risk Committee Chairman)	01/10/09	**60**	60
Colin Walklin	(Audit Committee Chairman)	20/07/11	**60**	60
Total			**410**	416

Executive Director Remuneration – 2015/16 (Audited)

Executive Director		**Basic Salary £000**	**Performance-Related Pay (1) £000**	**Pension £000**	**Other Benefits £000**	**Total £000**
Jonathan Westhoff	(Chief Executive)	363	150	91	32	**636**
Mark Gibbard	(Group Finance & Operations Director)	285	119	57	30	**491**
Total		**648**	**269**	**148**	**62**	**1,127**

Executive Director Remuneration – 2014/15 (Audited)

Executive Director		Basic Salary £000	Performance-Related Pay (1) £000	Pension £000	Other Benefits £000	Total £000
Jonathan Westhoff	(Chief Executive)	327	153	82	34	596
Mark Gibbard	(Group Finance Director)	262	123	52	28	465
Total		589	276	134	62	1,061

Notes:
1. Included in the amounts shown above is an element that is subject to deferral. The table overleaf headed 'Executive Director Deferred Performance-Related Pay Payable in Future Years' details the amount due for payment, subject to review by the Committee at the appropriate time.

Section 2 – Annual Report on Remuneration (continued)

A proportion of the Executive Directors' performance-related pay has been deferred as shown in the table below. Payment of any deferred award is subject to review by the Remuneration Committee and approval by the Board, and may be reduced or cancelled as appropriate.

Executive Director Deferred Performance-Related Pay
Payable in Future Years

		Payable after Year Ending			
Executive Director	**Deferred From**	**2015/16 £000**	**2016/17 £000**	**2017/18 £000**	**2018/19 £000**
Jonathan Westhoff	2012/13	13	-	-	-
	2013/14	18	18	-	-
	2014/15	20	20	20	-
	2015/16	-	20	20	20
Total		**51**	**58**	**40**	**20**
Mark Gibbard	2012/13	12	-	-	-
	2013/14	15	15	-	-
	2014/15	16	16	16	-
	2015/16	-	16	16	16
Total		**43**	**47**	**32**	**16**
Andrew Jones	2012/13	8	-	-	-
	2013/14	9	9	-	-
Total		**17**	**9**	**-**	**-**

Deferred elements due after the year ending 2015/16 (shown in the table above) have subsequently been approved by the Board for payment.

Statement on member voting at the 2015 AGM

At the 2015 AGM members voted in favour of approving the Directors' Remuneration Report as shown below:

Vote	Votes For	% of Votes	Votes Against	Withheld*
To approve the Directors' Remuneration Report	20,222	90.43%	2,140	460

* The withheld figures are not included in the calculation of % 'Votes For'.

The Remuneration Policy for 2016/17

The Remuneration Committee is required annually to review the salaries of the Executive Directors. A recommendation was made by the Remuneration Committee and subsequently approved by the Board, to increase the basic annual salary of the Chief Executive from £363,000 to £370,260 from 1 April 2016, representing a 2% award. Similarly, the Remuneration Committee recommended and the Board subsequently approved, an increase in the basic annual salary of the Group Finance & Operations Director from £285,000 to £290,700 representing a 2% award.

The annual salary review for staff, which provided an increase of 2%, was applied from 1 April 2016.

The Remuneration Committee considered the Executive Director Performance-Related Pay Scheme and intends, with effect from the financial year 2016/17, whilst not compelled to do so by regulation, to voluntarily introduce clawback in relation to the Scheme. Under clawback, the Society will have the right to seek recovery of the variable remuneration paid under the Scheme for serious failures by Executive Directors which result in a material adverse change in the Society's financial strength. This reflects our desire to be at the forefront of good corporate governance. The period of the clawback will be three years from the date of the award. The introduction of clawback will be put to an advisory vote at the 2017 AGM. The maximum performance-related pay award for Executive Directors will remain at 50% of salary for 2016/17.

The Remuneration Committee will continue to strive to align its decisions with industry best practice and regulatory requirements whilst considering both the best interests of the Society and the interests of members.

Martin Ritchley
Chairman of Remuneration Committee
25 May 2016

Independent Auditor's Report

Independent auditor's report to the members of West Bromwich Building Society

We have audited the Group and Society Annual Accounts of West Bromwich Building Society for the year ended 31 March 2016 set out on pages 40 to 102. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

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.

Respective responsibilities of Directors and Auditor

As explained more fully in the Directors' Responsibilities Statement set out on pages 23 to 24, the Directors are responsible for the preparation of Annual Accounts which give a true and fair view. Our responsibility is to audit, and express an opinion on, the Annual Accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the Audit of the Annual Accounts

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on Annual Accounts

In our opinion the Annual Accounts:

- give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of affairs of the Group and of the Society as at 31 March 2016 and of the income and expenditure of the Group and of the Society for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it and, as regards the Group Annual Accounts, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Building Societies Act 1986

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 for which the financial statements are prepared 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.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

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

Jonathan Holt (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
One Snowhill
Snow Hill Queensway
Birmingham
B4 6GH
25 May 2016

Income Statements

for the year ended 31 March 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Interest receivable and similar income	2	**126.7**	136.9	**118.0**	132.5
Interest expense and similar charges	3	**(66.7)**	(72.2)	**(67.4)**	(74.5)
Net interest receivable		**60.0**	64.7	**50.6**	58.0
Fees and commissions receivable		**3.7**	4.2	**3.8**	4.4
Other operating income	4	**3.9**	3.8	**30.5**	0.7
Total operating income		**67.6**	72.7	**84.9**	63.1
Fair value losses on financial instruments		**(1.0)**	(16.3)	**(1.6)**	(4.0)
Net realised profits	5	**0.6**	0.1	**0.6**	0.1
Total income		**67.2**	56.5	**83.9**	59.2
Administrative expenses	6	**(42.0)**	(40.6)	**(37.8)**	(36.3)
Depreciation and amortisation	16,18	**(5.1)**	(5.4)	**(5.1)**	(5.4)
Operating profit before revaluation gains, impairment and provisions		**20.1**	10.5	**41.0**	17.5
Gains on investment properties	17	**5.5**	5.5	**-**	-
Impairment on loans and advances	14	**(8.1)**	(0.2)	**1.6**	1.5
Provisions for liabilities	25	**(4.0)**	(3.4)	**(4.0)**	(3.6)
Provisions against investments in subsidiary undertakings	15	**-**	-	**(30.8)**	-
Profit before tax		**13.5**	12.4	**7.8**	15.4
Taxation	9	**(4.1)**	(3.2)	**0.3**	(1.1)
Profit for the financial year		**9.4**	9.2	**8.1**	14.3

The profit for the year derives wholly from continuing operations.

The notes on pages 47 to 102 form part of these accounts.

Statements of Comprehensive Income

for the year ended 31 March 2016

	Notes	Group 2016 £m	Group 2015 £m
Profit for the financial year		**9.4**	9.2
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss			
Available for sale investments			
Valuation loss taken to equity		**(2.2)**	(1.0)
Amounts transferred to Income Statement		**(0.6)**	(0.1)
Cash flow hedge losses taken to equity		**(0.2)**	(0.3)
Taxation	29	**0.2**	0.2
Items that will not subsequently be reclassified to profit or loss			
Actuarial losses on defined benefit obligations	30	**(0.9)**	(10.7)
Taxation	29	**0.1**	2.1
Other comprehensive income for the financial year, net of tax		**(3.6)**	(9.8)
Total comprehensive income for the financial year		**5.8**	(0.6)

	Notes	Society 2016 £m	Society 2015 £m
Profit for the financial year		**8.1**	14.3
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss			
Available for sale investments			
Valuation loss taken to equity		**(2.2)**	(1.0)
Amounts transferred to Income Statement		**(0.6)**	(0.1)
Taxation	29	**0.2**	0.2
Items that will not subsequently be reclassified to profit or loss			
Actuarial losses on defined benefit obligations	30	**(0.9)**	(10.7)
Taxation	29	**0.1**	2.1
Other comprehensive income for the financial year, net of tax		**(3.4)**	(9.5)
Total comprehensive income for the financial year		**4.7**	4.8

The notes on pages 47 to 102 form part of these accounts.

Statements of Financial Position

at 31 March 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Assets					
Cash and balances with the Bank of England	10	**215.4**	260.8	**215.4**	260.8
Loans and advances to credit institutions		**204.0**	186.5	**93.2**	82.1
Investment securities	11	**410.1**	274.3	**1,300.0**	1,270.1
Derivative financial instruments	12	**8.9**	19.0	**8.8**	19.0
Loans and advances to customers	13	**4,739.0**	4,677.4	**2,380.1**	1,984.5
Deferred tax assets	19	**20.4**	23.9	**13.5**	12.8
Trade and other receivables	20	**2.7**	2.7	**2.7**	2.6
Investments	15	**-**	-	**1,669.2**	1,901.4
Intangible assets	16	**8.2**	7.0	**7.6**	6.4
Investment properties	17	**123.7**	118.6	**-**	-
Property, plant and equipment	18	**33.9**	30.2	**33.9**	30.2
Retirement benefit assets	30	**0.8**	-	**0.8**	-
Total assets		**5,767.1**	5,600.4	**5,725.2**	5,569.9
Liabilities					
Shares	21	**4,385.1**	3,988.0	**4,385.1**	3,988.0
Amounts due to credit institutions		**259.0**	393.3	**259.0**	393.3
Amounts due to other customers	22	**157.0**	152.4	**500.0**	606.4
Derivative financial instruments	12	**77.1**	80.8	**67.4**	69.0
Debt securities in issue	23	**368.6**	467.1	**-**	-
Deferred tax liabilities	19	**4.7**	4.5	**0.6**	0.5
Trade and other payables	24	**15.2**	12.7	**14.2**	11.7
Provisions for liabilities	25	**2.7**	2.2	**2.6**	1.9
Retirement benefit obligations	30	**-**	7.5	**-**	7.5
Total liabilities		**5,269.4**	5,108.5	**5,228.9**	5,078.3
Equity					
Profit participating deferred shares	27	**179.5**	177.1	**179.5**	177.1
Subscribed capital	26	**74.9**	74.9	**74.9**	74.9
General reserves		**239.3**	233.1	**237.6**	232.7
Revaluation reserve		**3.4**	3.4	**3.4**	3.4
Available for sale reserve		**0.9**	3.5	**0.9**	3.5
Cash flow hedging reserve		**(0.3)**	(0.1)	**-**	-
Total equity attributable to members		**497.7**	491.9	**496.3**	491.6
Total liabilities and equity		**5,767.1**	5,600.4	**5,725.2**	5,569.9

The accounting policies and notes on pages 47 to 102 form part of these accounts.

Approved by the Board of Directors on 25 May 2016 and signed on its behalf by:

Mark Nicholls
Chairman

Jonathan Westhoff
Chief Executive

Mark Gibbard
Group Finance & Operations Director

Statements of Changes in Members' Interest

for the year ended 31 March 2016

Group	Profit participating deferred shares £m	Subscribed capital £m	General reserves £m	Revaluation reserve £m	Available for sale reserve £m	Cash flow hedging reserve £m	Total £m
At 1 April 2015	**177.1**	**74.9**	**233.1**	**3.4**	**3.5**	**(0.1)**	**491.9**
Profit for the financial year	2.4	-	7.0	-	-	-	**9.4**
Other comprehensive income for the period							
Available for sale investments: current year movement net of tax	-	-	-	-	(2.6)	-	**(2.6)**
Actuarial losses on defined benefit obligations	-	-	(0.8)	-	-	-	**(0.8)**
Cash flow hedge losses	-	-	-	-	-	(0.2)	**(0.2)**
Total other comprehensive income	**-**	**-**	**(0.8)**	**-**	**(2.6)**	**(0.2)**	**(3.6)**
Total comprehensive income for the year	**2.4**	**-**	**6.2**	**-**	**(2.6)**	**(0.2)**	**5.8**
At 31 March 2016	**179.5**	**74.9**	**239.3**	**3.4**	**0.9**	**(0.3)**	**497.7**

for the year ended 31 March 2015

Group	Profit participating deferred shares £m	Subscribed capital £m	General reserves £m	Revaluation reserve £m	Available for sale reserve £m	Cash flow hedging reserve £m	Total £m
At 1 April 2014	174.7	74.9	234.9	3.4	4.4	0.2	492.5
Profit for the financial year	2.4	-	6.8	-	-	-	9.2
Other comprehensive income for the period							
Available for sale investments: current year movement net of tax	-	-	-	-	(0.9)	-	(0.9)
Actuarial losses on defined benefit obligations	-	-	(8.6)	-	-	-	(8.6)
Cash flow hedge losses	-	-	-	-	-	(0.3)	(0.3)
Total other comprehensive income	-	-	(8.6)	-	(0.9)	(0.3)	(9.8)
Total comprehensive income for the year	2.4	-	(1.8)	-	(0.9)	(0.3)	(0.6)
At 31 March 2015	177.1	74.9	233.1	3.4	3.5	(0.1)	491.9

Statements of Changes in Members' Interest

for the year ended 31 March 2016

Society	Profit participating deferred shares £m	Subscribed capital £m	General reserves £m	Revaluation reserve £m	Available for sale reserve £m	Total £m
At 1 April 2015	**177.1**	**74.9**	**232.7**	**3.4**	**3.5**	**491.6**
Profit for the financial year	2.4	-	5.7	-	-	**8.1**
Other comprehensive income for the period						
Available for sale investments: current year movement net of tax	-	-	-	-	(2.6)	**(2.6)**
Actuarial losses on defined benefit obligations	-	-	(0.8)	-	-	**(0.8)**
Total other comprehensive income	**-**	**-**	**(0.8)**	**-**	**(2.6)**	**(3.4)**
Total comprehensive income for the year	**2.4**	**-**	**4.9**	**-**	**(2.6)**	**4.7**
At 31 March 2016	**179.5**	**74.9**	**237.6**	**3.4**	**0.9**	**496.3**

for the year ended 31 March 2015

Society	Profit participating deferred shares £m	Subscribed capital £m	General reserves £m	Revaluation reserve £m	Available for sale reserve £m	Total £m
At 1 April 2014	174.7	74.9	229.4	3.4	4.4	486.8
Profit for the financial year	2.4	-	11.9	-	-	14.3
Other comprehensive income for the period						
Available for sale investments: current year movement net of tax	-	-	-	-	(0.9)	(0.9)
Actuarial losses on defined benefit obligations	-	-	(8.6)	-	-	(8.6)
Total other comprehensive income	-	-	(8.6)	-	(0.9)	(9.5)
Total comprehensive income for the year	2.4	-	3.3	-	(0.9)	4.8
At 31 March 2015	177.1	74.9	232.7	3.4	3.5	491.6

Under the terms of the profit participating deferred shares (PPDS), 25% of the annual post-tax profits or (losses) are allocated against the PPDS reserve.

The notes on pages 47 to 102 form part of these accounts.

Statements of Cash Flows

for the year ended 31 March 2016

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Net cash inflow/(outflow) from operating activities (below)	**220.3**	103.9	**(191.5)**	(398.4)
Cash flows from investing activities				
Purchase of investment securities	**(386.7)**	(187.9)	**(386.7)**	(187.9)
Proceeds from disposal of investment securities	**298.0**	305.6	**403.9**	388.7
Proceeds from disposal of investment properties	**0.4**	2.1	**-**	-
Purchase of property, plant and equipment and intangible assets	**(8.8)**	(16.8)	**(8.8)**	(16.8)
New funding to subsidiaries	**-**	-	**(151.2)**	(57.7)
Dividends received	**-**	-	**30.7**	-
Repayment of funding from subsidiaries	**-**	-	**321.9**	203.2
Net cash flows from investing activities	**(97.1)**	103.0	**209.8**	329.5
Cash flows from financing activities				
Repayment of mortgage backed loan notes	**(98.5)**	(134.1)	**-**	148.8
Net cash flows from financing activities	**(98.5)**	(134.1)	**-**	148.8
Net increase in cash	**24.7**	72.8	**18.3**	79.9
Cash and cash equivalents at beginning of year	**444.1**	371.3	**339.7**	259.8
Cash and cash equivalents at end of year	**468.8**	444.1	**358.0**	339.7

For the purposes of the statements of cash flows, cash and cash equivalents comprise the following balances with less than 90 days maturity:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cash in hand (including Bank of England Reserve account)	**208.7**	253.6	**208.7**	253.6
Loans and advances to credit institutions	**204.0**	186.5	**93.2**	82.1
Investment securities	**56.1**	4.0	**56.1**	4.0
	468.8	444.1	**358.0**	339.7

The Group is required to maintain certain mandatory balances with the Bank of England which, at 31 March 2016, amounted to £6.7m (2014/15: £7.2m). The movement in these balances is included within cash flows from operating activities.

Statements of Cash Flows (continued)

for the year ended 31 March 2016

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cash flows from operating activities				
Profit on ordinary activities before tax from continuing activities	**13.5**	12.4	**7.8**	15.4
Movement in prepayments and accrued income	**(0.2)**	0.3	**(0.2)**	(0.3)
Movement in accruals and deferred income	**(0.4)**	-	**(0.3)**	-
Impairment on loans and advances	**8.1**	0.2	**(1.6)**	(1.5)
Depreciation and amortisation	**5.1**	5.4	**5.1**	5.4
Revaluations of investment properties	**(5.5)**	(5.5)	**-**	-
Movement in provisions for liabilities	**0.5**	(2.9)	**0.7**	(2.0)
Movement in provisions against investments in subsidiary undertakings	**-**	-	**30.8**	-
Movement in derivative financial instruments	**6.4**	33.6	**8.6**	32.8
Movement in fair value adjustments	**(2.3)**	(14.0)	**(11.6)**	(14.5)
Change in retirement benefit obligations	**(9.2)**	(4.6)	**(9.2)**	(4.6)
Cash flows from operating activities before changes in operating assets and liabilities	**16.0**	24.9	**30.1**	30.7
Movement in loans and advances to customers	**(72.4)**	13.2	**(387.3)**	(240.8)
Movement in loans and advances to credit institutions	**0.6**	1.0	**0.5**	1.0
Movement in shares	**407.1**	(242.3)	**407.1**	(242.3)
Movement in deposits and other borrowings	**(129.7)**	308.5	**(240.7)**	53.2
Movement in trade and other receivables	**2.4**	(0.2)	**(1.9)**	(0.3)
Movement in trade and other payables	**(3.7)**	0.3	**0.7**	0.7
Tax paid	**-**	(1.5)	**-**	(0.6)
Net cash inflow/(outflow) from operating activities	**220.3**	103.9	**(191.5)**	(398.4)

The notes on pages 47 to 102 form part of these accounts.

Notes to the Accounts for the year ended 31 March 2016

1. Accounting policies

The principal accounting policies applied consistently in the preparation of these consolidated Annual Accounts are set out below.

Basis of preparation

The Annual Accounts of the Group and the Society have been prepared in accordance with International Financial Reporting Standards (IFRS) and its interpretations as adopted by the European Union (EU) and effective at 31 March 2016; and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 and the Building Societies Act 1986 applicable to societies reporting under IFRS.

The Annual Accounts have been prepared under the historical cost convention as modified by the revaluation of available for sale assets, derivatives, investment properties, property, plant and equipment and other financial assets at fair value through profit or loss.

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

Going concern

The Directors have prepared forecasts for the Group, including its capital position, for a period in excess of 12 months from the date of approval of these financial statements. The Directors have also considered the effect upon the Group's business, financial position, liquidity and capital of more pessimistic, but plausible, trends in its business using stress testing and scenario analysis techniques. The resultant forecasts and projections show that the Group will be able to operate at adequate levels of both liquidity and capital for the foreseeable future.

The Directors, therefore, consider that the Society and Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the financial statements. For further details see page 24 of the Directors' Report.

Accounting developments and change in accounting policy

The following new or amended accounting standards and interpretations, which are relevant to the Group, have been adopted during 2015/16 but have had no impact on the Annual Accounts:

- Amendments to IFRS 2 'Share-based Payments'
  The amendments clarify the definition of 'vesting condition' by separately defining 'performance condition' and 'service condition'.
- Amendments to IFRS 3 'Business Combinations'
  The amendments clarify the classification and measurement of contingent consideration in a business combination. When contingent consideration is a financial instrument, its classification as a liability or equity is determined by reference to IAS 32 Financial Instruments. Contingent consideration that is classified as an asset or a liability is always subsequently measured at fair value.
- Amendments to IFRS 8 'Operating Segments'
  The amendments require the explicit disclosure of judgements made by Management in applying criteria for the aggregation of operating segments.
- Amendments to IFRS 13 'Fair Value Measurement'
  The amendments clarify that the standard does not intend to prevent entities from measuring short-term receivables and payables that have no stated interest rate at their invoiced amounts without discounting, if the effect of not discounting is immaterial. Further clarity is provided that the IFRS 13 portfolio exception, whereby entities are exempted from measuring the fair value of a group of financial assets and financial liabilities with offsetting risk positions on a net basis if certain conditions are met applies to contracts in scope of IAS 39 and IFRS 9, regardless of whether they meet the definition of a financial asset or liability under IAS 32.
- Amendments to IAS 16 'Property, Plant and Equipment and IAS 38 'Intangible Assets'
  The amendments clarify the requirements of the revaluation model in IAS 16 and IAS 38, recognising that the restatement of accumulated depreciation or amortisation is not always proportionate to the change in the gross carrying amount of the asset.
- Amendments to IAS 19 'Defined Benefit Plans: Employee Contributions'
  This amendment is applicable to annual periods beginning on or after 1 July 2014 and clarifies the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service.
- Amendments to IAS 24 'Related Party Disclosures'
  The amendments have extended the definition to include a management entity that provides key management personnel services to the reporting entity.
- Amendments to IAS 40 'Investment Property'
  The amendments clarify that an entity should assess whether an acquired property is an investment property under IAS 40 or a business combination as defined by IFRS 3.

The following new or amended accounting standards and interpretations have been issued but are not effective for the twelve months ended 31 March 2016. The Group are monitoring developments and considering the associated impact:

- Amendments to IFRS 11 'Accounting for Acquisitions of Interests in Joint Operations'
  This amendment is applicable to annual periods beginning on or after 1 January 2016 and requires an acquirer of an interest in a joint operation, which constitutes a business, to apply the principles and disclosure requirements of other relevant IFRSs.
- Amendments to IAS 16 and IAS 38 'Clarification of Acceptable Methods of Depreciation and Amortisation'
  This amendment is applicable to annual periods beginning on or after 1 January 2016 and confirms the inappropriateness of certain depreciation and amortisation methods.
- Annual improvements to IFRSs 2012-2014 Cycle
  Four small amendments effective for reporting periods beginning on or after 1 January 2016, and include amendments to IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', IFRS 7 'Financial Instruments: Disclosures', IAS 19 'Employee Benefits' and IAS 34 'Interim Financial Reporting'.

1. Accounting policies (continued)

The following new accounting standards were neither adopted by the EU nor effective for the twelve months ended 31 March 2016. The Group are monitoring developments and considering the associated impact:

- IFRS 9 'Financial Instruments'
  IFRS 9 replaces the existing guidance in IAS 39 Financial Instruments: *Recognition and Measurement*. This standard introduces new requirements with respect to classification and measurement of financial instruments. It also changes the current incurred loss basis for provisioning to an expected credit loss model for calculating impairment on financial assets, as well as introducing new hedge accounting requirements. IFRS 9 is subject to EU endorsement, the timing of which is uncertain. The standard is currently expected to be effective for annual periods beginning on or after 1 January 2018.
- IFRS 15 'Revenue from Contracts with Customers'
  This standard will be effective for reporting periods beginning on or after 1 January 2018. This standard specifies how and when an entity should recognise revenue, providing a simple, principles based five-step model to be applied to all contracts with customers. The standard also prescribes further disclosure requirements in this area.
- IFRS 16 'Leases'
  The IASB announced the new standard will come into effect on 1 January 2019. This standard specifies that lessees would be required to recognise assets and liabilities arising from both operating and finance leases on the balance sheet.

Basis of consolidation

The Group financial statements consolidate the financial statements of the Society and its subsidiary undertakings.

Subsidiaries

Subsidiaries are all entities controlled by the Society. Control is achieved where the Group has the power to govern the financial and operating policies of an entity, has the exposure or rights to the variable returns from the involvement with the entity, and is able to use its power to affect the amount of returns for the Group. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of the subsidiaries are included in the results from the date that control commences until the date that control ceases.

The purchase 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. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the Income Statement.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Society, investments in subsidiary undertakings are carried at cost less any provisions for impairment.

Securitisation transactions

The Group has entered into securitisation transactions in which it sells mortgages to structured entities. In accordance with IAS 39, the Group continues to recognise securitised assets as loans and advances to customers. In subsequent periods, income from the securitised mortgages is recognised by the Group as disclosed below.

The equity of the structured entities created for these securitisations is not owned by the Group. However, to comply with the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004 and Standing Interpretations Committee (SIC) 12, the structured entities are included as subsidiaries in the consolidated financial statements.

The Society has entered into securitisation transactions in which it sold residential and commercial mortgages to structured entities. In accordance with IAS 39, the Society continues to recognise the securitised assets as loans and advances to customers and consequently also shows a deemed loan liability to the structured entities. The deemed loans are included within amounts due to other customers.

Segmental reporting

IFRS 8, 'Operating Segments', requires operating segments to be identified on the basis of internal reports and components of the Group regularly reviewed by the chief operating decision maker to allocate resources to segments and to assess their performance. In terms of the Group, the chief operating decision maker has been deemed to be the Board of Directors.

Each segment is determined according to the distinguishable operating component of the Group that is regularly reviewed by the Group's chief operating decision maker and for which discrete financial information is available.

Information regarding the results of each reportable segment is included in note 37.

Interest receivable and expense

Interest receivable and expense are recognised in the Income Statement for all instruments measured at amortised cost or available for sale using the effective interest method.

Effective interest rate

The effective interest method is used to calculate the amortised cost of financial instruments and to recognise interest receivable or payable over the relevant period. The effective interest rate (EIR) is the rate that exactly discounts estimated cash flows (excluding credit losses) to zero, through the expected life of the instrument. The main impact for the Group relates to mortgage advances where fees, such as application and arrangement fees, and costs are incorporated in the calculation. This has the effect of spreading these fees and costs over the expected life of the mortgage. Expected lives are estimated using historic data and management judgement and the calculation is adjusted when actual experience differs from estimates, with changes in deferred amounts being recognised immediately in the Income Statement.

Fees and commissions receivable and payable

Fees and commissions are generally recognised on an accruals basis when the service has been provided. Mortgage arrangement fees and other direct costs are deferred and recognised as an adjustment to the effective interest rate on the loan. Commissions and fees arising from negotiating or participating in the negotiation of a transaction with a third party are recognised on completion of the underlying transaction.

Investment properties

Investment properties are properties held for long-term rental yields and capital appreciation. Investment properties are carried in the Statement of Financial Position at fair value, representing open market value determined annually by a qualified internal valuer and at least every five years by an external valuer. Changes in fair values are recorded in the Income Statement in accordance with IAS 40 (revised 2003). Leasehold properties held for long-term rental yields are classified as investment properties and carried at fair value.

Financial instruments

In accordance with IAS 39, all financial assets and liabilities – which include derivative financial instruments – have to be recognised in the Statement of Financial Position and measured in accordance with their assigned category.

a) Financial assets

The Group allocates financial assets to the following IAS 39 categories: financial assets at fair value through profit or loss; loans and receivables; held to maturity investments; and available for sale financial assets. Management determines the classification of its financial instruments at initial recognition. Purchases and sales of non-derivative financial assets are accounted for at settlement date.

Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Group as at fair value through profit or loss upon initial recognition.

The Group uses derivative financial instruments to hedge its exposure to interest rate risk arising from operational, financing and investment activities.

In accordance with its Treasury Policy and the Building Societies Act 1986, the Group does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments (both assets and liabilities) are initially recognised and subsequently held at fair value in the Statement of Financial Position with changes in their fair value going through the Income Statement. However, by applying the hedge accounting rules set out in IAS 39, the changes in fair value of derivatives used to hedge particular risks can either be offset in the Income Statement or deferred to equity.

There are two types of hedge accounting strategies that the Group undertakes and these are summarised below:

- hedges of the fair value of recognised assets or liabilities or unrecognised firm commitments (fair value hedges); or
- hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedges).

Hedge accounting is used for derivatives designated in this way provided that certain criteria are met.

The Group documents, at the inception of any hedging transaction, the relationship between the hedging instrument and the hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

i) Fair value hedges – Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item, for which the effective interest method is used, is amortised to profit or loss over the remaining expected life of the previously hedged item.

ii) Cash flow hedges – The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised within the Statement of Comprehensive Income and the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the Income Statement. Amounts accumulated in equity are recycled to the Income Statement in the periods in which the hedged item will affect profit or loss (for example, when the forecast mortgage completion that is hedged takes place). When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in other operating income within the Income Statement. If a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the Income Statement.

iii) Derivatives that do not qualify for hedge accounting – Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the Income Statement. Certain derivatives are embedded within other non-derivative financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risk of the host instrument and where the hybrid instrument is not measured at fair value, the embedded derivative is separated from the host instrument with changes in fair value of the embedded derivative recognised in the Income Statement. Depending on the classification of the host instrument, the host instrument is then measured in accordance with the relevant IFRS standard.

The Group designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed. According to IAS 39, the fair value option is only applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise; or
- the financial asset is part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis; or
- the financial asset consists of a debt host and embedded derivative that must be separated.

To reduce accounting mismatch, the fair value option is applied to certain loans and receivables that are hedged with credit derivatives or interest rate swaps but for which the hedge accounting conditions of IAS 39 are not fulfilled. The loans would have been otherwise accounted for at amortised cost, whereas the derivatives are measured at fair value through profit or loss.

Financial assets for which the fair value option is applied are recognised in the notes to the accounts as financial assets designated at fair value. Fair value changes relating to financial assets designated at fair value through profit or loss are recognised as net gains on financial instruments designated at fair value through profit or loss.

1. Accounting policies (continued)

Available for sale (AFS)
Available for sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices or that are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit or loss. The Group's investment securities (e.g. certificates of deposit, gilts, etc.) are classified as available for sale assets.

Available for sale financial assets are initially recognised at fair value, which is the cash consideration including any directly attributable transaction costs, and measured subsequently at fair value with gains and losses being recognised in the consolidated Statement of Comprehensive Income, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised, whereupon the cumulative gains and losses previously recognised in other comprehensive income are reclassified to the Income Statement as a reclassification adjustment.

Interest is calculated using the effective interest method, and foreign currency gains and losses on monetary assets classified as available for sale are recognised in the consolidated Income Statement. Dividends on available for sale equity instruments are recognised in the Income Statement in dividend income when the Group's right to receive payment is established.

The fair values of available for sale assets are based on quoted prices or, if these are not available, valuation techniques developed by the Group. These include, but are not limited to, the use of discounted cash flow models, option pricing models and recent arm's length transactions.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- those that the Group intends to sell immediately or in the short term, which are classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss; or
- those that the Group upon initial recognition designates as available for sale; or
- those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any directly attributable transaction costs – and measured subsequently at amortised cost using the effective interest method. Loans and receivables are reported in the Statement of Financial Position as loans and advances to credit institutions or customers or as investment securities. Interest on loans is included in the consolidated Income Statement and is reported as interest receivable and similar income. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the loan and recognised in the Income Statement as impairment losses on loans and advances.

Held to maturity financial assets
Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity, other than:

- those that the Group upon initial recognition designates as at fair value through profit or loss;
- those that the Group designates as available for sale; and
- those that meet the definition of loans and receivables.

These are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method. Interest on held to maturity investments is included in the Income Statement and reported as interest receivable and similar income.
In the case of an impairment, the impairment loss has been reported as a deduction from the carrying value of the investment and recognised in the Income Statement as net gains/(losses) on investment securities.

b) Financial liabilities
The Group's holding in financial liabilities is in financial liabilities at fair value through profit or loss, financial liabilities at amortised cost and hedging derivatives. Financial liabilities are derecognised when extinguished.

All financial liabilities including shares, deposits, debt securities in issue and subordinated liabilities held by the Group are recognised initially at fair value, being the issue proceeds, net of premia, discounts and directly attributable transaction costs incurred.

Financial liabilities are subsequently measured at amortised cost using the effective interest method, except for those financial liabilities, for example derivative liabilities, which are measured at fair value through profit or loss.

c) Financial instruments designated at fair value through profit or loss
Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated by management. The Group may designate financial instruments at fair value when the designation eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different bases. Under this criteria, the main classes of financial instruments designated by the Group are where:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis; or
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

The fair value designation, once made, is irrevocable. Designation of financial assets and financial liabilities are recognised when the Group enters into the contractual provisions of the arrangements with counterparties and are normally derecognised when sold (assets) or extinguished (liabilities).
Measurement is initially at fair value, with transaction costs taken directly to the Income Statement. Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in net income from financial instruments designated at fair value. Note 31 sets out the amount of each class of financial asset or liability that has been designated at fair value through profit or loss.

d) Impairment of financial assets
Impairment of mortgage loans and advances
The Group assesses at each year end date whether there is objective evidence that a financial asset is impaired. Objective evidence of impairment can be defined as one or more events occurring after the initial recognition of the asset that have an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists for financial assets using the following criteria:

- Deterioration in payment status;
- Tenant failure;
- Expected future increase in arrears due to change in loan status;
- Breach of loan covenants; and
- Any other information suggesting that a loss is likely in the short to medium term.

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment, and for which an impairment loss is or continues to be recognised, are not included in a collective assessment of impairment.

A collective provision is made against a group of loans and advances where there is objective evidence that credit losses have been incurred but not identified at the reporting date. The collective impairment calculation takes into account a number of factors, including forbearance measures applied to the loans, such as term extensions and short-term interest only conversions.

If there is objective evidence of an impairment of loans and receivables, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. This calculation takes into account the Group's experience of default rates, loss emergence periods, the effect of regional movements in house prices based upon a recognised index and adjustments to allow for ultimate forced sales values and realisation costs. The amount of the loss is recognised in the Income Statement.

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.

Impairment losses on investment securities
At each year end date the Group assesses whether or not there is objective evidence that individual investment securities are impaired. In determining whether there is any objective evidence of impairment the Group takes into account a number of factors including:

- significant financial difficulties of the issuer or obligor;
- any breach of contract or covenants;
- the granting of any concession or rearrangement of terms;
- the disappearance of an active market;
- any significant downgrade of ratings; and
- any significant reduction in market value.

In some cases a significant adverse change in one of the above factors will cause the Group to determine that there is objective evidence of impairment. In other cases it may not be possible to identify a single event that identifies impairment. The Group may additionally determine that there is impairment where there are a number of factors contributing to that view.

Where the Group determines that there is objective evidence of impairment or that trigger events exist, then, in the case of available for sale instruments, the cumulative gain or loss that had been recognised directly in reserves is removed from reserves and recognised in the Income Statement. In the case of held to maturity instruments an appropriate charge is made to the Income Statement.

If, in a subsequent period, the fair value of an investment 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 shall be reversed, with the amount of the reversal recognised through the Income Statement.

Impairment losses on investments in subsidiary undertakings
The Society assesses, at each reporting date, whether there is any indication that its investments in subsidiary companies are impaired. If any indication of impairment exists, the Society compares the relevant asset's recoverable amount with its carrying value and, if an impairment loss has arisen, recognises it in the Income Statement immediately.

The recoverable amount of the investment is calculated with reference to the present value of the subsidiary's estimated future cash flows, primarily those arising from the continued trading of the subsidiary. This approach is based on the assumption that the Society, by virtue of control, is able to extract the subsidiary's cash flows in the form of loan repayment and/or dividends. In line with IAS 39, the discount rate used to arrive at the present value of future cash flows is the intergroup interest charge rate representing the EIR of the investment asset being assessed.

e) Derecognition of financial assets and liabilities
The Group's policy is to derecognise financial assets when the contractual right to the cash flows from the financial asset expires. The Group also derecognises financial assets that it transfers to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset and substantially all the risks and rewards of ownership.

The Group derecognises financial liabilities only when the obligation specified in the contract is discharged, cancelled or has expired.

f) Determination of fair value
The Group determines fair values by the three tier valuation hierarchy as defined within IAS 39 and Amendments to IFRS 7 'Financial Instruments: Disclosures'.

Level 1: For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges (for example, FTSE, NYSE) and broker quotes from Bloomberg and Reuters.

1. Accounting policies (continued)

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

Level 2: For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs (for example, LIBOR yield curve, FX rates, volatilities and counterparty spreads) existing at the reporting dates.

The Group uses widely recognised valuation models for determining fair values of non-standardised financial instruments of lower complexity, such as options or interest rate and currency swaps. For these financial instruments, inputs into models are generally market observable.

Level 3: Fair value is determined using valuation techniques where significant inputs are not based on observable market data.

The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

g) Sale and repurchase agreements

Investment and other securities may be lent or sold subject to a commitment to repurchase them. Where substantially all of the risks and rewards of ownership remain with the Group, the securities are retained on the Statement of Financial Position. The counterparty liability is recognised separately in the Statement of Financial Position as appropriate. The difference between the sale and repurchase price is accrued over the life of the agreements.

Intangible assets

Goodwill

Goodwill arising on the acquisition of subsidiary undertakings, joint ventures, associates or businesses represents the excess of the fair value of consideration over the fair value of identifiable net assets and contingent liabilities acquired at the date of acquisition. In accordance with IFRS 3, 'Business Combinations', goodwill is not systematically amortised but is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill which is recognised as an asset is reviewed for impairment at least annually. Any impairment is recognised in the Income Statement and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's applicable cash generating units. Each unit is tested at least annually and reviewed for impairment indicators at each reporting date, with a further impairment test performed if indicators deem necessary. The impairment test compares the carrying value of goodwill to the higher of its fair value less costs of sale and its value in use. The value in use calculations are carried out by discounting the future cash flows of the cash generating unit.

On the sale of a subsidiary undertaking, the profit or loss on sale is calculated after charging or crediting the net book value of any related goodwill. Negative goodwill arising on an acquisition would be recognised directly in the Income Statement.

Computer software

Computer software which is not an integral part of the related hardware is recorded as an intangible asset. The identifiable and directly associated external and internal costs of acquiring and developing software are capitalised where the software is controlled by the Group, and where it is probable that future economic benefits that exceed its cost will flow from its use over more than one year. Intangible assets are held at amortised cost, amortisation is charged to the Income Statement on a straight line basis over the estimated useful life of 3 to 7 years; they are subject to regular impairment reviews. Costs associated with maintaining software are recognised as an expense when incurred.

Property, plant and equipment

Land and buildings comprise mainly branches and offices. All property is stated at valuation less depreciation and plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. All gains on the revaluation of property are recognised in the revaluation reserve when they arise.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the Income Statement during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight line method (unless otherwise stated) to allocate their cost less their residual values over their estimated useful lives, as follows:

Buildings	Up to 50 years
Short leasehold properties	Annual instalments over the period of the lease
Equipment, fixtures and fittings and motor vehicles	
• Office equipment	3 to 7 years
• Computer equipment	3 to 7 years
• Motor vehicles	25% per annum reducing balance
• Refurbishments	5 to 10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each year end date. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the Income Statement.

Leases

The leases entered into by the Group are primarily operating leases. The total payments made under operating leases are charged to the Income Statement on a straight line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Cash and cash equivalents

For the purposes of the cash flow statement, cash comprises cash in hand and loans and advances to credit institutions repayable on demand. Cash equivalents comprise highly liquid investments that are convertible into cash with an insignificant risk of changes in value, with maturities of 90 days or less.

Taxation

Tax on the profit/loss for the year comprises current tax and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in other comprehensive income within the Statement of Comprehensive Income.

Current tax is the expected tax payable/receivable on the taxable income/expense for the year, using the tax rate which applies to the accounting period ending at the date of the Statement of Financial Position, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided in full, using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is determined using tax rates (and laws) that have been substantively enacted by the year end date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Provisions and contingent liabilities

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events, not wholly within the control of the Group, is a contingent liability. A contingent liability is disclosed but not recognised in the Statement of Financial Position.

Employee benefits

The Group provides both a defined benefit scheme (closed to new employees from 2002/3 and accruals from 2009/10) and a defined contribution scheme on behalf of staff and Directors. The defined benefit scheme is funded by contributions from the Society at rates assessed by independent actuaries. These contributions are invested separately from the Group's assets. The Scheme assets are measured at market value at each year end date and the liabilities are measured using the projected unit valuation method, by qualified actuaries, discounted using a corporate bond rate. The resulting pension scheme surplus or deficit is recognised in the Statement of Financial Position.

Actuarial gains and losses are recognised in full in the period in which they occur. As permitted by the revised standard, actuarial gains and losses are recognised outside profit or loss and presented in other comprehensive income.

Net interest, comprising interest income on plan assets less interest costs on scheme liabilities, and other expenses relating to the defined benefit pension scheme are recognised in the Income Statement. Actuarial gains or losses, that are gains or losses arising from differences between previous actuarial assumptions and actual experience, are recognised in the Statement of Comprehensive Income.

For defined contribution plans, the contributions are recognised as employee benefit expense in the Income Statement when they are due, in accordance with the rules of the scheme. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements 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.

Pensions

The Group operates a defined benefit pension scheme. Significant judgements (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 judgements, which are based upon the Board receiving external advice from the scheme actuaries, are outlined in note 30 to the Accounts.

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 judgement. Provisions are calculated using historic default and loss experience, but require judgement to be exercised in predicting economic conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time before impairments are identified (emergence period). The most critical estimate is of the level of house prices where a variance of 10% equates to £2.7m of provision. Other sensitivities include the emergence period, where a variance of six months equates to £0.5m, and the loss given default rate, where a 10% variance equates to £4.1m of provision.

For commercial mortgages the key sensitivities are interest rates, rental yields and exit yields, the rental yield impacting on annual returns and also the value of the commercial properties which provide security. A 0.5% increase in the current and projected future interest rates would increase commercial provision requirements by £4.0m before any compensating hedging transactions. A 0.25% reduction in expected rental income would increase provision requirements by £2.0m. A 0.25% increase in expected exit yield requirements would increase provisions by £3.6m.

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.

1. Accounting policies (continued)

Effective interest rate
The calculation of an effective interest rate requires the Group to make assumptions around the expected lives of mortgages and the likely levels of early repayment fees to be received. Management regularly reviews these assumptions and compares with actual results.

If the average lives of the mortgages were to increase by 5%, the carrying value of mortgages would change by £1.0m with a corresponding change to income.

Investment properties
The calculation of the fair value of investment properties involves house price assumptions which are regularly reviewed by management.

If house prices were to change by 5%, the carrying value of the investment properties would change by £6.2m with a corresponding change to income.

Taxation
Significant estimates are required in determining the provision for corporation tax. There are a number of transactions for which the final tax determination is uncertain at the year end date.

Fair value of derivatives and financial assets
The most reliable fair values of derivative financial instruments and available for sale assets are quoted market prices in an actively traded market. Where there is no active market, valuation techniques are used. Techniques adopted include valuation models used to calculate the present value of expected future cash flows, and options pricing models, if market values are not available. These techniques make use of observable market data and hence fair value estimates can be considered to be reliable. Where inputs are not observable they may be based on historic data. Changes in assumptions used in the models could affect the reported fair value of derivatives and available for sale assets.

Where previously active markets no longer provide prices, other market sources are monitored, such as real-time market information, custodian and independent financial institution valuations, and management judgement is exercised in determining fair values for these or similar instruments.

Basis risk derivatives are valued using discounted cash flow models, using observable market data and will be sensitive to benchmark interest rate curves.

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.

Based on its analysis, management has determined that the tax losses held by the Society and various other Group companies primarily result from the recent economic downturn. The housing and credit market conditions in existence during the UK recession led to increases in credit losses and contracting margins, with higher unemployment levels also leading to higher credit losses. 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 the current economic situation. They include assumptions about the depth and severity of potential further house price depreciation and about the UK economy, including unemployment levels and their related impact on credit losses.

The assumptions surrounding future expected credit losses and increases in the Bank Rate of interest represent the most subjective areas of judgement 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 18%, being the rate substantively enacted at the date of the Statement of Financial Position.

Securitisation transactions
In order to determine whether the Society controls a structured entity or not, the Society has to make judgements about risks and rewards and assess the ability to make operational decisions for the structured entity in question. In many instances, elements are present that, considered in isolation, indicate control or lack of control over a structured entity, but when considered together make it difficult to reach a clear conclusion. When assessing whether the Group has to consolidate a structured entity it evaluates a range of factors. The following are the prime factors that are considered and the applicable accounting treatment in each case:

- When the Group, in substance, controls the entity to which financial assets have been transferred, the entity is included in these consolidated financial statements and the transferred assets are recognised in the Group's Statement of Financial Position;
- When the Group transfers financial assets to an unconsolidated entity and it retains substantially all of the risk and rewards relating to the transferred assets, the transferred assets are recognised in the Group's Statement of Financial Position;
- When the Group transfers substantially all the risks and rewards relating to the transferred financial assets to an unconsolidated entity, the assets are derecognised from the Group's Statement of Financial Position; and
- When the Group neither transfers nor retains substantially all the risks and rewards relating to a transferred financial asset and it retains control of the transferred asset, the Group continues to recognise the transferred financial asset to the extent of its continuing involvement in that transferred financial asset. Details of the Group's securitisation activities are given in note 13.

2. Interest receivable and similar income

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
On financial assets not at fair value through profit or loss:				
Loans fully secured on residential property	**108.4**	109.5	**61.0**	54.6
Other loans				
Connected undertakings	**-**	-	**56.7**	75.8
Loans fully secured on land	**28.6**	39.0	**1.2**	1.2
Investment securities	**5.0**	5.8	**13.5**	16.1
Other liquid assets	**1.5**	1.2	**1.2**	0.9
On financial assets at fair value through profit or loss:				
Net expense on derivative financial instruments	**(18.2)**	(20.6)	**(15.6)**	(16.1)
Loans fully secured on land	**1.4**	2.0	**-**	-
Total interest income	**126.7**	136.9	**118.0**	132.5
Interest receivable includes:				
Income from fixed income securities	**3.0**	3.5	**3.0**	3.5

Included within interest receivable and similar income is interest accrued on impaired residential mortgage assets: Group £1.8m (2014/15: £2.5m) and Society £1.2m (2014/15: £1.5m) and interest accrued on impaired commercial mortgage assets: Group £6.3m (2014/15: £9.0m) and Society £nil (2014/15: £nil).

3. Interest expense and similar charges

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
On financial liabilities not at fair value through profit or loss:				
Shares held by individuals	**51.5**	56.0	**51.5**	56.0
Deposits from banks and other deposits	**7.6**	8.3	**6.6**	7.5
Interest on debt securities in issue	**7.1**	7.8	**0.9**	0.8
Deemed loans	**-**	-	**9.0**	11.3
On financial liabilities at fair value through profit or loss:				
Net income on derivative financial instruments	**(0.6)**	(1.1)	**(0.6)**	(1.1)
Interest on debt securities in issue	**1.1**	1.2	**-**	-
Total interest expense	**66.7**	72.2	**67.4**	74.5

4. Other operating income

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
Other operating income includes:				
Rent receivable on investment property	**6.2**	6.0	**-**	-
Operating expenses on investment property	**(2.1)**	(2.0)	**-**	-
Pension fund net interest (note 30)	**(0.1)**	-	**(0.1)**	-
Dividends received from Group undertakings	**-**	-	**30.7**	-
Other	**(0.1)**	(0.2)	**(0.1)**	0.7
Total other operating income	**3.9**	3.8	**30.5**	0.7

5. Net realised profits

Net realised profits arise on the sale of treasury instruments. The Society is required to periodically sell a proportion of its liquid assets to prove that they remain liquid. By their nature these sources of income are highly variable.

6. Administrative expenses

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Staff costs				
Wages and salaries	22.6	21.9	22.4	21.7
Social security costs	1.8	1.9	1.8	1.9
Other pension costs	1.4	1.3	1.3	1.3
Rental charges payable under operating leases	0.5	0.6	0.5	0.6
Other administrative expenses	15.7	14.9	11.8	10.8
	42.0	40.6	37.8	36.3
Other administrative expenses include:				
Remuneration of auditor (excluding VAT element)				
Audit of these financial statements	0.1	0.1	0.1	0.1
Audit of the subsidiary financial statements	0.1	0.1	-	-
Other assurance services	0.1	-	0.1	-

Wages and salaries include £0.3m (2014/15: £0.8m) redundancy costs paid as part of the restructuring and rationalisation of the Group's cost base.

7. Employee numbers

	Group 2016	Group 2015	Society 2016	Society 2015
The average number of employees employed throughout the year was:				
Full time	616	614	609	605
Part time	124	111	123	111
	740	725	732	716
Building Society				
Central administration	490	472	490	472
Branches	242	244	242	244
Subsidiaries	8	9	-	-
	740	725	732	716

All employees were employed within the United Kingdom.

8. Directors' emoluments

Total Directors' emoluments amounted to £1.537m (2014/15: £1.477m). Full details are given in the Directors' Remuneration Report on pages 32 to 38.

9. Taxation

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
UK corporation tax at 20% (2014/15: 21%)	**2.5**	1.3	**2.5**	1.3
Corporation tax - adjustment in respect of prior years	**(1.2)**	(1.2)	**(1.2)**	(1.9)
Total current tax	**1.3**	0.1	**1.3**	(0.6)
Deferred tax				
Current year	**1.8**	2.0	**0.6**	2.1
Adjustment in respect of prior periods	**1.0**	1.1	**(2.2)**	(0.4)
Tax on profit on ordinary activities	**4.1**	3.2	**(0.3)**	1.1

UK corporation tax has been calculated at the applicable prevailing rate.

The effective tax rate for the Group for the year ended 31 March 2016 is 30% (2014/15: 26%). The rate is higher than the UK standard rate of tax due mainly to allowing for future changes in corporation tax rates (which reduce to 18% by 2021). This reduces the benefit that may be obtained in the future from utilising brought forward tax losses and a charge of £1.4m has been included in the current years deferred tax charge for this.

The tax charge is reconciled to the profit before tax in the Income Statement as follows:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Profit before tax	**13.5**	12.4	**7.8**	15.4
Profit before tax multiplied by the UK standard rate of tax of 20% (2014/15: 21%)	**2.7**	2.6	**1.6**	3.2
Effects of:				
Income not taxable and expenses not deductible for tax purposes	**0.7**	0.7	**0.5**	0.3
Changes to tax rate	**1.4**	0.1	**1.0**	(0.1)
Adjustment in respect of prior years	**(0.2)**	(0.1)	**(3.4)**	(2.3)
Revaluation	**(0.5)**	(0.1)	**-**	-
Tax charge	**4.1**	3.2	**(0.3)**	1.1

10. Cash and balances with the Bank of England

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cash in hand	**2.2**	2.3	**2.2**	2.3
Cash ratio deposit with the Bank of England	**6.7**	7.2	**6.7**	7.2
Other deposits with the Bank of England	**206.5**	251.3	**206.5**	251.3
	215.4	260.8	**215.4**	260.8

Cash ratio deposits are mandatory deposits with the Bank of England which are not available for use in the Group's day-to-day operations. Cash in hand and the mandatory deposit with the Bank of England are non-interest bearing.

11. Investment securities

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Investment securities: available for sale				
Listed	**359.0**	274.3	**359.0**	274.3
Unlisted	**51.1**	-	**51.1**	-
Investment securities: held to maturity				
Listed	**-**	-	**889.9**	995.8
Total investment securities	**410.1**	274.3	**1,300.0**	1,270.1

In accordance with IAS 39, available for sale investment securities are stated at fair value and held to maturity investment securities are stated at amortised cost. Gains/(losses) on disposal of investment securities are disclosed as net realised profits/(losses) on the face of the Income Statement.

The movement in investment securities may be summarised as follows:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
At beginning of year	**274.3**	461.6	**1,270.1**	1,540.5
Additions	**440.0**	193.1	**440.0**	193.1
Disposals (sale and redemption)	**(302.0)**	(379.4)	**(407.9)**	(462.5)
Losses from changes in fair value	**(2.2)**	(1.0)	**(2.2)**	(1.0)
At end of year	**410.1**	274.3	**1,300.0**	1,270.1

The Directors consider that the primary purpose for holding investment securities is prudential. The investment securities are held as liquid assets with the intention of use on a continuing basis in the Group's activities.

At 31 March 2016, £48.4m (2014/15: £78.9m) of Group investment securities and £nil (2014/15: £nil) of cash were pledged as collateral under sale and repurchase agreements. All sale and repurchase transactions are conducted in line with market standard terms and conditions as defined in ISMA PSA Global Master Repurchase Agreements.

12. Derivative financial instruments

A description of the derivative financial instruments used by the Group for hedging purposes is given in note 33.

The fair values of derivative instruments held at 31 March 2016 are set out below. The other derivatives held for hedging are held for economic hedging purposes.

	Notional principal amount	Fair values	
Group	**2016 £m**	**Assets 2016 £m**	**Liabilities 2016 £m**
Derivatives held for hedging			
Derivatives designated as fair value hedges	**1,323.7**	**2.1**	**(62.9)**
Derivatives designated as cash flow hedges	**133.0**	**0.1**	**-**
Other derivatives held for hedging	**756.0**	**6.7**	**(14.2)**
Total derivative assets/(liabilities) held for hedging	**2,212.7**	**8.9**	**(77.1)**

Group	Notional principal amount 2015 £m	Fair values Assets 2015 £m	Fair values Liabilities 2015 £m
Derivatives held for hedging			
Derivatives designated as fair value hedges	1,169.1	2.5	(54.8)
Derivatives designated as cash flow hedges	66.0	-	(0.1)
Other derivatives held for hedging	1,207.2	16.5	(25.9)
Total derivative assets/(liabilities) held for hedging	2,442.3	19.0	(80.8)

Society	**Notional principal amount 2016 £m**	**Fair values Assets 2016 £m**	**Fair values Liabilities 2016 £m**
Derivatives held for hedging			
Derivatives designated as fair value hedges	**1,437.1**	**2.1**	**(57.3)**
Other derivatives held for hedging	**548.0**	**6.7**	**(10.1)**
Total derivative assets/(liabilities) held for hedging	**1,985.1**	**8.8**	**(67.4)**

Society	Notional principal amount 2015 £m	Fair values Assets 2015 £m	Fair values Liabilities 2015 £m
Derivatives held for hedging			
Derivatives designated as fair value hedges	1,187.9	2.5	(48.3)
Other derivatives held for hedging	923.9	16.5	(20.7)
Total derivative assets/(liabilities) held for hedging	2,111.8	19.0	(69.0)

At 31 March 2016, £81.5m (2014/15: £75.5m) of cash was pledged as collateral against derivative financial instruments.

13. Loans and advances to customers

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
Loans and receivables				
Loans fully secured on residential property	**4,131.2**	3,921.4	**2,357.3**	1,967.4
Other loans				
Loans fully secured on land	**584.4**	713.1	**13.8**	13.8
Other loans	**0.1**	0.1	**-**	-
	4,715.7	4,634.6	**2,371.1**	1,981.2
At fair value through profit or loss				
Other loans				
Loans fully secured on land	**26.0**	44.5	**-**	-
	4,741.7	4,679.1	**2,371.1**	1,981.2
Fair value adjustment for hedged risk	**62.0**	68.0	**19.6**	16.3
Less: impairment provisions	**(64.7)**	(69.7)	**(10.6)**	(13.0)
	4,739.0	4,677.4	**2,380.1**	1,984.5

13. Loans and advances to customers (continued)

Certain residential and commercial mortgage balances are used to secure external funding as follows:

Group	Assets pledged 2016 £m	Secured funding 2016 £m	Assets pledged 2015 £m	Secured funding 2015 £m
Securitisations	**378.8**	**368.6**	474.6	467.1
Mortgage loan pools	**317.4**	**-**	391.8	-

Included within loans and advances to customers are £92.1m (2014/15: £130.7m) of commercial mortgage balances (loans fully secured on land) and £1,165.8m (2014/15: £1,334.9m) of residential mortgage balances that the Group has sold to bankruptcy remote structured entities. The structured entities have been funded by issuing mortgage backed securities (MBSs) of which £889.9m (2014/15: £995.8m) are held by the Group.

The Group has made subordinated loans to the structured entities to provide some level of credit enhancement to the MBSs. In future periods the Group will earn interest income on the subordinated loans and fees for managing the loans. The Group will earn deferred consideration once the cash flows generated by the structured entities have been used to pay interest and capital to the holders of the MBSs. Since the Group maintains substantially all of the risks (key risk being an exposure to credit risk through the subordinated loan agreements) and rewards emanating from the mortgages, they have been retained on the Group's Statement of Financial Position in accordance with IAS 39.

The Group has pools of residential mortgages totalling £317.4m (2014/15: £391.8m) pledged to the Bank of England to provide additional collateral to obtain secured funding. There was £170.0m cash drawn at 31 March 2016 (2014/15: £nil).

14. Allowance for losses on loans and advances

	Loans fully secured on residential property		Loans fully secured on land		Total		
Group	**Individual £m**	**Collective £m**	**Individual £m**	**Collective £m**	**Individual £m**	**Collective £m**	**Total £m**
At 1 April 2015	15.8	8.7	37.3	7.9	53.1	16.6	**69.7**
Amounts written off	(3.8)	-	(9.4)	-	(13.2)	-	**(13.2)**
Charge/(Credit) for the year comprising:							
Provision for loan impairment	0.8	0.3	8.0	1.2	8.8	1.5	**10.3**
Change in carrying value of debt securities in issue	-	-	(0.5)	0.4	(0.5)	0.4	**(0.1)**
Adjustments to provisions resulting from recoveries	(1.0)	-	(1.1)	-	(2.1)	-	**(2.1)**
(Credit)/Charge for the year	(0.2)	0.3	6.4	1.6	6.2	1.9	**8.1**
Non-recourse finance on securitised advances	-	-	0.5	(0.4)	0.5	(0.4)	**0.1**
At 31 March 2016	**11.8**	**9.0**	**34.8**	**9.1**	**46.6**	**18.1**	**64.7**

	Loans fully secured on residential property		Loans fully secured on land		Total		
Group	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Total £m
At 1 April 2014	20.3	7.2	49.2	8.5	69.5	15.7	85.2
Amounts written off	(4.3)	-	(11.9)	-	(16.2)	-	(16.2)
Charge/(Credit) for the year comprising:							
Provision/(Release) for loan impairment	1.2	1.5	0.4	(0.6)	1.6	0.9	2.5
Change in carrying value of debt securities in issue	-	-	(0.6)	0.1	(0.6)	0.1	(0.5)
Adjustments to provisions resulting from recoveries	(1.4)	-	(0.4)	-	(1.8)	-	(1.8)
(Credit)/Charge for the year	(0.2)	1.5	(0.6)	(0.5)	(0.8)	1.0	0.2
Non-recourse finance on securitised advances	-	-	0.6	(0.1)	0.6	(0.1)	0.5
At 31 March 2015	15.8	8.7	37.3	7.9	53.1	16.6	69.7

Included within loans fully secured on residential property are loans originated through the commercial division. At 31 March 2016, the provision against these loans totalled £nil (2014/15: £0.8m), with a net credit for the year of £0.1m (2014/15: charge £0.6m). The total provision balance relating to the commercial division is £43.9m (2014/15: £46.0m), with a charge for the year of £7.9m (2014/15: credit £0.6m).

The charge for the year includes impairments of £0.6m (2014/15: £0.5m) against loans in securitised entities, Sandwell Commercial Finance No.1 Plc: £0.8m charge (2014/15: £0.3m charge) and Sandwell Commercial Finance No. 2 Plc: £0.2m credit (2014/15: £0.2m charge). The loss from these impairments is borne by the external loan note holders as it exceeds the first loss exposure held by the Group. The carrying value of the external loan notes has been adjusted by an equivalent amount.

Society	Loans fully secured on residential property Individual £m	Collective £m	Loans fully secured on land Individual £m	Collective £m	Total Individual £m	Collective £m	Total £m
At 1 April 2015	8.7	4.3	-	-	8.7	4.3	**13.0**
Amounts written off	(0.8)	-	-	-	(0.8)	-	**(0.8)**
Credit for the year comprising:							
Release of provision for loan impairment	(0.4)	(0.8)	-	-	(0.4)	(0.8)	**(1.2)**
Adjustments to provisions resulting from recoveries	(0.4)	-	-	-	(0.4)	-	**(0.4)**
Credit for the year	(0.8)	(0.8)	-	-	(0.8)	(0.8)	**(1.6)**
At 31 March 2016	**7.1**	**3.5**	**-**	**-**	**7.1**	**3.5**	**10.6**

Society	Loans fully secured on residential property Individual £m	Collective £m	Loans fully secured on land Individual £m	Collective £m	Total Individual £m	Collective £m	Total £m
At 1 April 2014	11.5	4.6	-	-	11.5	4.6	16.1
Amounts written off	(1.6)	-	-	-	(1.6)	-	(1.6)
Credit for the year comprising:							
Release of provision for loan impairment	(0.5)	(0.3)	-	-	(0.5)	(0.3)	(0.8)
Adjustments to provisions resulting from recoveries	(0.7)	-	-	-	(0.7)	-	(0.7)
Credit for the year	(1.2)	(0.3)	-	-	(1.2)	(0.3)	(1.5)
At 31 March 2015	8.7	4.3	-	-	8.7	4.3	13.0

15. Investments

Society	Shares in subsidiary undertakings 2016 £m	2015 £m	Loans to subsidiary undertakings 2016 £m	2015 £m	Total 2016 £m	2015 £m
Cost						
At beginning of year	**0.6**	0.6	**1,910.7**	2,097.8	**1,911.3**	2,098.4
Decrease for the year	**-**	-	**(201.4)**	(187.1)	**(201.4)**	(187.1)
At end of year	**0.6**	0.6	**1,709.3**	1,910.7	**1,709.9**	1,911.3
Provisions						
At beginning of year	**-**	-	**9.9**	9.9	**9.9**	9.9
Charge for the year	**-**	-	**30.8**	-	**30.8**	-
At end of year	**-**	-	**40.7**	9.9	**40.7**	9.9
Net book value at end of year	**0.6**	0.6	**1,668.6**	1,900.8	**1,669.2**	1,901.4

Investments in subsidiary undertakings are financial fixed assets and are held at cost less impairment. All subsidiary loans are provided at open market rates.

Following continued contraction of the Commercial mortgage book and additional losses within West Bromwich Commercial Limited, the Society has carried out a further review of the carrying value of its investment in West Bromwich Commercial Limited. The value of the Society's investment in West Bromwich Commercial Limited has been calculated by estimating the future cash flows that are expected to arise from the underlying net assets of the subsidiary. The cash flows predominantly consist of those arising from the continued trading of the subsidiary (e.g. interest from loans secured on commercial real estate). In line with IAS 39, the appropriate discount rate used is that applicable to the intra-group loan account. Following this review it has been necessary to write-down the value of the investment by £30.8m.

15. Investments (continued)

The Society holds directly (unless otherwise stated) the following interests in key subsidiary undertakings, all of which are registered in England:

Name	Major activities	Class of shares held	Interest of Society
West Bromwich Mortgage Company Limited	Hold and dispose of debts secured on land and lend money on the security of land	Ordinary £1 shares	100%
West Bromwich Commercial Limited	Commercial lending	Ordinary £1 shares	100%
CL Mortgages Limited (1)	Hold and dispose of debts secured on land and lend money on the security of land	Ordinary £1 shares	100%
West Bromwich Homes Limited	Investment in property for rental	Ordinary £1 shares	100%
West Bromwich Financial Planning Limited (2)	Financial services product vendor	Ordinary £1 shares	100%
Insignia Finance Limited	Second charge lending	Ordinary £500 shares	100%
White Label Lending Limited (3)	Second charge lending	Ordinary £1 shares	100%

(1) The entire share capital of CL Mortgages Limited is held by West Bromwich Mortgage Company Limited.

(2) West Bromwich Financial Planning Limited was dissolved in May 2015.

(3) The entire share capital of White Label Lending Limited is held by Insignia Finance Limited.

Securitisation entities

The results of the following securitisation entities are consolidated into the results of the Group under the rules and guidance of IFRS 10:

Name	Country of incorporation	Principal activity
Sandwell Finance Holdings Limited	United Kingdom	Holding company
Sandwell Commercial Finance No. 1 Plc	United Kingdom	Securitisation entity
Sandwell Commercial Finance No. 2 Plc	United Kingdom	Securitisation entity
Hawthorn Hold Co Limited	United Kingdom	Holding company
Hawthorn Asset Co Limited	United Kingdom	Securitisation entity
Hawthorn Finance Limited	Jersey	Securitisation entity
Kenrick No. 1 Holdings Limited	United Kingdom	Holding company
Kenrick No. 1 Plc	United Kingdom	Securitisation entity
Kenrick No. 2 Holdings Limited	United Kingdom	Holding company
Kenrick No. 2 Plc	United Kingdom	Securitisation entity

The Society has no shareholdings in any of the companies listed above. Unless stated otherwise above, all are incorporated in the United Kingdom and operate in Great Britain.

The assets and liabilities within Sandwell Commercial Finance No. 1 Plc have been accounted for using the fair value option available under IAS 39.

16. Intangible assets

Group	Goodwill 2016 £m	Computer software 2016 £m	Total 2016 £m	Goodwill 2015 £m	Computer software 2015 £m	Total 2015 £m
Cost						
At beginning of year	0.6	15.3	15.9	0.6	14.2	14.8
Additions	-	4.0	4.0	-	1.1	1.1
At end of year	0.6	19.3	19.9	0.6	15.3	15.9
Aggregate amortisation						
At beginning of year	-	8.9	8.9	-	6.1	6.1
Charge for the year	-	2.8	2.8	-	2.8	2.8
At end of year	-	11.7	11.7	-	8.9	8.9
Net book value at end of year	0.6	7.6	8.2	0.6	6.4	7.0
Net book value at beginning of year	0.6	6.4	7.0	0.6	8.1	8.7

Society	Goodwill 2016 £m	Computer software 2016 £m	Total 2016 £m	Goodwill 2015 £m	Computer software 2015 £m	Total 2015 £m
Cost						
At beginning of year	-	15.3	15.3	-	14.2	14.2
Additions	-	4.0	4.0	-	1.1	1.1
At end of year	-	19.3	19.3	-	15.3	15.3
Aggregate amortisation						
At beginning of year	-	8.9	8.9	-	6.1	6.1
Charge for the year	-	2.8	2.8	-	2.8	2.8
At end of year	-	11.7	11.7	-	8.9	8.9
Net book value at end of year	-	7.6	7.6	-	6.4	6.4
Net book value at beginning of year	-	6.4	6.4	-	8.1	8.1

The goodwill has been assessed as having an indefinite life. In accordance with IAS 38 'Intangible Assets', the Group carries out an annual impairment test in relation to goodwill.

The recoverable amount has been calculated with reference to future earnings and value in use. The calculations incorporate cash flow projections from the three year business plan approved by the Group Board and cash flow forecasts for the following 10 years, reflecting the enduring nature of the business concerned. The long term growth rates of 3.0% (2014/15: 3.0%) are based upon management's expectations of long-term GDP growth over the forecast period. The pre-tax rate used to discount projected cash flows is 12.5% (2014/15: 12.5%), reflecting management's estimate of the required return.

17. Investment properties

	Group 2016 £m	Group 2015 £m
Valuation		
At beginning of year	118.6	115.2
Disposals	(0.4)	(2.1)
Revaluation gains	5.5	5.5
At end of year	123.7	118.6

A national firm of specialist residential valuers, Connells Limited, has carried out a valuation review of the residential investment properties held by West Bromwich Homes Limited. This review involved a physical 'drive by' inspection of a sample of approximately 10% of the total portfolio, together with a review of desktop market value assessments and output from an automated valuation model of all remaining properties on an individual basis.

Connells Limited confirms that, based on the valuation output reviewed, it is satisfied that the overall valuation of the portfolio at 31 March 2016 is a fair reflection of market value. The valuation was prepared in accordance with the Valuation Standards issued by the Royal Institution of Chartered Surveyors (known as the 'Red Book'), in particular UK Practice Statement 1. Market value is as defined in Practice Statement 3.2. This fair value measurement is categorised as a Level 3 fair value measurement, based on the inputs to the valuation technique used as described in note 31.

If the land and buildings were carried at cost, the carrying amount would be £84.9m (2014/15: £85.3m).

The Group leases investment properties to non-commercial individuals for a contract period of up to 18 months. The future minimum lease receipts under non-cancellable operating leases that end within 12 months are £2.5m (2014/15: £2.5m). The Group has not recognised any contingent rent in the period (2014/15: £nil).

18. Property, plant and equipment

Group	Land and buildings: Freehold £m	In the course of construction £m	Held for sale £m	Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost or valuation						
At 1 April 2015	5.0	16.4	0.5	0.7	20.4	**43.0**
Additions	1.2	3.6	-	-	1.2	**6.0**
Transfers	19.5	(20.0)	-	-	0.5	**-**
At 31 March 2016	**25.7**	**-**	**0.5**	**0.7**	**22.1**	**49.0**
Accumulated depreciation						
At 1 April 2015	0.1	-	-	0.6	12.1	**12.8**
Charge for the year	0.2	-	-	-	2.1	**2.3**
At 31 March 2016	**0.3**	**-**	**-**	**0.6**	**14.2**	**15.1**
Net book value						
At 31 March 2016	**25.4**	**-**	**0.5**	**0.1**	**7.9**	**33.9**

Group	Land and buildings: Freehold £m	In the course of construction £m	Held for sale £m	Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost or valuation						
At 1 April 2014	5.0	2.9	0.5	0.7	19.5	28.6
Additions	-	13.5	-	-	0.9	14.4
At 31 March 2015	5.0	16.4	0.5	0.7	20.4	43.0
Accumulated depreciation						
At 1 April 2014	-	-	-	0.6	9.6	10.2
Charge for the year	0.1	-	-	-	2.5	2.6
At 31 March 2015	0.1	-	-	0.6	12.1	12.8
Net book value						
At 31 March 2015	4.9	16.4	0.5	0.1	8.3	30.2

Society	**Freehold £m**	**Land and buildings: In the course of construction £m**	**Held for sale £m**	**Short leasehold £m**	**Equipment, fixtures, fittings and vehicles £m**	**Total £m**
Cost or valuation						
At 1 April 2015	5.0	16.4	0.5	0.7	20.2	**42.8**
Additions	1.2	3.6	-	-	1.2	**6.0**
Transfers	19.5	(20.0)	-	-	0.5	**-**
At 31 March 2016	**25.7**	**-**	**0.5**	**0.7**	**21.9**	**48.8**
Accumulated depreciation						
At 1 April 2015	0.1	-	-	0.6	11.9	**12.6**
Charge for the year	0.2	-	-	-	2.1	**2.3**
At 31 March 2016	**0.3**	**-**	**-**	**0.6**	**14.0**	**14.9**
Net book value						
At 31 March 2016	**25.4**	**-**	**0.5**	**0.1**	**7.9**	**33.9**

Society	Freehold £m	Land and buildings: In the course of construction £m	Held for sale £m	Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost or valuation						
At 1 April 2014	5.0	2.9	0.5	0.7	19.3	28.4
Additions	-	13.5	-	-	0.9	14.4
At 31 March 2015	5.0	16.4	0.5	0.7	20.2	42.8
Accumulated depreciation						
At 1 April 2014	-	-	-	0.6	9.4	10.0
Charge for the year	0.1	-	-	-	2.5	2.6
At 31 March 2015	0.1	-	-	0.6	11.9	12.6
Net book value						
At 31 March 2015	4.9	16.4	0.5	0.1	8.3	30.2

The net book value of land and buildings occupied for the Society's own use is £26.0m (2014/15: £21.8m).

The Group's freehold branch properties were revalued at 31 March 2014 by Colliers International, a firm of independent chartered surveyors. The valuations were undertaken in accordance with the Valuation Standards issued by the Royal Institution of Chartered Surveyors in the United Kingdom. These valuations have been incorporated into the financial statements and the resulting revaluation adjustments taken to the revaluation reserve.

If land and buildings were carried at cost, the carrying amount would be £22.6m (2014/15: £18.4m).
The additions on land and buildings in the course of construction represent additional expenditure on the new Head Office of £3.6m. Since practical completion of the new Head Office in February 2016, £19.5m was transferred to Freehold property and £0.5m to Equipment, fixtures and fittings.

19. Deferred tax

Deferred tax is calculated on all temporary differences under the liability method using an effective tax rate of 18% (2014/15: 20%). The movement on the deferred tax account is as follows:

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
At beginning of year	**19.4**	20.2	**12.3**	11.7
Current year Income Statement charge	**(1.8)**	(2.0)	**(0.6)**	(2.1)
Amount recognised directly in other comprehensive income	**(0.9)**	2.3	**(1.0)**	2.3
Adjustments in respect of prior years	**(1.0)**	(1.1)	**2.2**	0.4
At end of year	**15.7**	19.4	**12.9**	12.3

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

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
Deferred tax assets				
Accelerated tax depreciation	**5.3**	5.3	**5.3**	5.3
Carried forward tax losses	**14.7**	15.7	**7.5**	4.8
Pensions and other post retirement benefits	**-**	1.5	**-**	1.5
Other temporary differences	**0.4**	1.4	**0.7**	1.2
	20.4	23.9	**13.5**	12.8
Deferred tax liabilities				
Property valuations	**(4.1)**	(4.0)	**(0.4)**	(0.5)
Other temporary differences	**(0.6)**	(0.5)	**(0.2)**	-
	(4.7)	(4.5)	**(0.6)**	(0.5)

The deferred tax (charge)/credit in the Income Statement comprises the following temporary differences:

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
Accelerated tax depreciation	**-**	0.8	**-**	0.8
Other provisions	**(0.7)**	(0.4)	**(0.4)**	(0.3)
Carried forward tax losses	**(1.9)**	(2.5)	**2.0**	(2.2)
Property valuations	**(0.2)**	(1.0)	**-**	-
	(2.8)	(3.1)	**1.6**	(1.7)

Deferred tax assets are recognised only to the extent that realisation of the related tax benefit against future taxable profits is probable over the foreseeable future. The deferred tax asset balances attributable to carried forward losses are expected to be substantially recovered against future taxable profits (as projected in the latest Strategic Plan) within five years. The assumptions surrounding future expected credit losses and increases in the Bank Rate of interest represent the most subjective areas of judgement in management's projections of future taxable profits. The deferred tax assets have not been discounted.

Deferred tax assets and liabilities are offset where there is a legally enforceable right to do so.

Reductions in the UK corporation tax rate to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013, with further reductions to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) substantively enacted on 26 October 2015. This will reduce the Group's future current tax charge accordingly.

Deferred tax assets and liabilities have been calculated at 18% (2014/15: 20%), being the rate substantively enacted at the Statement of Financial Position date. Whilst it was announced in the Finance Bill 2016 that the UK corporation tax rate will reduce to 17% rather than 18% with effect from 1 April 2020, this legislation has not been substantively enacted and is therefore not reflected in the tax provisions reported in these accounts. The effect of the reduction from 18% to 17% would be to reduce the Group's net deferred tax asset from £15.7m to £14.6m.

20. Trade and other receivables

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Prepayments and accrued income	**2.4**	2.2	**2.4**	2.2
Other	**0.3**	0.5	**0.3**	0.4
	2.7	2.7	**2.7**	2.6

21. Shares

Group and Society	2016 £m	2015 £m
Held by individuals	**4,377.4**	3,970.0
Other shares	**1.1**	1.1
Fair value adjustment for hedged risk	**6.6**	16.9
	4,385.1	3,988.0

22. Amounts due to other customers

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Deemed loans	**-**	-	**341.3**	452.8
Other customers	**157.0**	152.4	**158.7**	153.6
	157.0	152.4	**500.0**	606.4

23. Debt securities in issue

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Non-recourse finance on securitised advances	**368.6**	467.1	**-**	-

The non-recourse finance comprises mortgage backed floating rate notes (the Notes) secured over portfolios of mortgage loans secured by first charges over residential and commercial properties in the United Kingdom (see note 13). Prior to redemption of the Notes on the final interest payment dates, the Notes will be subject to mandatory and/or optional redemption, in certain circumstances, on each interest payment date. See note 28 for details of assets and liabilities held at fair value through profit or loss.

24. Trade and other payables

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Accruals	**7.9**	7.0	**7.6**	6.6
Other creditors	**4.7**	3.1	**4.0**	2.5
Income tax	**2.6**	2.6	**2.6**	2.6
	15.2	12.7	**14.2**	11.7

25. Provisions and contingent liabilities

Group	**FSCS 2016 £m**	**Onerous contracts 2016 £m**	**Other 2016 £m**	**Total 2016 £m**
At beginning of year	**1.8**	**-**	**0.4**	**2.2**
Utilised in the year	**(3.0)**	**-**	**(0.5)**	**(3.5)**
Charge for the year	**2.6**	**0.1**	**1.3**	**4.0**
At end of year	**1.4**	**0.1**	**1.2**	**2.7**

Group	FSCS 2015 £m	Onerous contracts 2015 £m	Other 2015 £m	Total 2015 £m
At beginning of year	2.1	0.5	2.5	5.1
Utilised in the year	(3.9)	(0.6)	(1.8)	(6.3)
Charge/(Release) for the year	3.6	0.1	(0.3)	3.4
At end of year	1.8	-	0.4	2.2

Society	**FSCS 2016 £m**	**Onerous contracts 2016 £m**	**Other 2016 £m**	**Total 2016 £m**
At beginning of year	**1.8**	**-**	**0.1**	**1.9**
Utilised in the year	**(3.0)**	**-**	**(0.3)**	**(3.3)**
Charge for the year	**2.6**	**0.1**	**1.3**	**4.0**
At end of year	**1.4**	**0.1**	**1.1**	**2.6**

Society	FSCS 2015 £m	Onerous contracts 2015 £m	Other 2015 £m	Total 2015 £m
At beginning of year	2.1	0.5	1.3	3.9
Utilised in the year	(3.9)	(0.6)	(1.1)	(5.6)
Charge/(Release) for the year	3.6	0.1	(0.1)	3.6
At end of year	1.8	-	0.1	1.9

Financial Services Compensation Scheme (FSCS)

In common with all regulated UK deposit takers, the Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. During 2008 and 2009 claims were triggered against the FSCS in relation to Bradford & Bingley plc, Kaupthing Singer and Friedlander, Heritable Bank plc, Landsbanki Islands hf, London Scottish Bank plc and Dunfermline Building Society.

The FSCS met these claims by way of loans received from HM Treasury. The terms of these loans were interest only for the first three years, and the FSCS recovers the interest cost, together with ongoing management expenses, by way of annual management levies on members.

The Society FSCS provision reflects market participation up to the reporting date. The provision at 31 March 2016 represents the estimated management expenses levy for the scheme year 2015/16. This provision was calculated based on the Society's current share of protected deposits and the FSCS estimate of total management expenses for the scheme year.

Onerous contracts

The provision for onerous contracts covers the loss anticipated in connection with future lease expenses from non-cancellable lease commitments in branches that the Society has, as part of its branch restructure, decided are no longer required.

Other provisions and contingent liabilities

Other provisions include an allowance for customer claims relating to Payment Protection Insurance (PPI) redress. The charge for the year represents the amounts expected to be settled based on an expected deadline for PPI claims for Spring 2018.

Certain external parties initiated legal proceedings against West Bromwich Mortgage Company Limited (the Company) in relation to an interest rate increase on certain buy to let loans. The rate uplift contributed £8.7m to Group interest receivable in the year to 31 March 2016 and since the application of the rate change in December 2013 has contributed £25.1m. Following our successful defence of this challenge in the High Court an appeal was heard in April 2016, the outcome of which is not yet known. No provision has been included in these financial statements for this matter.

26. Subscribed capital

Group and Society	2016 £m	2015 £m
Permanent interest bearing shares	**74.9**	74.9

In a winding up or dissolution of the Society the claims of the holders of permanent interest bearing shares (PIBS) would rank behind all other creditors of the Society, with the exception of holders of profit participating deferred shares (PPDS) with which the PIBS rank pari-passu, and the claims of members holding shares as to principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon winding up or dissolution of the Society.

With respect to future interest payments, as a condition of the PPDS (see note 27), the Society has undertaken to pay an amount which, when annualised, represents the lower of: 6.15% of the outstanding principal amount of the PIBS and the dividend yield attributable to the PPDS with respect to the prior financial year ending 31 March whose payment is at the discretion of the Society.

27. Profit participating deferred shares

Group and Society	2016 £m	2015 £m
Book value		
Nominal value	**182.5**	182.5
Cumulative fair value adjustments at date of transition	**3.8**	3.8
Capitalised issue costs	**(2.2)**	(2.2)
	184.1	184.1
Cumulative reserve deficit		
At beginning of year	**(7.0)**	(9.4)
Share of profit for the financial year	**2.4**	2.4
	(4.6)	(7.0)
Net value at end of year	**179.5**	177.1

The profit participating deferred shares (PPDS) are entitled to receive a distribution, at the discretion of the Society, of up to 25% of the Group's post-tax profits in the future (calculated prior to payment of the PPDS dividend). No such distribution may be made if the cumulative reserves are in deficit.

28. Financial assets and liabilities at fair value through profit or loss

Financial assets and liabilities are valued at fair value through profit or loss when this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases. The 'Fair Value Option' is used by the Group where financial assets or liabilities would otherwise be measured at amortised cost, the associated derivatives used to economically hedge the risk are held at fair value, and it is not practical to apply hedge accounting. The table below shows the carrying value of financial assets and liabilities that upon initial recognition, or at 1 April 2005 on the adoption of IAS 39, were valued at fair value through profit or loss, and the net gains or losses on these instruments:

	Group 2016 £m	Group 2015 £m
Financial assets at fair value through profit or loss		
Loans fully secured on land		
Carrying value at 31 March	**23.6**	42.6
Net losses in the year	**(0.5)**	-
Financial liabilities at fair value through profit or loss		
Non-recourse finance on securitised advances		
Carrying value at 31 March	**21.8**	38.6
Net losses in the year	**-**	(0.5)
Derivative financial instruments		
Carrying value at 31 March	**(3.0)**	(3.5)
Net gains in the year	**0.5**	0.5

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

Group	Before tax amount 2016 £m	Taxation 2016 £m	Net of tax amount 2016 £m
Available for sale financial assets	**(2.8)**	**0.2**	**(2.6)**
Actuarial losses on defined benefit obligations	**(0.9)**	**0.1**	**(0.8)**
Cash flow hedges	**(0.2)**	**-**	**(0.2)**
Other comprehensive income	**(3.9)**	**0.3**	**(3.6)**

Group	Before tax amount 2015 £m	Taxation 2015 £m	Net of tax amount 2015 £m
Available for sale financial assets	(1.1)	0.2	(0.9)
Actuarial losses on defined benefit obligations	(10.7)	2.1	(8.6)
Cash flow hedges	(0.3)	-	(0.3)
Other comprehensive income	(12.1)	2.3	(9.8)

Society	Before tax amount 2016 £m	Taxation 2016 £m	Net of tax amount 2016 £m
Available for sale financial assets	**(2.8)**	**0.2**	**(2.6)**
Actuarial losses on defined benefit obligations	**(0.9)**	**0.1**	**(0.8)**
Other comprehensive income	**(3.7)**	**0.3**	**(3.4)**

Society	Before tax amount 2015 £m	Taxation 2015 £m	Net of tax amount 2015 £m
Available for sale financial assets	(1.1)	0.2	(0.9)
Actuarial losses on defined benefit obligations	(10.7)	2.1	(8.6)
Other comprehensive income	(11.8)	2.3	(9.5)

30. Retirement benefit obligations

Group and Society	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Defined benefit pension scheme (asset)/obligation	**(0.8)**	7.5	1.4	(0.4)	0.4

Defined benefit plans

The Society operates the West Bromwich Building Society Staff Retirement Scheme (SRS), a funded pension scheme providing benefits for some of its employees based on final pensionable emoluments. The assets of the scheme are held in a separate trustee administered fund. In addition, the Society has some unregistered arrangements in place in respect of former Directors. The financial effect of these arrangements is included in this note.

The results of a formal actuarial valuation at 31 March 2013 carried out by the appointed actuary to the scheme were updated to the accounting date by an independent qualified actuary in accordance with IAS 19, 'Employee Benefits'. The next formal valuation as at 31 March 2016 has commenced, but the results of this are not yet available.

The Society closed the scheme to the future accrual of benefits with effect from 1 August 2009, at which date all previously active members became entitled to deferred pensions in the scheme.

The agreed Schedule of Contributions to the Pension scheme was supported by a priority charge over residential mortgage backed securities, specifically Granite Master Issuer Notes. Following the Government's decision to sell the Granite Mortgage loans the Notes were fully redeemed and the assets over which there was a charge were fully repaid. The funding was paid into the Pension Scheme, resulting in total cash contributions paid in 2015/16 of £9.5m. No further amounts are due under the Schedule of Contributions agreed following the last triennial valuation.

The scheme is subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, sets out the framework for funding defined benefit occupational pension schemes in the UK.

IAS 19 allows an employer to recognise a surplus as an asset to the extent that it is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme, even if the refunds may only be available at some distant time in the future, such as after the last benefit has been paid.

The key assumptions used by the actuary in the updated calculation were:

Group and Society	2016	2015	2014	2013	2012
Pension increases in payment (RPI capped at 5%)	**2.8%**	2.8%	3.3%	3.3%	3.2%
Pension increases in payment (CPI capped at 2.5%)	**1.6%**	1.6%	2.0%	2.0%	1.9%
Discount rate	**3.7%**	3.5%	4.6%	4.4%	4.8%
Life expectancy of male aged 65 at year end date	**23.0**	22.9	22.9	22.3	22.2
Life expectancy of female aged 65 at year end date	**24.4**	24.3	24.2	23.7	24.5
Life expectancy of male aged 65 at year end date plus 20 years	**24.4**	24.3	24.2	24.6	23.7
Life expectancy of female aged 65 at year end date plus 20 years	**25.9**	25.8	25.7	26.1	26.0

The sensitivity of the defined benefit obligation to changes in the significant actuarial assumptions is shown in the table below:

Group and Society	2016 £m	2015 £m
Discount rate		
Effect on defined benefit obligation of a 1% increase	**(15.8)**	(17.3)
Inflation		
Effect on defined benefit obligation of a 1% increase	**13.3**	14.8
Life expectancy		
Effect on defined benefit obligation of a 1 year increase	**2.8**	2.8

30. Retirement benefit obligations (continued)

The amounts recognised in the Statement of Financial Position are as follows:

Group and Society	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Present value of funded obligations	**93.6**	97.8	85.1	87.9	79.1
Present value of unfunded obligations	**0.6**	1.0	0.9	0.9	0.8
	94.2	98.8	86.0	88.8	79.9
Fair value of scheme assets	**(95.0)**	(91.3)	(84.6)	(89.2)	(79.5)
Net (asset)/liability in the Statement of Financial Position	**(0.8)**	7.5	1.4	(0.4)	0.4

The amounts recognised in the Income Statement are as follows:

Group and Society	2016 £m	2015 £m	2014 £m
Interest cost	**3.4**	3.9	3.8
Interest receivable on plan assets	**(3.3)**	(3.9)	(3.9)
Running costs	**0.2**	0.2	0.4
Total pension fund cost	**0.3**	0.2	0.3

Running costs, other than those associated with management of scheme assets, are shown in administrative expenses whilst interest cost and interest receivable on plan assets are disclosed as other operating income.

Change in benefit obligations

Group and Society	2016 £m	2015 £m	2014 £m
Benefit obligations at beginning of year	**98.8**	86.0	88.8
Interest cost	**3.4**	3.9	3.8
Actuarial (gains)/losses	**(5.2)**	12.2	(3.7)
Running costs (release of reserve)	**(0.1)**	(0.1)	(0.1)
Benefits paid	**(2.7)**	(3.2)	(2.8)
Benefit obligations at end of year	**94.2**	98.8	86.0

Change in scheme assets

Group and Society	2016 £m	2015 £m	2014 £m
Fair value of scheme assets at beginning of year	**91.3**	84.6	89.2
Interest receivable on plan assets	**3.3**	3.9	3.9
Actuarial (losses)/gains	**(6.1)**	1.5	(9.9)
Contribution by employer	**9.5**	4.8	4.7
Running costs	**(0.3)**	(0.3)	(0.5)
Benefits paid	**(2.7)**	(3.2)	(2.8)
Fair value of scheme assets at end of year	**95.0**	91.3	84.6

The amount recognised outside profit and loss in the Statement of Comprehensive Income for 2015/16 is an actuarial loss of £0.9m (2014/15: £10.7m). The cumulative amount recognised outside profit and loss at 31 March 2016 is an actuarial loss of £43.2m.

History of experience gains and losses

Group and Society	2016	2015	2014	2013	2012
Experience (losses)/gains on scheme assets:					
Amount (£m)	**(6.1)**	1.5	(9.9)	5.8	0.6
Percentage of scheme assets	**(6%)**	2%	(12%)	7%	1%
Experience (gains)/losses on scheme liabilities:					
Amount (£m)	**(1.7)**	(1.3)	(0.4)	(0.2)	2.1
Percentage of scheme liabilities	**(2%)**	(1%)	(0%)	(0%)	3%

Scheme assets

Provisional asset information at bid value was supplied by the investment managers. The value of the invested assets at 31 March 2016 was £95.0m, analysed as follows:

Group and Society	2016 £m	2015 £m	2014 £m
Diversified growth fund	**53.5**	51.8	50.0
Liability driven investment	**23.6**	19.2	17.5
Insurance asset	**17.2**	18.4	16.5
Cash and other assets	**0.7**	1.9	0.6
	95.0	91.3	84.6

As part of its asset and liability matching investment strategy, designed to mitigate inflation and interest rate risk exposure, the Scheme has invested in three pooled liability driven investment funds. In addition, an insurance policy has been purchased to provide income which provides a specific match against the liabilities arising from a large proportion of the Scheme's current pensioners.

With a view to reducing the investment risk within the Scheme's asset portfolio, a large proportion of the investments are now held in Diversified Growth Funds (DGFs), rather than direct equity funds. Although DGFs do themselves include equity investments this is part of a more diversified strategy which is expected to reduce overall investment volatility whilst still maintaining relatively strong returns.

Stakeholder scheme

The total cost for the year of the stakeholder plan to the Group and Society was £1.0m (2014/15: £0.9m) and there were no outstanding contributions at the end of the year (2014/15: £nil).

For the period through to 31 July 2009 staff could contribute between 2% and 9% with the Society contributing on a sliding scale between 2% and 7%. From 1 August 2009 staff have been able to contribute between 2% and 10% with the Society providing matched funding.

31. Financial instruments

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity of another entity.

The Group is a retailer of financial instruments, mainly in the form of mortgages and savings. The Group uses wholesale financial instruments to invest liquid asset balances and raise wholesale funding, and to manage the risks arising from its operations. As a result of these activities, the Group is exposed to a variety of risks, the most significant of which are credit risk, liquidity risk and market risk (principally interest rate, foreign currency and equity risk). These risks are described in notes 32 to 34.

The use of derivative financial instruments for risk management purposes is described in note 33.

Classification of financial assets and financial liabilities

The following tables show the classification of the Group's and Society's financial assets and liabilities:

At 31 March 2016

Group	Amortised Cost £m	Available for sale £m	Fair value through profit or loss £m	Total £m
Assets				
Cash and balances with the Bank of England	215.4	-	-	**215.4**
Loans and advances to credit institutions	204.0	-	-	**204.0**
Investment securities	-	410.1	-	**410.1**
Derivative financial instruments	-	-	8.9	**8.9**
Loans and advances to customers	4,715.4	-	23.6	**4,739.0**
Total financial assets	**5,134.8**	**410.1**	**32.5**	**5,577.4**
Non-financial assets				**189.7**
Total assets				**5,767.1**

	Other financial liabilities £m	Fair value through profit or loss £m	Total £m
Liabilities			
Shares	4,385.1	-	**4,385.1**
Amounts due to credit institutions	259.0	-	**259.0**
Amounts due to other customers	157.0	-	**157.0**
Derivative financial instruments	-	77.1	**77.1**
Debt securities in issue	346.8	21.8	**368.6**
Total financial liabilities	**5,147.9**	**98.9**	**5,246.8**
Non-financial liabilities			**22.6**
Total liabilities			**5,269.4**

At 31 March 2015

Group	Amortised Cost £m	Available for sale £m	Fair value through profit or loss £m	Total £m
Assets				
Cash and balances with the Bank of England	260.8	-	-	260.8
Loans and advances to credit institutions	186.5	-	-	186.5
Investment securities	-	274.3	-	274.3
Derivative financial instruments	-	-	19.0	19.0
Loans and advances to customers	4,634.8	-	42.6	4,677.4
Total financial assets	5,082.1	274.3	61.6	5,418.0
Non-financial assets				182.4
Total assets				5,600.4

	Other financial liabilities £m	Fair value through profit or loss £m	Total £m
Liabilities			
Shares	3,988.0	-	3,988.0
Amounts due to credit institutions	393.3	-	393.3
Amounts due to other customers	152.4	-	152.4
Derivative financial instruments	-	80.8	80.8
Debt securities in issue	428.5	38.6	467.1
Total financial liabilities	4,962.2	119.4	5,081.6
Non-financial liabilities			26.9
Total liabilities			5,108.5

31. Financial instruments (continued)

Classification of financial assets and financial liabilities (continued)

At 31 March 2016

Society	Amortised Cost £m	Available for sale £m	Fair value through profit or loss £m	Total £m
Assets				
Cash and balances with the Bank of England	215.4	-	-	**215.4**
Loans and advances to credit institutions	93.2	-	-	**93.2**
Investment securities	889.9	410.1	-	**1,300.0**
Derivative financial instruments	-	-	8.8	**8.8**
Loans and advances to customers	2,380.1	-	-	**2,380.1**
Investments	1,669.2	-	-	**1,669.2**
Total financial assets	**5,247.8**	**410.1**	**8.8**	**5,666.7**
Non-financial assets				**58.5**
Total assets				**5,725.2**

	Other financial liabilities £m	Fair value through profit or loss £m	Total £m
Liabilities			
Shares	4,385.1	-	**4,385.1**
Amounts due to credit institutions	259.0	-	**259.0**
Amounts due to other customers	500.0	-	**500.0**
Derivative financial instruments	-	67.4	**67.4**
Total financial liabilities	**5,144.1**	**67.4**	**5,211.5**
Non-financial liabilities			**17.4**
Total liabilities			**5,228.9**

At 31 March 2015

Society	Amortised Cost £m	Available for sale £m	Fair value through profit or loss £m	Total £m
Assets				
Cash and balances with the Bank of England	260.8	-	-	260.8
Loans and advances to credit institutions	82.1	-	-	82.1
Investment securities	995.8	274.3	-	1,270.1
Derivative financial instruments	-	-	19.0	19.0
Loans and advances to customers	1,984.5	-	-	1,984.5
Investments	1,901.4	-	-	1,901.4
Total financial assets	5,224.6	274.3	19.0	5,517.9
Non-financial assets				52.0
Total assets				5,569.9

	Other financial liabilities £m	Fair value through profit or loss £m	Total £m
Liabilities			
Shares	3,988.0	-	3,988.0
Amounts due to credit institutions	393.3	-	393.3
Amounts due to other customers	606.4	-	606.4
Derivative financial instruments	-	69.0	69.0
Total financial liabilities	4,987.7	69.0	5,056.7
Non-financial liabilities			21.6
Total liabilities			5,078.3

The Group and Society financial assets and liabilities recorded at fair value through profit or loss consist of derivative financial instruments and instruments that were designated as such upon initial recognition to avoid an accounting mismatch. As discussed in notes 1 and 28, these are economically hedged where it is not practical to apply hedge accounting.

31. Financial instruments (continued)

Fair values of financial assets and financial liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Group determines fair values by the following three tier valuation hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Valuation techniques where all inputs are taken from observable market data, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Valuation techniques where significant inputs are not based on observable market data.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist and other valuation models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, equity index prices and expected price volatilities. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length. Observable prices are those that have been seen either from counterparties or from market pricing sources including Bloomberg. The use of these depends upon the liquidity of the relevant market.

Financial assets and financial liabilities held at amortised cost

The tables below show the fair values of the Group's and Society's financial assets and liabilities held at amortised cost in the Statements of Financial Position, analysed according to the fair value hierarchy described above.

At 31 March 2016

Group	Carrying value £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Cash and balances with the Bank of England	**215.4**	215.4	-	-	**215.4**
Loans and advances to credit institutions	**204.0**	-	204.0	-	**204.0**
Loans and advances to customers	**4,715.4**	-	-	4,684.7	**4,684.7**
	5,134.8	**215.4**	**204.0**	**4,684.7**	**5,104.1**
Financial liabilities					
Shares	**4,385.1**	-	-	4,371.6	**4,371.6**
Amounts due to credit institutions	**259.0**	-	259.0	-	**259.0**
Amounts due to other customers	**157.0**	-	157.0	-	**157.0**
Debt securities in issue	**346.8**	329.9	8.1	-	**338.0**
	5,147.9	**329.9**	**424.1**	**4,371.6**	**5,125.6**

At 31 March 2015

Group	Carrying value £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Cash and balances with the Bank of England	260.8	260.8	-	-	260.8
Loans and advances to credit institutions	186.5	-	186.5	-	186.5
Loans and advances to customers	4,634.8	-	-	4,604.5	4,604.5
	5,082.1	260.8	186.5	4,604.5	5,051.8
Financial liabilities					
Shares	3,988.0	-	-	3,982.1	3,982.1
Amounts due to credit institutions	393.3	-	393.3	-	393.3
Amounts due to other customers	152.4	-	152.4	-	152.4
Debt securities in issue	428.5	417.4	7.8	-	425.2
	4,962.2	417.4	553.5	3,982.1	4,953.0

At 31 March 2016

Society	Carrying value £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Cash and balances with the Bank of England	**215.4**	215.4	-	-	**215.4**
Loans and advances to credit institutions	**93.2**	-	93.2	-	**93.2**
Investment securities	**889.9**	58.6	830.5	-	**889.1**
Loans and advances to customers	**2,380.1**	-	-	2,404.0	**2,404.0**
	3,578.6	**274.0**	**923.7**	**2,404.0**	**3,601.7**
Financial liabilities					
Shares	**4,385.1**	-	-	4,371.6	**4,371.6**
Amounts due to credit institutions	**259.0**	-	259.0	-	**259.0**
Amounts due to other customers	**500.0**	-	500.0	-	**500.0**
	5,144.1	**-**	**759.0**	**4,371.6**	**5,130.6**

At 31 March 2015

Society	Carrying value £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Cash and balances with the Bank of England	260.8	260.8	-	-	260.8
Loans and advances to credit institutions	82.1	-	82.1	-	82.1
Investment securities	995.8	66.6	928.3	-	994.9
Loans and advances to customers	1,984.5	-	-	2,046.0	2,046.0
	3,323.2	327.4	1,010.4	2,046.0	3,383.8
Financial liabilities					
Shares	3,988.0	-	-	3,982.1	3,982.1
Amounts due to credit institutions	393.3	-	393.3	-	393.3
Amounts due to other customers	606.4	-	606.4	-	606.4
	4,987.7	-	999.7	3,982.1	4,981.8

31. Financial instruments (continued)

a) Loans and advances to customers
The fair value of loans and advances to customers has been calculated on an individual loan basis, taking into account factors such as impairment and interest rates. The fair values have been calculated on a product basis and as such do not necessarily represent the value that could have been obtained for a portfolio if it were sold at 31 March 2016.

b) Shares and borrowings
The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new deposits with similar remaining maturity. The fair values have been calculated on a product basis and as such do not necessarily represent the value that could have been obtained for a portfolio if it were sold at 31 March 2016.

c) Debt securities in issue
The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

Financial assets and financial liabilities held at fair value through profit or loss

The tables below show the fair values of the Group's and Society's financial assets and liabilities held at fair value in the Statements of Financial Position, analysed according to the fair value hierarchy described previously.

Group	**Level 1 2016 £m**	**Level 2 2016 £m**	**Total 2016 £m**
Financial assets			
Investment securities	359.0	51.1	**410.1**
Derivative financial instruments	-	8.9	**8.9**
Loans and advances to customers	-	23.6	**23.6**
	359.0	**83.6**	**442.6**
Financial liabilities			
Derivative financial instruments	-	77.1	**77.1**
Debt securities in issue	-	21.8	**21.8**
	-	**98.9**	**98.9**

Group	Level 1 2015 £m	Level 2 2015 £m	Total 2015 £m
Financial assets			
Investment securities	274.3	-	274.3
Derivative financial instruments	-	19.0	19.0
Loans and advances to customers	-	42.6	42.6
	274.3	61.6	335.9
Financial liabilities			
Derivative financial instruments	-	80.8	80.8
Debt securities in issue	-	38.6	38.6
	-	119.4	119.4

Society	**Level 1 2016 £m**	**Level 2 2016 £m**	**Total 2016 £m**
Financial assets			
Investment securities	359.0	51.1	**410.1**
Derivative financial instruments	-	8.8	**8.8**
	359.0	**59.9**	**418.9**
Financial liabilities			
Derivative financial instruments	-	67.4	**67.4**
	-	**67.4**	**67.4**

Society	Level 1 2015 £m	Level 2 2015 £m	Total 2015 £m
Financial assets			
Investment securities	274.3	-	274.3
Derivative financial instruments	-	19.0	19.0
	274.3	19.0	293.3
Financial liabilities			
Derivative financial instruments	-	69.0	69.0
	-	69.0	69.0

32. 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 (consumers - residential mortgages, including buy to let);
- businesses (non-consumers - previous commercial lending and elements of buy to let exposure). The Group ceased new commercial lending and buy to let in July 2008; and
- wholesale counterparties (including other financial institutions). Specifically 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.

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, measure, monitor, manage and report credit risk within the Group's risk appetite.

The Risk Committee is responsible for the oversight of credit risk appetite that has been established by the Board and for approving lending policy and setting limits on credit exposures, which are monitored and reviewed on a monthly basis. The minutes of this committee are presented to the Board. This committee is supported by three Executive sub-committees; the Executive Risk Committee, the Residential Credit Committee and the Commercial Loans Risk Committee. Their role in the credit risk framework is outlined below:

- The Executive Risk Committee (ERC) is responsible for providing the Executive and Risk Committee with an enterprise wide view of the risk profile of the Society including current and potential risks. The ERC is also accountable for driving the detailed implementation of the Society's Risk Management Framework. In the context of Credit Risk the Executive Risk Committee proposes to Risk Committee any recommendations for Board approval regarding the Residential Lending Statement, Credit Risk Appetite Statement and Lending and Security Policies.
- The Residential Credit Committee is responsible for the monitoring of the Group's residential credit exposures and approving changes to the credit scoring systems that are utilised. In addition, the Committee reviews the type and quality of approved residential mortgage business and appraises actual arrears and repossession levels against trends and industry averages. A summary of the minutes of this committee are presented to the Executive Risk Committee.
- The Commercial Loans Risk Committee reviews individual commercial loans at levels mandated by the Board. This may involve reviewing individual cases on a quarterly, half yearly or annual basis.

The Group adopts a responsible approach to lending ensuring that loans are, and are expected to remain affordable.

The maximum credit risk exposure is the carrying value as shown in the tables on pages 78 to 79. The Group's most significant exposures to credit risk are loans secured on UK residential properties and loans secured on UK land.

Residential assets

Concentration by loan type	**Group 2016 £m**	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
Prime owner occupied	**2,045.6**	1,641.2	**1,850.4**	1,414.1
Buy to let	**1,974.7**	2,156.5	**488.4**	534.5
Other	**90.9**	100.9	**1.9**	2.2
Gross balances	**4,111.2**	3,898.6	**2,340.7**	1,950.8
Impairment provisions	**(20.8)**	(23.7)	**(10.6)**	(13.0)
Fair value adjustments	**13.0**	13.4	**12.4**	9.0
	4,103.4	3,888.3	**2,342.5**	1,946.8

The table below shows the geographic spread of the residential loan portfolio at the year end date:

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
East Anglia	**110.7**	99.9	**56.2**	38.7
East Midlands	**380.7**	344.6	**215.2**	162.5
Greater London	**591.2**	616.5	**243.7**	219.3
Northern Ireland	**5.8**	6.2	**1.1**	1.2
North	**147.7**	127.3	**83.8**	58.1
North West	**460.8**	419.7	**261.9**	209.0
Scotland	**126.8**	140.2	**40.3**	47.2
South East	**742.1**	707.4	**413.1**	336.7
South West	**336.5**	301.6	**195.8**	148.2
Wales	**194.7**	188.2	**112.3**	99.8
West Midlands	**713.1**	687.5	**554.0**	516.0
Yorkshire	**301.1**	259.5	**163.3**	114.1
	4,111.2	3,898.6	**2,340.7**	1,950.8

The table below shows analysis of the indexed loan to value distribution of the residential loan portfolio at the year end date:

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
>95%	**78.8**	175.8	**34.8**	49.5
90% – 95%	**166.4**	236.5	**84.4**	41.6
85% – 90%	**326.3**	323.7	**125.5**	118.2
75% – 85%	**765.9**	844.0	**400.2**	391.9
50% – 75%	**1,930.8**	1,601.9	**1,096.8**	821.7
<50%	**843.0**	716.7	**599.0**	527.9
	4,111.2	3,898.6	**2,340.7**	1,950.8

The Group's average indexed loan to value at the year end date is 59.9% (2014/15: 59.9%).

The table below provides further information on the Group's residential loans and advances to customers by payment due status at 31 March 2016:

	Group 2016 £m	Group* 2015 £m	**Society 2016 £m**	Society* 2015 £m
Loans neither past due or impaired	**4,001.5**	3,766.5	**2,283.9**	1,877.9
Past due but not impaired				
Past due 1 to 3 months	**35.8**	41.5	**12.3**	12.6
Impaired				
Past due 1 to 3 months	**22.6**	35.1	**21.8**	34.4
Past due 3 to 6 months	**16.2**	23.3	**6.3**	9.7
Past due 6 to 12 months	**16.0**	20.0	**6.7**	7.7
Past due over 12 months	**8.1**	9.3	**3.1**	5.4
Possessions	**11.0**	2.9	**6.6**	3.1
	4,111.2	3,898.6	**2,340.7**	1,950.8

* Prior year comparatives have been reclassified. Loans past due by more than 3 months with no individual provision for impairment have been reclassified as impaired, based on the 3 months plus arrears status.

The following table indicates collateral held against residential loans and advances to customers:

Fair value of collateral held	**Group 2016 £m**	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
Not impaired	**7,604.8**	7,023.4	**4,541.2**	3,913.5
Impaired	**92.5**	58.0	**52.5**	31.0
Possessions	**10.4**	10.8	**5.6**	4.8
	7,707.7	7,092.2	**4,599.3**	3,949.3

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 renegotiated loans

A range of forbearance strategies are employed in order to work with our borrowers to control arrears and, wherever possible, avoid repossession. These are set out in our Arrears and Possessions Policy. The agreed strategy will reflect the customer's individual circumstances and will be used in line with industry guidance. Forbearance arrangements include extended payment terms, a reduction in interest or principal repayments, and approved external debt management plans.

Some of these forbearance activities are applied on a small number of commercial mortgages. Loans that have been restructured (generally via a term extension) and would otherwise have been past due or impaired are classified as renegotiated. The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition. Interest is recorded on renegotiated loans on the basis of new contractual terms following renegotiation. At 31 March 2016 there were 41 accounts subject to forbearance (2015: 42 accounts).

32. Credit risk (continued)

The table below analyses residential mortgage balances with renegotiated terms at the year end date:

Group	**Arrangements 2016 £m**	**Concessions 2016 £m**	**Capitalisation 2016 £m**	**Short-term interest only conversions 2016 £m**	**Term extensions 2016 £m**	**Total 2016 £m**
Loans neither past due or impaired	2.1	0.7	2.3	-	10.6	**15.7**
Past due but not impaired						
Past due 1 to 3 months	4.3	0.7	0.2	-	0.2	**5.4**
Impaired						
Not past due but impaired	-	-	0.1	-	0.1	**0.2**
Past due 1 to 3 months	0.1	0.2	0.1	-	0.2	**0.6**
Past due 3 to 6 months	6.0	0.4	0.2	-	0.2	**6.8**
Past due 6 to 12 months	7.0	0.3	0.3	-	0.2	**7.8**
Past due over 12 months	2.2	-	-	0.2	-	**2.4**
	21.7	**2.3**	**3.2**	**0.2**	**11.5**	**38.9**

Group*	Arrangements 2015 £m	Concessions 2015 £m	Capitalisation 2015 £m	Short-term interest only conversions 2015 £m	Term extensions 2015 £m	Total 2015 £m
Loans neither past due or impaired	8.2	0.8	3.0	2.0	6.6	20.6
Past due but not impaired						
Past due 1 to 3 months	10.3	0.7	1.3	-	0.2	12.5
Impaired						
Not past due but impaired	-	-	-	-	-	-
Past due 1 to 3 months	-	-	-	-	-	-
Past due 3 to 6 months	8.2	0.4	0.3	0.4	0.5	9.8
Past due 6 to 12 months	8.0	0.5	0.5	0.3	0.4	9.7
Past due over 12 months	3.0	0.2	0.2	0.2	0.1	3.7
	37.7	2.6	5.3	2.9	7.8	56.3

* Prior year comparatives have been reclassified. Loans past due by more than 3 months with no individual provision for impairment have been reclassified as impaired, based on the 3 months plus arrears status.

Commercial assets

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Concentration by loan type				
Loans secured on commercial property	**610.4**	757.6	**13.8**	13.8
Loans secured on residential property	**20.2**	22.9	**16.6**	16.6
Gross balances	**630.6**	780.5	**30.4**	30.4
Impairment provisions	**(43.9)**	(46.0)	**-**	-
Fair value adjustments	**49.0**	54.6	**7.2**	7.3
	635.7	789.1	**37.6**	37.7

Of the fair value adjustments, £48.7m (2014/15: £54.5m) relate to loans secured on commerical property. £0.3m (2014/15: £0.1m) relate to loans secured on residential property.

The analysis of loans secured on commercial property by industry type is as follows:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Healthcare and leisure	**167.0**	186.4	**-**	-
Industrial and warehouse	**23.1**	34.9	**3.5**	3.5
Office	**48.7**	117.6	**4.0**	4.0
Retail	**350.2**	395.7	**6.3**	6.3
Other	**21.4**	23.0	**-**	-
	610.4	757.6	**13.8**	13.8

The table below shows the geographic spread of the commercial loan portfolio at the year end date:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
East Anglia	**14.5**	16.7	**0.1**	0.1
East Midlands	**38.4**	43.2	**2.0**	2.0
Greater London	**74.1**	138.0	**19.1**	19.1
North	**41.7**	47.6	**-**	-
North West	**202.7**	215.8	**3.5**	3.5
Scotland	**16.8**	20.3	**0.9**	0.9
South East	**93.3**	118.9	**1.4**	1.4
South West	**24.4**	45.1	**0.1**	0.1
Wales	**18.7**	20.8	**0.5**	0.5
West Midlands	**59.7**	63.3	**-**	-
Yorkshire	**46.3**	50.8	**2.8**	2.8
	630.6	780.5	**30.4**	30.4

The Group's average indexed loan to value at the year end date is 82.9% (2014/15: 93.1%).

32. Credit risk (continued)

The table below provides further information on the Group's commercial assets by payment due status at 31 March 2016:

	Group 2016 £m	Group* 2015 £m	Society 2016 £m	Society 2015 £m
Loans neither past due or impaired	358.4	550.9	30.4	30.4
Not past due but impaired	136.3	115.6	-	-
Past due but not impaired				
Past due up to 3 months	4.9	1.4	-	-
Impaired				
Past due up to 3 months	5.0	4.0	-	-
Past due 3 to 6 months	6.5	3.1	-	-
Past due 6 to 12 months	11.1	-	-	-
Past due over 12 months	108.4	105.5	-	-
	630.6	780.5	30.4	30.4

* Prior year comparatives have been reclassified. Loans past due by more than 3 months with no individual provision for impairment have been reclassified as impaired, based on the 3 months plus arrears status.

The following table indicates collateral held against commercial loans and advances to customers:

Group

Value of collateral held	Indexed 2016 £m	Unindexed 2016 £m	Indexed 2015 £m	Unindexed 2015 £m
Not impaired	503.6	438.6	766.2	675.3
Impaired	192.4	170.2	117.9	108.4
	696.0	608.8	884.1	783.7

Society

Value of collateral held	Indexed 2016 £m	Unindexed 2016 £m	Indexed 2015 £m	Unindexed 2015 £m
Not impaired	84.8	71.5	79.2	71.5

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

The analysis below sets out the commercial mortgage balances with evidence of forbearance and renegotiated terms during the past 12 months.

Group	Arrangements 2016 £m	Capitalisation 2016 £m	Term extensions 2016 £m	Total 2016 £m
Loans neither past due or impaired	0.5	-	67.6	**68.1**
Not past due but impaired	4.6	11.3	20.6	**36.5**
Impaired				
Past due over 12 months	19.4	-	-	**19.4**
	24.5	**11.3**	**88.2**	**124.0**

Group*	Arrangements 2015 £m	Capitalisation 2015 £m	Term extensions 2015 £m	Total 2015 £m
Loans neither past due or impaired	0.5	11.0	83.6	95.1
Not past due but impaired	5.0	-	23.7	28.7
Impaired				
Past due 3 to 6 months	2.4	-	2.4	4.8
Past due over 12 months	18.9	-	-	18.9
	26.8	11.0	109.7	147.5

* Prior year comparatives have been reclassified. Loans past due by more than 3 months with no individual provision for impairment have been reclassified as impaired, based on the 3 months plus arrears status.

Credit risk – impairment

As described in note 1, the Group uses a number of experience-based and judgemental factors to determine the appropriate level of residential impairment provisions. The key assumptions applied are as follows:

Group and Society	2016	2015
Probability of possession given default*	**10% to 50%**	10% to 50%
Loss emergence period	**6 to 12 months**	6 to 12 months
House price inflation		
2015/16	**5.20%**	4.50%
2016/17	**4.72%**	4.50%
2017/18	**4.00%**	4.50%
2018/19	**3.92%**	4.50%
2019/20	**3.92%**	4.50%
2020/21 onwards	**3.00%**	3.00%
Forced sale discount	**20% to 40%**	20% to 42%

* Default is defined as 3 months+ arrears

32. Credit risk (continued)

Credit risk – loans and advances to credit institutions and investment 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 judgement. In making this judgement, 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 March 2016 and 31 March 2015 none of the Group's treasury investments were either past due or impaired and no impairment charges were required during the year.

At 31 March 2016, 100.0% (2014/15: 100.0%) of the Group's treasury assets were invested in or deposited with counterparties rated single A or better or classified as a Global Systemically Important Counterparty (GSIC). The Group has no exposure in its liquidity portfolio to Greece, Ireland, Italy, Portugal or Spain, the emerging markets or to any mortgage market other than the UK and no exposure to non-UK sovereign debt. The tables below show the relative concentrations of the Group's treasury investment portfolio, all of which are denominated in sterling:

	Group 2016 £m	Group 2015 £m	**Society 2016 £m**	Society 2015 £m
Concentration by credit grading				
AAA	**162.9**	126.3	**162.9**	126.3
AA+ to AA-	**353.9**	418.8	**295.6**	369.4
A+ to A-	**290.1**	167.9	**237.7**	112.9
BBB+	**21.6**	-	**21.6**	-
Building societies	**1.0**	8.6	**1.0**	8.6
Other	**-**	-	**889.8**	995.8
	829.5	721.6	**1,608.6**	1,613.0
Concentration by sector				
Financial institutions	**451.2**	331.0	**340.4**	226.6
Asset backed securities	**109.4**	84.5	**999.3**	1,080.3
Supranational institutions	**53.5**	45.3	**53.5**	45.3
Sovereign	**215.4**	260.8	**215.4**	260.8
	829.5	721.6	**1,608.6**	1,613.0
Concentration by region				
UK	**626.6**	547.0	**1,475.1**	1,508.4
Europe (excluding UK)	**86.3**	87.0	**16.9**	17.0
North America	**32.9**	12.9	**32.9**	12.9
Australasia	**28.8**	29.4	**28.8**	29.4
Supranational	**53.5**	45.3	**53.5**	45.3
Asia	**1.4**	-	**1.4**	-
	829.5	721.6	**1,608.6**	1,613.0

33. Market risk

Market risk is the potential adverse change in Group income, or the value of Group net worth, arising from movements in interest rates, exchange rates, equity prices or other market prices. The Board recognises that the effective management of market risk is essential to the maintenance of stable earnings and the preservation of member value.

The Group's exposure to market risk is governed by the Board approved Treasury and Financial Risks Management Policy, which sets out the nature of risks that may be taken and defines aggregate risk limits. Within this Policy, the Board has delegated responsibility for the management and control of market rate risk to the Assets & Liabilities Committee (ALCo). At each meeting, ALCo reviews reports which show the Group's current and forecast exposure to market risks together with the results of extensive stress testing.

The Society's Assets and Liabilities Management function is responsible for operational management of the Group's exposure to market risk. It achieves this by taking advantage of natural hedges arising within the Group's businesses and, for the purpose of reducing risk, transacting appropriate hedging instruments where no natural hedges exist.

Interest rate risk

The Group's exposure to interest rate risk is reported against target operating ranges set by ALCo, which themselves fall within Board Policy limits. The effect upon the Group's current and forecast net market value of assets and liabilities is determined for parallel yield curve shifts in the range +2% to -2%, subject to a floor at 0%, and for a variety of stressed non-parallel yield curve shifts, including extreme convergent and divergent Bank Rate and LIBOR paths. The impact upon net interest income is also assessed for rate movements using the same parallel and non-parallel stress rates, including convergent and divergent Bank Rate and LIBOR paths.

Analysis is also presented to show the mismatches between assets and liabilities whose rates move in line with different variable rate benchmarks such as Bank Rate, LIBOR and rates administered by the Group. Such mismatches generate additional interest rate risks (Basis Risk) to those assessed by parallel and non-parallel shift analysis. The Board has imposed limits upon these absolute basis mismatches.

To ensure that the overall reported interest rate risk position does not mask excessive offsetting concentrations in different periods, reprice gap concentration limits are in place to limit the maximum mismatch between assets and liabilities repricing in any one month. In conducting this analysis, general reserves, PPDS and PIBS are allocated over a range of time buckets against treasury and other assets in accordance with targets set by ALCo. The resulting 'reverse cumulative gap report' allows the income and market value sensitivity of a one basis point movement in interest rates upon the whole balance sheet to be calculated.

The Group's gap and basis mismatch positions are reported quarterly to the Prudential Regulation Authority (PRA). The levels of Group pre-tax interest rate risk exposures to a +2% parallel shift, through the reporting period were as follows:

	At 31 March 2016 £m	Average 2016 £m	High 2016 £m	Low 2016 £m
Market value	**(0.3)**	(1.0)	(1.7)	(0.3)
Net interest income	**(0.1)**	(1.0)	(1.5)	(0.1)

Foreign currency risk

The Group had no foreign currency exposure at 31 March 2016 (2014/15: £nil).

Equity risk

Equity risk arises from index linked savings products offered by the Group and is managed through the use of derivative contracts. The Group's only exposure to equity risk at 31 March 2016 was £47.9m (2014/15: £85.4m) of fully hedged savings products.

Derivative financial instruments

Instruments used for risk management purposes include derivative financial instruments (derivatives). Derivatives are instruments whose value is derived from one or more underlying price, rate or index (such as interest rates, exchange rates or stock market indices) but have a smaller or no initial net investment relative to financial assets/liabilities offering the same risk/return, as cash flows are generally settled at a future date.

The Group uses derivatives to reduce market risk in its daily activities. Derivatives are not used in trading activity or for speculative purposes. The nature of these instruments means that the nominal value of these transactions is not included in the Statements of Financial Position. The interest payments, receipts and changes in fair value of effective hedges are recognised in the Income Statement. Fair values are recorded in the Statements of Financial Position.

Types of derivatives

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

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

Activity	Risk	Managed by
Management of the investment of reserves and other non-interest bearing liabilities	Sensitivity to changes in interest rates	Matching against fixed rate assets
Fixed rate mortgage lending and other assets	Sensitivity to rises in interest rates	Pay fixed rate interest rate swaps, matching against fixed rate liabilities
Fixed rate savings products and funding	Sensitivity to falls in interest rates	Receive fixed rate interest rate swaps, matching against fixed rate receipts
Equity linked investment products	Sensitivity to changes in equity indices	Equity linked swaps and options
Capped, collared or floored products	Sensitivity to changes in interest rates	Matching against appropriate cap, collar or floor derivatives or suitable assets or liabilities

34. 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 exposure to liquidity risk is governed by the Liquidity and Funding Policy sections of the Board approved Treasury and Financial Risks Management Policy.

The Liquidity and Funding Policy limit framework is designed to ensure that adequate liquid assets are held to cover statutory, regulatory and operational cash requirements in both business-as-usual and stressed environments.

The Group's liquidity risk is managed as follows:

- The Board has delegated authority for the management of liquidity risk to the Assets & Liabilities Committee (ALCo) within risk tolerances set out in the Liquidity and Funding Policies. ALCo meets monthly;
- Operational management of liquidity risk is further delegated to the Liquidity Management Committee (LMC). LMC meets weekly to agree, based upon detailed customer behavioural analysis, the amount of funding required to maintain the adequacy of Group liquidity over horizons of up to three months. LMC plans cash requirements at a higher level over an extended rolling 12 month plan period;
- LMC also considers a series of daily, weekly and monthly stress tests which are designed to ensure that the Committee maintains sufficient liquidity to meet the Group's cash flow needs under any one of a number of adverse scenarios. These scenarios simulate both Group specific, general market and combined events including severe savings outflows and the unavailability of wholesale funding; and
- Under the PRA's liquidity regime, the Group is required to hold sufficient Extremely High Quality Liquid Assets (EHQLA), such as government securities, supranational bonds, covered bonds and cash deposited with the Bank of England, to ensure that it can meet its anticipated liabilities over a 30 day period. This is known as its Liquidity Coverage Ratio (LCR). The Group holds both EHQLA and other high quality liquidity above that required by the LCR in accordance with its own day-to-day assessment of liquidity adequacy.

There are three measures that the Group considers key to monitoring its liquidity position:

- Liquidity ratios - assesses daily the amount of EHQLA necessary to meet its LCR, and to maintain overall liquidity adequacy;
- Wholesale refinancing gap - sets the maximum net wholesale outflow permitted over the following two weeks; and
- Liquidity stress tests - models the adequacy of Group liquidity under a number of different stress scenarios within the context of the Board's liquidity risk tolerance.

Further details of liquidity management are contained within the Risk Management Report on pages 17 to 20.

The table below analyses the Group's assets and liabilities across maturity periods that reflect the residual maturity from the year end date to the contractual maturity date. The actual repayment profile of loans and advances is likely to be significantly different to that shown in the analysis.

At 31 March 2016

Group	Repayable on demand £m	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specific maturity £m	Total £m
Assets							
Cash and balances with the Bank of England	208.7	-	-	-	-	6.7	**215.4**
Loans and advances to credit institutions	80.4	123.6	-	-	-	-	**204.0**
Investment securities	-	56.1	92.1	261.9	-	-	**410.1**
Derivative financial instruments	-	1.5	3.0	3.8	0.6	-	**8.9**
Loans and advances to customers	-	333.6	98.1	309.1	3,998.2	-	**4,739.0**
Deferred tax assets	-	-	-	-	-	20.4	**20.4**
Trade and other receivables	-	-	-	-	-	2.7	**2.7**
Intangible assets	-	-	-	-	-	8.2	**8.2**
Investment properties	-	-	-	-	-	123.7	**123.7**
Property, plant and equipment	-	-	-	-	-	33.9	**33.9**
Retirement benefit assets	-	-	-	-	-	0.8	**0.8**
	289.1	**514.8**	**193.2**	**574.8**	**3,998.8**	**196.4**	**5,767.1**
Liabilities and equity							
Shares	3,355.2	182.1	208.7	639.1	-	-	**4,385.1**
Amounts due to credit institutions	-	54.2	134.6	70.2	-	-	**259.0**
Amounts due to other customers	8.6	84.2	64.2	-	-	-	**157.0**
Derivative financial instruments	-	0.3	3.0	23.5	50.3	-	**77.1**
Debt securities in issue	-	-	-	296.0	72.6	-	**368.6**
Deferred tax liabilities	-	-	-	-	-	4.7	**4.7**
Trade and other payables	-	-	-	-	-	15.2	**15.2**
Provisions for liabilities	-	-	-	-	-	2.7	**2.7**
Retirement benefit obligations	-	-	-	-	-	-	**-**
Profit participating deferred shares	-	-	-	-	-	179.5	**179.5**
Subscribed capital	-	-	-	-	-	74.9	**74.9**
General reserves	-	-	-	-	-	239.3	**239.3**
Revaluation reserve	-	-	-	-	-	3.4	**3.4**
Available for sale reserve	-	-	-	-	-	0.9	**0.9**
Cash flow hedging reserve	-	-	-	-	-	(0.3)	**(0.3)**
	3,363.8	**320.8**	**410.5**	**1,028.8**	**122.9**	**520.3**	**5,767.1**

34. Liquidity risk (continued)

At 31 March 2015

Group	Repayable on demand £m	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specific maturity £m	Total £m
Assets							
Cash and balances with the Bank of England	253.6	-	-	-	-	7.2	260.8
Loans and advances to credit institutions	66.5	120.0	-	-	-	-	186.5
Investment securities	-	4.0	43.0	217.9	9.4	-	274.3
Derivative financial instruments	-	6.8	2.3	8.9	1.0	-	19.0
Loans and advances to customers	-	332.3	111.1	639.4	3,594.6	-	4,677.4
Deferred tax assets	-	-	-	-	-	23.9	23.9
Trade and other receivables	-	-	-	-	-	2.7	2.7
Intangible assets	-	-	-	-	-	7.0	7.0
Investment properties	-	-	-	-	-	118.6	118.6
Property, plant and equipment	-	-	-	-	-	30.2	30.2
	320.1	463.1	156.4	866.2	3,605.0	189.6	5,600.4
Liabilities and equity							
Shares	2,663.9	174.3	240.5	909.3	-	-	3,988.0
Amounts due to credit institutions	-	280.7	112.6	-	-	-	393.3
Amounts due to other customers	9.0	101.2	42.2	-	-	-	152.4
Derivative financial instruments	-	-	1.7	25.5	53.6	-	80.8
Debt securities in issue	-	-	-	356.7	110.4	-	467.1
Deferred tax liabilities	-	-	-	-	-	4.5	4.5
Trade and other payables	-	-	-	-	-	12.7	12.7
Provisions for liabilities	-	-	-	-	-	2.2	2.2
Retirement benefit obligations	-	-	-	-	-	7.5	7.5
Profit participating deferred shares	-	-	-	-	-	177.1	177.1
Subscribed capital	-	-	-	-	-	74.9	74.9
General reserves	-	-	-	-	-	233.1	233.1
Revaluation reserve	-	-	-	-	-	3.4	3.4
Available for sale reserve	-	-	-	-	-	3.5	3.5
Cash flow hedging reserve	-	-	-	-	-	(0.1)	(0.1)
	2,672.9	556.2	397.0	1,291.5	164.0	518.8	5,600.4

At 31 March 2016

Society	Repayable on demand £m	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specific maturity £m	Total £m
Assets							
Cash and balances with the Bank of England	208.7	-	-	-	-	6.7	**215.4**
Loans and advances to credit institutions	11.7	81.5	-	-	-	-	**93.2**
Investment securities	-	56.1	92.1	355.2	796.6	-	**1,300.0**
Derivative financial instruments	-	1.5	3.0	3.8	0.5	-	**8.8**
Loans and advances to customers	-	14.8	13.4	104.9	2,247.0	-	**2,380.1**
Deferred tax assets	-	-	-	-	-	13.5	**13.5**
Trade and other receivables	-	-	-	-	-	2.7	**2.7**
Investments	-	-	-	-	-	1,669.2	**1,669.2**
Intangible assets	-	-	-	-	-	7.6	**7.6**
Property, plant and equipment	-	-	-	-	-	33.9	**33.9**
Retirement benefit assets	-	-	-	-	-	0.8	**0.8**
	220.4	**153.9**	**108.5**	**463.9**	**3,044.1**	**1,734.4**	**5,725.2**
Liabilities and equity							
Shares	3,355.2	182.1	208.7	639.1	-	-	**4,385.1**
Amounts due to credit institutions	-	54.2	134.6	70.2	-	-	**259.0**
Amounts due to other customers	10.4	88.0	68.3	45.3	288.0	-	**500.0**
Derivative financial instruments	-	0.3	3.0	23.1	41.0	-	**67.4**
Deferred tax liabilities	-	-	-	-	-	0.6	**0.6**
Trade and other payables	-	-	-	-	-	14.2	**14.2**
Provisions for liabilities	-	-	-	-	-	2.6	**2.6**
Retirement benefit obligations	-	-	-	-	-	-	**-**
Profit participating deferred shares	-	-	-	-	-	179.5	**179.5**
Subscribed capital	-	-	-	-	-	74.9	**74.9**
General reserves	-	-	-	-	-	237.6	**237.6**
Revaluation reserve	-	-	-	-	-	3.4	**3.4**
Available for sale reserve	-	-	-	-	-	0.9	**0.9**
	3,365.6	**324.6**	**414.6**	**777.7**	**329.0**	**513.7**	**5,725.2**

34. Liquidity risk (continued)

At 31 March 2015

Society	Repayable on demand £m	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specific maturity £m	Total £m
Assets							
Cash and balances with the Bank of England	253.6	-	-	-	-	7.2	260.8
Loans and advances to credit institutions	6.6	75.5	-	-	-	-	82.1
Investment securities	-	4.0	43.0	358.2	864.9	-	1,270.1
Derivative financial instruments	-	6.8	2.3	8.9	1.0	-	19.0
Loans and advances to customers	-	81.5	42.9	221.9	1,638.2	-	1,984.5
Deferred tax assets	-	-	-	-	-	12.8	12.8
Trade and other receivables	-	-	-	-	-	2.6	2.6
Investments	-	-	-	-	-	1,901.4	1,901.4
Intangible assets	-	-	-	-	-	6.4	6.4
Property, plant and equipment	-	-	-	-	-	30.2	30.2
	260.2	167.8	88.2	589.0	2,504.1	1,960.6	5,569.9
Liabilities and equity							
Shares	2,663.9	174.3	240.5	909.3	-	-	3,988.0
Amounts due to credit institutions	-	280.7	112.6	-	-	-	393.3
Amounts due to other customers	10.2	104.9	48.7	52.3	390.3	-	606.4
Derivative financial instruments	-	-	1.1	24.8	43.1	-	69.0
Deferred tax liabilities	-	-	-	-	-	0.5	0.5
Trade and other payables	-	-	-	-	-	11.7	11.7
Provisions for liabilities	-	-	-	-	-	1.9	1.9
Retirement benefit obligations	-	-	-	-	-	7.5	7.5
Profit participating deferred shares	-	-	-	-	-	177.1	177.1
Subscribed capital	-	-	-	-	-	74.9	74.9
General reserves	-	-	-	-	-	232.7	232.7
Revaluation reserve	-	-	-	-	-	3.4	3.4
Available for sale reserve	-	-	-	-	-	3.5	3.5
	2,674.1	559.9	402.9	986.4	433.4	513.2	5,569.9

The significant development of liquidity stress testing and forecast models has continued throughout 2016 due to economic and market conditions. A wide range of scenarios is considered including mild and severe distresses, credit downgrades and a total closure of the wholesale market. An analysis of the liquidity portfolio is set out in the table below:

Group	2016 £m	2016 %	2015 £m	2015 %
Cash in hand and balances with the Bank of England	**215.4**	**26.0**	260.8	36.1
Cash with banks and building societies	**204.0**	**24.6**	186.5	25.9
Fixed rate bonds	**42.9**	**5.2**	52.1	7.2
Floating rate notes	**259.1**	**31.2**	140.3	19.4
Residential mortgage backed securities	**108.1**	**13.0**	81.9	11.4
Total	**829.5**	**100.0**	721.6	100.0

During the year the liquidity balances have increased from £721.6m at 31 March 2015 to £829.5m at 31 March 2016. Expressed as a proportion of combined shares and deposits liabilities, this represents an increase from 15.92% to 17.28%.

The following table is an analysis of the gross contractual cash flows payable under financial liabilities:

At 31 March 2016

Group	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	3,815.8	345.8	251.2	-	**4,412.8**
Amounts owed to credit institutions, other customers and holders of debt securities	146.8	179.4	72.0	74.9	**473.1**
Derivative financial instruments	7.4	21.0	77.5	86.0	**191.9**
	3,970.0	**546.2**	**400.7**	**160.9**	**5,077.8**

At 31 March 2015

Group	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	3,669.5	160.3	172.2	-	4,002.0
Amounts owed to credit institutions, other customers and holders of debt securities	387.8	137.1	-	74.9	599.8
Derivative financial instruments	7.7	22.2	72.4	150.7	253.0
	4,065.0	319.6	244.6	225.6	4,854.8

34. Liquidity risk (continued)

At 31 March 2016

Society	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	3,815.8	345.8	251.2	-	**4,412.8**
Amounts owed to credit institutions, other customers and holders of debt securities	146.8	179.4	72.0	74.9	**473.1**
Derivative financial instruments	6.3	17.9	60.6	1.8	**86.6**
	3,968.9	**543.1**	**383.8**	**76.7**	**4,972.5**

At 31 March 2015

Society	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	3,669.5	160.3	172.2	-	4,002.0
Amounts owed to credit institutions, other customers and holders of debt securities	387.8	137.1	-	74.9	599.8
Derivative financial instruments	6.0	17.0	44.7	34.4	102.1
	4,063.3	314.4	216.9	109.3	4,703.9

For each material class of financial liability a maturity analysis is provided on pages 91 to 94.

35. Financial commitments

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
a) Capital commitments				
Capital expenditure contracted but not yet provided for in the accounts	**4.2**	1.6	**4.2**	1.6
b) Leasing commitments				
Total commitments under non-cancellable leases				
Rental commitments arising:				
Within one year	**0.4**	0.5	**0.4**	0.5
Later than one year and not later than five years	**0.9**	1.1	**0.9**	1.1
After five years	**0.2**	0.3	**0.2**	0.3
	1.5	1.9	**1.5**	1.9
c) Loan commitments				
Undrawn loan facilities	**159.4**	97.7	**159.4**	97.7

36. Related party transactions

i) Subsidiary, parent and ultimate controlling party

The subsidiaries of the Society (the ultimate controlling party) are detailed in note 15.

ii) Key management personnel

The Board considers key management personnel to comprise Executive and Non-Executive Directors. Details of Directors' emoluments are disclosed in note 8.

iii) Transactions with key management personnel and their close family members

The table below shows outstanding balances and transactions with key management personnel, which comprises Group Directors and their close family members:

Group and Society	No. of key management personnel 2016	Amount in respect of key management personnel and their close family members 2016 £000	No. of key management personnel 2015	Amount in respect of key management personnel and their close family members 2015 £000
Savings balances at 31 March	**9**	**17**	9	18
Interest payable on savings balances	**9**	**0**	9	1

Mortgage loans and savings are available to key management personnel and members of their close family at normal commercial terms. At 31 March 2016, there were no mortgage loans (2014/15: nil) outstanding to Directors and their connected persons.

A register is maintained by the Society containing details of loans and transactions and arrangements made between the Society or its subsidiary undertakings and Directors of the Society or persons connected with Directors of the Society. The register will be available for inspection by members at the Annual General Meeting and during normal office hours at the Society's Principal Office (2 Providence Place, West Bromwich) during the period 15 days prior to the meeting.

iv) Contributions to pension schemes

During the year the Group paid contributions of £9.5m (2014/15: £4.8m) to defined benefit pension schemes, which are classified as related parties.

36. Related party transactions (continued)

v) Transactions with Group companies

	Interest paid to Society 2016 £m	Interest paid to Society 2015 £m
Insignia Finance Limited	**0.4**	0.5
West Bromwich Commercial Limited	**20.6**	28.0
West Bromwich Homes Limited	**2.9**	3.3
West Bromwich Mortgage Company Limited	**32.8**	44.0
	56.7	75.8

At the year end the following balances were outstanding with Group companies:

	Loans owed by subsidiaries 2016 £m	Loans owed by subsidiaries 2015 £m
Insignia Finance Limited	**12.2**	17.9
Kenrick No. 1 Plc	**0.2**	1.5
Kenrick No. 2 Plc	**-**	3.0
West Bromwich Commercial Limited	**586.1**	714.5
West Bromwich Homes Limited	**86.4**	87.5
West Bromwich Mortgage Company Limited	**983.7**	1,076.4
	1,668.6	1,900.8

Transactions and balances between Group companies are on normal commercial terms and conditions.
The loans owed by West Bromwich Commercial Limited are net of impairment provisions of £40.0m (2014/15: £9.9m).

37. Business segments

Operating segments are reported in accordance with the internal reporting provided to the Group Board (the chief operating decision maker), which is responsible for allocating resources to the reportable segments and assessing their performance.

The Group has three main business segments:

- Retail - incorporating residential lending, savings, investments and protection;
- Commercial - primarily representing loans for commercial property investment; and
- Property - a portfolio of residential properties for rent.

Central Group operations have been included in Retail and comprise risk management, funding, treasury services, human resources and computer services, none of which constitute a separately reportable segment.

There were no changes to reportable segments during the year.

Transactions between the business segments are carried out at arm's length. The revenue from external parties reported to the Group Board is measured in a manner consistent with that in the consolidated Income Statement.

Funds are ordinarily allocated between segments, resulting in funding cost transfers disclosed in inter-segment net interest income. Interest charged for these funds is based on the Group's cost of capital. Central administrative costs are also allocated between segments and are disclosed in inter-segment administrative expenses. There are no other material items of income or expense between the business segments.

The Group does not consider its operations to be cyclical or seasonal in nature.

Income Statements for the year ended 31 March 2016

	Retail £m	Commercial £m	Property £m	Consolidation adjustments £m	Total Group £m
Interest receivable and similar income	123.2	19.4	-	(15.9)	**126.7**
Interest expense and similar charges	(65.0)	(14.7)	(2.9)	15.9	**(66.7)**
Net interest receivable/(expense)	**58.2**	**4.7**	**(2.9)**	**-**	**60.0**
Fees and commissions receivable	3.7	-	-	-	**3.7**
Other operating income	30.5	-	4.1	(30.7)	**3.9**
Total operating income	**92.4**	**4.7**	**1.2**	**(30.7)**	**67.6**
Fair value (losses)/gains on financial instruments	(1.2)	0.6	-	(0.4)	**(1.0)**
Net realised gains	0.6	-	-	-	**0.6**
Total income/(expense)	**91.8**	**5.3**	**1.2**	**(31.1)**	**67.2**
Administrative expenses	(40.1)	(1.7)	(0.2)	-	**(42.0)**
Depreciation and amortisation	(5.1)	-	-	-	**(5.1)**
Operating profit before revaluation gains, impairment and provisions	**46.6**	**3.6**	**1.0**	**(31.1)**	**20.1**
Gains on investment properties	-	-	5.5	-	**5.5**
Impairment on loans and advances	(0.2)	(7.9)	-	-	**(8.1)**
Provisions for liabilities	(34.8)	-	-	30.8	**(4.0)**
Profit/(Loss) before tax	**11.6**	**(4.3)**	**6.5**	**(0.3)**	**13.5**
Taxation	(3.5)	1.3	(2.0)	0.1	**(4.1)**
Profit/(Loss) for the financial year	**8.1**	**(3.0)**	**4.5**	**(0.2)**	**9.4**

Statements of Financial Position at 31 March 2016

	Retail £m	Commercial £m	Property £m	Consolidation adjustments £m	Total Group £m
Total assets	**5,944.9**	**542.7**	**128.1**	**(848.6)**	**5,767.1**
Total liabilities	**5,434.6**	**637.5**	**90.3**	**(893.0)**	**5,269.4**
Capital expenditure	**10.0**	**-**	**-**	**-**	**10.0**

37. Business segments (continued)

Income Statements
for the year ended 31 March 2015

	Retail £m	Commercial £m	Property £m	Consolidation adjustments £m	Total Group £m
Interest receivable and similar income	131.7	26.2	-	(21.0)	136.9
Interest expense and similar charges	(70.4)	(19.6)	(3.3)	21.1	(72.2)
Net interest receivable/(expense)	61.3	6.6	(3.3)	0.1	64.7
Fees and commissions receivable	4.1	0.1	-	-	4.2
Other operating income/(expense)	0.8	-	3.9	(0.9)	3.8
Total operating income/(expense)	66.2	6.7	0.6	(0.8)	72.7
Fair value losses on financial instruments	(5.0)	(11.1)	-	(0.2)	(16.3)
Net realised gains	0.1	-	-	-	0.1
Total income/(expense)	61.3	(4.4)	0.6	(1.0)	56.5
Administrative expenses	(38.6)	(1.8)	(0.2)	-	(40.6)
Depreciation and amortisation	(5.4)	-	-	-	(5.4)
Operating profit/(loss) before revaluation gains, impairment and provisions	17.3	(6.2)	0.4	(1.0)	10.5
Gains on investment properties	-	-	5.5	-	5.5
Impairment on loans and advances	(0.7)	0.6	-	(0.1)	(0.2)
Provisions for liabilities	(3.4)	-	-	-	(3.4)
Profit/(Loss) before tax	13.2	(5.6)	5.9	(1.1)	12.4
Taxation	(3.5)	1.5	(1.5)	0.3	(3.2)
Profit/(Loss) for the financial year	9.7	(4.1)	4.4	(0.8)	9.2

Statements of Financial Position
at 31 March 2015

	Retail £m	Commercial £m	Property £m	Consolidation adjustments £m	Total Group £m
Total assets	5,736.8	725.2	123.2	(984.8)	5,600.4
Total liabilities	5,202.7	813.9	91.1	(999.2)	5,108.5
Capital expenditure	15.5	-	-	-	15.5

38. Capital management

Capital is held as the ultimate protection for depositors. The Board sets the internal level of capital with the aim of ensuring capital levels are always above minimum regulatory requirements. Group capital requirements are reviewed on a monthly basis and the results of this monitoring are reported to the Group Capital Committee, Group Risk Committee and the Board.

The Group's capital structure is shown in the table below. For details of the Group's capital management processes, see the Risk Management Report on pages 17 to 20.

At 31 March

	Notes	Transitional CRD IV rules 2016 £m	Full implementation of CRD IV 2016 £m	Transitional CRD IV rules 2015 £m	Full implementation of CRD IV 2015 £m
Common Equity Tier 1 capital					
General reserves		**239.3**	**239.3**	233.1	233.1
Revaluation reserve		**3.4**	**3.4**	3.4	3.4
Available for sale reserve (AFS)		**0.9**	**0.9**	3.5	3.5
Cash flow hedging reserve		**(0.3)**	**(0.3)**	(0.1)	(0.1)
Profit participating deferred shares		**179.5**	**179.5**	177.1	177.1
Common Equity Tier 1 prior to regulatory adjustments		**422.8**	**422.8**	417.0	417.0
Regulatory adjustments:					
Defined benefit pension fund asset	1	**(0.8)**	**(0.8)**	-	-
Cash flow hedging reserve	2	**0.3**	**0.3**	0.1	0.1
Intangible assets and goodwill	3	**(8.2)**	**(8.2)**	(7.0)	(7.0)
Deferred tax asset relating to operating losses	4	**(14.7)**	**(14.7)**	(15.7)	(15.7)
Other deductions		**(2.4)**	**(2.4)**	(4.1)	(4.1)
Common Equity Tier 1 capital		**397.0**	**397.0**	390.3	390.3
Additional Tier 1 capital					
Permanent interest bearing shares (PIBS)		**74.9**	**74.9**	74.9	74.9
Regulatory adjustments:					
Amortisation of PIBS under transitional rules	5	**(30.0)**	**(74.9)**	(22.5)	(74.9)
Total Tier 1 capital		**441.9**	**397.0**	442.7	390.3
Tier 2 capital					
Collective provision		**18.1**	**18.1**	16.1	16.1
Total capital		**460.0**	**415.1**	458.8	406.4

Notes

1. A full deduction is made from CET1 for the defined benefit pension fund asset.
2. The cash flow hedging reserve is not included in capital.
3. A full deduction is made from CET1 for intangible assets and goodwill.
4. Under the rules of CRD IV (transitional and on full implementation) deferred tax assets relating to previous operating losses are deducted from capital.
5. Under the transitional rules applicable to the current year, 40% of the value of PIBS is deducted from Tier 1 capital. Under the transitional rules the amortisation deduction is increased by 10% p.a. every 1 January through to 2021, with the final 10% deducted on 5 April 2021, the earliest call date for the PIBS.

39. Country-by-Country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 introduce reporting obligations for institutions within the scope of the European Union's Capital Requirements Directive (CRD IV). The requirements aim to give increased transparency regarding the activities of institutions.

West Bromwich Building Society (the Society) is the 7th largest building society in the UK. As a mutual organisation, the Society is owned and run for the benefit of its members with the safety of members' funds being paramount. In providing a safe haven for members' funds, the Society can fulfil its primary purpose of enabling home ownership through the provision of mortgages.

The consolidated financial statements of the West Bromwich Building Society Group (the Group) include the audited results of the Society, its subsidiary undertakings and a number of securitisation entities. The consolidated entities, their principal activities and countries of incorporation are detailed in note 15. All of the consolidated entities were incorporated in the United Kingdom (UK), with the exception of Hawthorn Finance Limited which is incorporated in Jersey.

Basis of Preparation

- 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 7 to the Annual Accounts.
- Turnover represents Group total income as disclosed in the Group Income Statement. Total income comprises net interest, fees and commissions receivable and other operating income, together with fair value gains/losses and net realised profits/losses on financial instruments.
- 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 amount of tax paid during the year, as disclosed in the Group Cash Flow Statement.
- Public subsidies received represent direct support by the government and exclude any central bank operations that are designed for financial stability purposes or operations that aim to facilitate the functioning of the monetary policy transmission mechanism.

For the year ended 31 March 2016:

- Hawthorn Finance Limited did not transact with entities outside the Group and had no employees (2014/15: nil).
- Group total income, all of which arose in the UK, was £67.2m (2014/15: £56.5m).
- Group profit before tax, all of which arose in the UK, was £13.5m (2014/15: £12.4m).
- The average number of Group full time equivalent employees, all of which were employed in the UK, was 740 (2014/15: 725).
- The Group made corporation tax payments of £nil (2014/15: £1.5m) in the UK.
- The Group received no public subsidies (2014/15: £nil).

Annual Business Statement for the year ended 31 March 2016

1. Statutory percentages

	2016 %	Statutory limit %
Lending limit	**13.7**	25.0
Funding limit	**8.7**	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986.

The lending limit measures the proportion of business assets not in the form of loans secured on residential property. Business assets are the total assets of the Group plus allowance for losses on loans and advances less liquid assets, investment properties, intangible assets and property, plant and equipment as shown in the Group Statement of Financial Position.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals.

Securitised assets and related liabilities are excluded from the lending limit and funding limit calculations in line with the Building Societies Act 1986 as updated by the Modification of the Lending Limit and Funding Limit Calculations Order 2004.

The statutory limits are as laid down under the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. Other percentages

	2016 %	2015 %
As a percentage of shares and borrowings:		
Gross capital	**10.37**	10.85
Free capital	**7.29**	7.78
Liquid assets	**17.28**	15.92
As a percentage of mean total assets:		
Profit for the financial year	**0.17**	0.16
Management expenses	**0.83**	0.82

The above percentages have been prepared from the Group's accounts and in particular:

- 'Shares and borrowings' represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue excluding non-recourse finance, in each case including accrued interest.
- 'Gross capital' represents the aggregate of general reserves, available for sale reserve, revaluation reserve, cash flow hedging reserve, subscribed capital and profit participating deferred shares.
- 'Free capital' represents the aggregate of gross capital and collective impairment provisions for losses on loans and advances less intangible assets, investment properties and property, plant and equipment.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Liquid assets' represent the total of cash and balances with the Bank of England, loans and advances to credit institutions and investment securities.
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

Information relating to Directors' and Officers' other directorships and interests at 31 March 2016

Name, qualification and date of birth	Role	Date of appointment	Other directorships and interests
Claire Hafner MA, ACA 24 June 1959	Non-Executive Director	1 September 2011	Glendrake Limited 9 Winthorpe Road Freehold Limited
Mark Nicholls MA (Cantab), MBA 5 May 1949	Chairman	1 January 2010	Burcot House Management Limited Northern Investors Company PLC Rathbone Brothers Plc Rathbone Investment Management Ltd
Mark Preston BA (Hons), ACIB 11 February 1960	Non-Executive Director	18 May 2011	
Martin Ritchley FCA, FCIB, Hon DBA (Coventry) 1 July 1946	Deputy Chairman and Senior Independent Director	1 September 2009	Royal Shakespeare Theatre Trust
Richard Sommers MA (Oxon), ACIB 4 September 1956	Non-Executive Director	1 October 2009	Treasurer and Fellow of Lady Margaret Hall Lady Margaret Hall Properties Limited Lady Margaret Hall Trading Limited LMH Hospitality Services Limited
Colin Walklin BSc, FCA 9 May 1954	Non-Executive Director	20 July 2011	Ignis Asset Management Limited Ignis Investment Services Limited Ignis Fund Managers Limited Ignis Investment Management Limited Ignis Nominees Limited Standard Life Investments (Holdings) Limited Standard Life Investments Limited Standard Life Portfolio Investments Limited Standard Life Wealth Limited Mastscreen Limited Scottish Mutual Investment Managers Limited Scottish Mutual PEP and ISA Managers Limited Standard Life Oversea Holdings Limited
Mark Gibbard BSc, FCA, MCT 31 August 1961	Group Finance & Operations Director	16 February 2011	
Jonathan Westhoff BA (Hons) Financial Services, FCMA, CGMA, ACIB 11 July 1964	Chief Executive	5 May 2009	West Bromwich Commercial Limited West Bromwich Homes Limited

All Directors are members of the Society. None of the Directors have at any time in the year, or at the year end, any beneficial interest in shares or debentures of any associated body of the Society.

Service contracts

The Society's policy in relation to the duration of contracts for the Executive Directors is that their contract would normally continue until termination by either party, subject to the required notice or until retirement. The service contract is terminable with 12 months' notice if given by the Society or six months' notice if given by the Director. Jonathan Westhoff entered into his contract as Chief Executive on 25 May 2011 and Mark Gibbard entered into his service contract on 23 November 2010, on this basis.

For further details of the Executive Directors' service contracts, see the Directors' Remuneration Report on pages 32 to 38.

Documents may be served on any of the above named Directors at the following address: Addleshaw Goddard, Sovereign House, Sovereign Street, Leeds LS1 1HQ.

Senior management	Role	Directorships and interests
Manjit Hayre BSc (Hons), PGc	Chief Financial Risk Officer	
Peter Collingridge BSc (Hons), MEng	Divisional Director, IT	
Thomas Lynch MA, ACA	Divisional Director, Treasury & Finance	Central Processing Limited CL Mortgages Limited White Label Lending Limited Sandwell Commercial Finance No. 1 Plc Sandwell Commercial Finance No. 2 Plc Sandwell Finance Holdings Limited West Bromwich Mortgage Company Limited
John McErlean MIIA, FIIA	Divisional Director, Internal Audit	
Neil Noakes	Group Secretary	Insignia Finance Limited West Bromwich Homes Limited White Label Lending Limited
Jacqui Randle BSc, FCIPD	Divisional Director, Human Resources	WBBS (SRS) Limited
Stephen Smart	Divisional Director, Operations	CL Mortgages Limited Insignia Finance Limited West Bromwich Commerical Limited West Bromwich Mortgage Company Limited White Label Lending Limited
James Wright BSc, ACIB, CIM Dip	Divisional Director, Sales & Marketing	Central Processing Limited CL Mortgages Limited West Bromwich Mortgage Company Limited

Glossary

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears – Customers are said to be in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is unpaid or overdue. The value of the arrears is the value of the payments that have been missed.

Asset backed securities (ABS) – Securities that represent an interest in an underlying pool of referenced assets. Typically these assets are pools of residential or commercial mortgages.

Basel lll – In December 2010, the Basel Committee on Banking Supervision issued the Basel lll rules text, which presents the details of the strengthened global regulatory standards on bank capital adequacy and liquidity. The requirements, embedded using CRD IV, became effective from 1 January 2014.

Buffer liquidity – Cash and investments with the UK government (deposits with the Bank of England or holdings of UK Gilts and similar investments) and with supranational institutions. The limit is set by the Prudential Regulation Authority (PRA).

Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV) – CRD IV is the legislative package made up of the Capital Requirements Regulation and the Capital Requirements Directive to implement the Basel III agreement.

Commercial lending – Loans secured on commercial assets. Commercial assets can include office buildings, industrial property, hotels, medical centres, shopping centres, farm land, buy to let and housing association properties.

Commercial mortgage backed securities (CMBS) – Securities that represent interests in a pool of commercial mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).

Common Equity Tier 1 capital (CET1) – CET1 capital comprises internally generated capital from general reserves and other reserves less intangible assets, goodwill and other regulatory adjustments.

Common Equity Tier 1 capital ratio – Common Equity Tier 1 capital as a percentage of risk weighted assets.

Contractual maturity – The final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal and interest is due to be paid.

Credit risk – The risk that a customer or counterparty is unable to honour their obligations as they fall due.

Debt securities in issue – Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit and non-recourse finance.

Derivative financial instruments – A derivative financial instrument is a type of financial instrument (or an agreement between two parties) whose value depends on the underlying asset, index or reference rate it is linked to. The Group uses derivative financial instruments to hedge its exposures to market risks such as interest rate, equity and currency risk.

Effective interest method – The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. The calculation includes all fees and penalties paid or received between parties to the contract that are considered integral.

Fair value – Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Financial Services Compensation Scheme (FSCS) – The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.

Free capital – The aggregate of gross capital and collective impairment provisions for losses on loans and advances to customers less intangible assets, investment properties and property, plant and equipment.

Funding for Lending Scheme (FLS) – A scheme launched by the Bank of England and HM Treasury providing funding to incentivise banks and building societies to boost lending to the economy.

Funding limit – Measures the proportion of shares and borrowings not in the form of shares held by individuals excluding non-recourse finance. The calculation of the funding limit is explained in the Annual Business Statement.

Goodwill – Goodwill arises on the acquisition of subsidiary undertakings, joint ventures, associates or businesses and represents the excess of the fair value of consideration over the fair value of identifiable net assets and contingent liabilities acquired at the date of acquisition.

Gross capital – The aggregate of general reserves, available for sale reserve, revaluation reserve, cash flow hedging reserve, subscribed capital and profit participating deferred shares.

Impaired loans – Loans which have been assessed and there is evidence to suggest that the Group will not receive all of the cash flows or there is an expectation that these will be received at a later date.

Individual Liquidity Adequacy Assessment (ILAA) – The Group's internal assessment of the levels of liquidity that need to be held by the Society to meet its regulatory liquidity requirements.

Individually/collectively assessed – At each Statement of Financial Position date the Group assesses whether or not there is objective evidence that individual financial assets are impaired. If no objective evidence of impairment exists for an individually assessed financial asset, it is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. A collective provision is made against a group of financial assets where there is evidence that credit losses have been incurred, but not individually identified, at the reporting date.

Interest rate risk – Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Internal Capital Adequacy Assessment Process (ICAAP) – The Group's own assessment, as part of regulatory requirements, of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios.

International Swaps and Derivatives Association (ISDA) master agreement – A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions.

Investment securities – Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.

Lending limit – Measures the proportion of business assets not in the form of loans fully secured on residential property. The calculation of the lending limit is explained in the Annual Business Statement.

Leverage ratio – Tier 1 capital as a percentage of total exposures which include on and off balance sheet assets after netting derivatives.

Liquid assets – Total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities.

Liquidity coverage ratio (LCR) – A Basel III measure to ensure sufficient highly liquid assets cover expected net cash outflows under a 30-day liquidity stress scenario.

Liquidity risk – The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash inflows and outflows.

Loan to value ratio (LTV) – A ratio which expresses the amount of a mortgage as a percentage of the value of the property on which it is secured. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).

Loans past due/past due loans – Loans on which payments are overdue including those on which partial payments are being made.

Management expenses – Management expenses represent administrative expenses. The management expense ratio is management expenses expressed as a percentage of mean total assets.

Market risk – The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will reduce income or portfolio values.

Mean total assets – Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.

Medium term notes (MTN) – Corporate notes continuously offered by a company to investors through a dealer across a range of maturities.

Member – A person who has a share investment or a mortgage loan with the Society.

Mortgage backed securities (MBS) – Assets which are referenced to underlying mortgages.

Net interest income – The difference between interest received on assets and interest paid on liabilities.

Net interest margin – This ratio calculates the net interest income as a percentage of mean total assets.

Net stable funding ratio (NSFR) – A ratio calculated as the amount of available stable funding against the amount of required stable funding. This measure will be taken over an observation period of one year.

Non-recourse finance – A secured loan (debt) that is secured by a pledge of collateral but for which the borrower is not personally liable. If the borrower defaults, the lender/issuer can seize the collateral, but the lender's recovery is limited to the collateral alone.

OECD – Used to refer to member countries of the OECD (Organisation for Economic Cooperation and Development). The OECD is an international organisation of countries with highly developed economies and democratic governments. The OECD has 34 member countries including (but not limited to) key European countries, the United States, Canada and Japan.

Operational risk – The risk of loss arising from inadequate or failed internal processes, people and systems or from external events.

Other income – The income received from selling non-mortgage and savings products (e.g. home and contents insurance, investment products, other insurances and property rental income).

Permanent interest bearing shares (PIBS) – Unsecured, deferred shares that rank behind the claims of all depositors, payables and investing members of the West Brom and rank equally with profit participating deferred shares.

Prime – Prime mortgages are those granted to the most credit worthy category of borrower.

Profit participating deferred shares (PPDS) – A form of unsecured capital that are included as Common Equity Tier 1 capital. PPDS rank behind the claims of all depositors, payables and investing members of the West Brom and rank equally with PIBS.

Renegotiated loans – Loans are classed as renegotiated with the customer's consent, when their terms have changed during the year. Loans and advances are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower.

Repo/Reverse repo – Short to medium-term funding agreements which allow a borrower to sell a financial asset, such as asset backed securities (ABS) or government bonds as security for cash. As part of the agreement the borrower agrees to repurchase the security at some later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future), it is a reverse repurchase agreement or reverse repo.

Residential loans – Money loaned to individuals rather than institutions. Residential mortgage lending is secured against residential property.

Glossary (continued)

Residential mortgage backed securities (RMBS) – A category of asset backed securities (ABS) that represents interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).

Risk appetite – The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives.

Risk weighted assets (RWA) – The value of assets, after adjustment, under Basel III rules to reflect the degree of risk they represent.

Securitisation – A process by which a group of assets, usually loans, are aggregated into a pool which is used to back the issuance of new securities. A company transfers these assets to a structured entity which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities.

Shares – Money deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.

Shares and borrowings – The total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and fair value adjustments for hedged risk.

Sub-prime – Loans to borrowers typically having weakened credit histories that include payment delinquencies and, in some cases, potentially more severe problems such as court judgements and discharged bankruptcies.

Tier 1 capital – An element of regulatory capital and measure of financial strength, comprising Common Equity Tier 1 and Additional Tier 1 capital. Additional Tier 1 capital is not deemed to be fully loss absorbing and can only be included in capital under the transitional arrangements of CRD IV.

Tier 2 capital – An element of regulatory capital comprising the Group's collective impairment allowance and certain regulatory deductions made for the purposes of assessing capital adequacy.

Wholesale funding – The total of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Head Office: 2 Providence Place, West Bromwich B70 8AF.
www.westbrom.co.uk

Registered Number: 651B

the West Brom

1627-05/16-01