Annual Report and Accounts

Year ended 31 March 2019

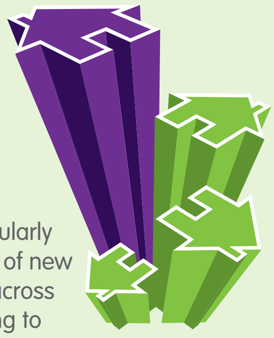
the West Brom

Contents

Key highlights of the 2018/19 financial year

New mortgage lending

£691m



Despite intensified competition, particularly in the second half of the year, £691m of new mortgage lending (2017/18: £837m) across an extended product range, continuing to support home ownership and enabling more than 2,700 borrowers (2017/18: more than 3,100) to purchase their first home.

Average rate earned

45%

more than market average

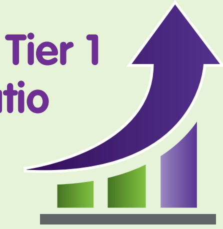
Delivering savers a significant increase in the average rate earned on their savings compared with the market average[1]; during the year, on average, we paid savers some 45% more than the market average (2017/18: 26% above).

Profit before tax

£10.5m

Common Equity Tier 1 (CET 1) capital ratio

16.0%



Profit before tax of £10.5m (2017/18: £8.8m), representing a 19% increase year on year which, along with the successful modernisation of the Society's capital structure through a liability management exercise (announced in March 2018 and completed in April 2018), resulted in a 14.5% increase in members' general reserves and further strengthening of the Society's capital position. The Common Equity Tier 1 ratio increased to 16.0% from 14.8%.

High

Customer satisfaction and Net Promoter Score

Sustained high levels of customer satisfaction of 94% (2017/18: 94%) and higher customer service Net Promoter Score®[2] of +72 (2017/18: +65) which compares favourably with the Financial Services Benchmark of +50 (2017/18: +45).

Member Council

Enhanced stakeholder engagement, following the establishment of Member and Employee Councils and the sector first of a binding vote on Executive Director Remuneration Policy in July 2018.

9%

reduction in non-core commercial loan book

Continued success in rebalancing the lending portfolio: a 9% reduction in the non-core commercial loan book (2017/18: 17%) and 5% (2017/18: 13%) increase in prime owner occupied balances.

1 Average market rates sourced from Bank of England Bankstats table A6.1

2 Net Promoter Score and NPS are trademarks of Satmetrix Systems, Inc., Bain & Company, Inc., and Fred Reichheld.

Chairman's Statement

It gives me great pleasure to report that the Society continued to perform strongly over the past year, despite a challenging market.

We achieved this by staying firm to our purpose - supporting the financial wellbeing of our members by helping people to own their homes and providing a good and safe return for savers.

During the year the Society extended further our support to first-time buyers and also sought to assist those who are seeking a different path into home ownership by, for example, offering mortgages for customers who want to build their own property. Continuing to utilise our members' savings to support these critical elements of the housing market reflects the delivery of mutuality at its most fundamental level.

The economy

Uncertainty continues to cloud our economic outlook largely as a consequence of the prolonged uncertainty around the terms of Brexit. The most recent indications from the Bank of England (BoE) are that, upon leaving the EU, any negative effects on the economy would be dealt with using the Bank Rate and a range of financial stimulus tools. Indeed, the Governor of the BoE has commented that, while a disorderly exit would cause a number of concerns, the resilience of the financial system should not be one of them. It is not, therefore, projected that Brexit will impact the Society as directly as some UK businesses, but the secondary effects might be significant, particularly if the downside risks that have been articulated come to pass, most notably in terms of the potential impact on house prices and unemployment.

Following some positive data in 2018, the growth in the economy has since slowed. Despite this, wage growth reached its highest level since 2008 and the unemployment rate reached its lowest level for over 40 years. When combined with a moderation in house price inflation and the supply of new housing stock increasing, the long-term trend of deteriorating housing affordability may at last be coming to an end.

Although savers benefited from a further increase to the Bank Rate last August and, notwithstanding the positive impact on incomes described above, we still have seen a worrying fall in the amount being saved overall in recent years. Initiatives such as increasing the capacity for tax free savings are welcome, in that they increase the value of returns available, but clearly more needs to be done to encourage a habit of saving. Whilst the Help to Buy ISA has clearly been an example of the type of initiative that can change behaviours, the jury is out on the Lifetime ISA. It may be that a more simple structure would be more attractive to savers.

Governance

In July of last year, the Financial Reporting Council (FRC) published an updated version of the UK Corporate Governance Code (the Code), the first significant update for a number of years. The Code is not aimed at organisations such as the West Brom but we do voluntarily have regard to its principles, in so far as we believe they are relevant to a building society. A key area where the updated Code differs from its previous iteration is in its recommendations regarding stakeholder engagement. Being a mutual, owned by our members, we have a long tradition of engagement and have, during the year, increased this through two enhancements to our corporate governance structures. We have recruited both a Member Council and an Employee Council, with a broad diversity of representation on both. The Councils have already shared their thoughts on a range of Board matters such as executive pay, areas of compliance with the Corporate Governance Code, a potential diversification of the Society's offering and our risk management frameworks.

This innovation follows our earlier initiative in becoming the first building society to offer its members a binding vote on Executive Director Remuneration Policy (the results of which can be found in the Directors' Remuneration Report).

Diversity

We have now entered the second year of mandatory reporting on our gender pay gap. As previously explained, the Society's gap is due to the legacy issue of males occupying a greater proportion than females of the senior roles at the Society. It does not mean that males and females are being paid different amounts for performing the same job.

I am very encouraged by the efforts that have been made to progress diversity in all its permutations – not only gender, but other areas such as ethnicity, age and disability. Our gender pay gap statistics have improved year on year with the mean gender pay gap reducing from 38.0% to 36.4%, reflecting more female representation at senior levels. We have already exceeded our 30% female representation target for the Board which we committed to achieve by 2020.

Regulation

Many developments have taken place during the past year with regards to regulation; all of which we hope will lead to better customer outcomes. Two in particular are worth a brief mention.

Operational Resilience has been for some time an area of concern for the Regulators, as the incidence of system failures becomes more prevalent. In July 2018 the BoE, Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) published a joint paper on the topic; the work has developed over the subsequent months and the intention is to ensure that firms are able to maintain an appropriate level of service to customers upon occurrence of an adverse event that impacts operations. The Society has responded to this initiative by reviewing its systems, processes and activities to ensure that we can continue to provide an appropriate service even where the cause of the event is outside our control.

A proper assessment of borrower's ability to meet their repayment obligations is at the very heart of responsible lending. However, it would appear that as an unintended consequence of the responsible lending rules, introduced by the regulator following the financial crash, some borrowers have been unable to switch to more affordable mortgages despite being up to date with their payments. To this end the recent changes put forward by the FCA's Mortgage Market Study are welcomed, along with other actions to make the mortgage market work better for consumers.

Board changes

During the year, two long-standing members of the Board, Richard Sommers and Colin Walklin, stepped down having served all or close to their full nine year terms. I would like to record our sincere gratitude to both of them for their invaluable guidance, their unwavering commitment and their generous support during a pivotal time in the Society's history.

I am delighted to welcome Lynne Shamwana as our latest Non-Executive Board member, a key addition to our Board as we continue to implement our succession plans.

Looking forward

The continued uncertain political and economic outlook creates a challenging environment for all firms; the Society's response will be to remain resolute in delivery of its founding principles – enabling home ownership and providing a good and safe return for members. This purpose has guided the Society through to its 170th year; a milestone we can all be proud of – members and colleagues alike. On this note, I would like to offer my thanks to our membership and our employees for their continued support and loyalty.

Mark Nicholls
Chairman
29 May 2019

Chief Executive's Review

I'm pleased to report that the Society has had another successful year supporting the financial wellbeing of our members through the delivery of safe, good value products and services.

During the year we have continued to support first-time buyers to own their own home, launched a market-leading easy access savings account and paid on average a 45% higher rate to our savers than the market average rate[1], all of which have been achieved in a fiercely competitive market environment. This year's achievements, coupled with our long-term strategies to reduce legacy risk and keep control of costs have helped support a 19% increase in profits before tax and improved capital ratios, which provide a robust base for future investments as we celebrate our 170th year.

19% increase

in profit before tax
to £10.5m (2017/18: £8.8m)

Balancing the benefits of savers and borrowers in a highly competitive marketplace

The forces of change in mainstream financial services have perhaps never been greater with economic forces, consumer behaviour, technology and regulation all combining to drive a challenging agenda. Within this environment it's important the Society remains true to its mutual purpose and continues to balance the needs of savers and borrowers appropriately.

With market growth in gross residential lending moderated at 3.0%, HPI remaining relatively flat, the withdrawal of the Bank of England's Term Funding Scheme package and the increased lending capacity of both ring-fenced and challenger banks, in the second half of this year we took the decision to reduce our lending in those markets where, put simply, the rates we would be charging to our new borrowers would, in some cases, be uneconomic. Indeed, while the Bank of England increased the Bank Rate in August by 0.25%, the average rate paid by the market on new mortgages reduced relative to Bank Rate, which meant that there was a risk of an imbalance between the value distributed to our saving and borrowing members.

At £691m (2017/18: £837m) our level of gross residential lending has achieved an appropriate balance and therefore represents a responsible decision to reposition ourselves and strengthen our lending proposition in markets that allow us to offer safe, secure returns to saving members.

Refining our focus on purpose

It gives me great pride that 43% (2017/18: 34%) of all new borrowers welcomed to the Society have been first-time buyers, evidencing further the Society's commitment to help the next generation of home owners. As referenced in the Chairman's Statement, throughout the year we have worked hard to extend our lending proposition to support borrowers who align to our traditional building society purpose but are potentially lesser served by mainstream lenders. What we like to call 'new-traditional' lending. Increasingly, we are now able to support a diverse range of borrower needs: whether that be those looking to buy their first home with the help of a sponsor, build a home using a self-build mortgage, remortgage an existing Help to Buy property or support the private rented sector as a portfolio landlord. In the forthcoming financial year we will continue to extend our product range further whilst also introducing online functionality to our existing customers and our intermediary partners looking to change products at the end of their initial incentive periods.

43%

of all new borrowers were first
time buyers (2017/18: 34%)

Safe, good returns for savers

Our savers provide balances that support 84% (2017/18: 84%) of all our mortgage lending and are very much fundamental to the continued success of our mutual model. I'm pleased to say that following the decision of the Bank of England to increase Bank Rate we rewarded our savers by increasing the average rate of interest from 0.78% in 2017/18 to 0.94%. The rate we pay is 45% (2017/18: 26%) above the average rate paid across the rest of the market of 0.65% (2017/18: 0.62%)[1] which, in simple terms, means that the Society has paid £11.4m (2017/18: £6.5m) in mutual benefit to savers.

[1] Average market rates sourced from Bank of England Bankstats table A6.1

While the trajectory of Bank Rate remains somewhat uncertain, in the short term at least, our savings proposition will continue to offer members safe, good value products that complement a range of needs, allowing us to support sustainable levels of residential lending.

45%

more than the market average rate paid to savers[1] (2017/18: 26%)

Commitment to outstanding service

With price competition remaining intense, we recognise the decision of many of our members to borrow or save with us will be based as much on service as it is on price. To this end we set ourselves ambitious targets to maintain outstanding levels of service that meet the principles of our customer proposition; offering products and services that reflect *individual* customer needs, are *easy* to use and understand and help our members *trust* us with their financial wellbeing. Over the year the Society's Net Promoter Score®[2] was an impressive +72 (2017/18: +65) and customer satisfaction was maintained at 94%.

As a regional building society which lends across the country the service offered by our mortgage intermediary partners really is something the Society values. We also recognise that maintaining this relationship is a two-way endeavour with the Society striving to extend products and services that are as accessible as possible. During the year our service standards to intermediary partners were independently recognised at the 2018 Financial Adviser Service Awards, where the Society received the highest accolade, a coveted five star rating for its quality of service. Further extensions of both our product and service offerings are planned for our intermediary partners in the coming year.

Presence in our heartland

With many main banks reducing their presence on the high street, it's also pleasing that our high-street proposition has continued to prove attractive with branch balances growing by 3% (£85m). While it's important to acknowledge that the branch network is expensive to run and is being used less year on year, we also recognise that the value of our branches extends beyond being an important source of funding, contributing 69% of all retail funding balances (2017/18: 66%), with the network seen by many of our members as an essential part of the West Brom's regional identity. This was a view confirmed by our Member Council.

Over the last year we have maintained our commitment to the network by taking an opportunity to secure a new flagship premises right in the heart of West Bromwich. We had been actively engaged in the search for a new West Bromwich position for a number of years so securing a position in the vibrant New Square shopping area really is something to be celebrated, offering members a brand new branch right in the heart of our home town. The opening of this new site has also provided the opportunity to consolidate the two existing, poorly located, West Bromwich positions (Dartmouth Square and High Street) into one central location. We encourage our members to visit the new branch and will continue to seek opportunities to deliver a more efficient network that adds value to the membership as a whole.

+72

Net Promoter Score®[2]
(2017/18: +65)

Responsible approach to risk

The impressive strides the Society has made to reduce exposure to those areas of lending that do not fit our mutual purpose have remained a consistent theme of my Annual Report messages for the last 10 years. The scale of the progress we have made here should not be underestimated with non-core commercial exposures now reduced to just 26% of their peak position. This long-term progress to shift materially the composition and riskiness of the Society's lending activities has not however reduced our focus on pursuing opportunities to exit individual positions where these make economic sense for members. Indeed over the course of the last 12 months we have reduced non-core commercial assets by a further 9% with total remaining exposures now below £450m, which when combined with the growth in residential lending has once again supported a reduction in balance sheet risk and an improved capital position.

16.0%

Common Equity Tier 1 Capital Ratio
(2017/18: 14.8%), up 1.2%

Our responsible approach to risk is also evidenced in the performance of new lending that has been originated in the last five years with only 2 new mortgage members in arrears of three months or more. When you consider across that period we have welcomed some 35,000 new mortgage members to the Society this figure goes to evidence the responsible safeguards we put in place to ensure new borrowers can afford their mortgages both now and at interest rates much higher than they are today. Moreover when borrowers do struggle to meet their payments the West Brom prides itself on taking an individual approach that also meets our responsibility as a mutual lender.

Welcoming our Member and Employee Councils

As a building society the interests of our members guide the decisions we make and, as a member of the Society's Board, I frequently receive questions on how we make these decisions and how much consideration is given to other people's views. Following last year's introduction of a binding vote on Directors' Remuneration Policy, a position unique within the building society sector, this year we have taken our commitment to stakeholder engagement as a key principle of good, mutual corporate governance further through the creation of two consultative groups, the Member and Employee Councils.

[1] Average market rates sourced from Bank of England Bankstats table A6.1
[2] Net Promoter Score and NPS are trademarks of Satmetrix Systems, Inc., Bain & Company, Inc., and Fred Reichheld.

We've formed these bodies to include as diverse a range of views as possible to ensure the views expressed are a representative cross-section of the diversity we observe, celebrate and promote in both our membership and our employee populations. Crucially the purpose of the Councils extends beyond feedback with members able to articulate stakeholder views back to the Society's Board and senior leadership team on particular matters of strategic importance. Agendas have included a variety of topics, from Directors' remuneration to the boundaries between comply or explain under the Corporate Governance Code, and a proposition to grow home ownership from the rented sector. Each meeting has been chaired by myself, or the chair of the Remuneration Committee where the subject matter has required, with representation from senior managers and Non-Executive Directors where appropriate.

I would like to take this opportunity to thank formally all members and employees who have helped create this pioneering initiative, setting a new standard amongst other mutuals in terms of stakeholder engagement. I would also encourage members who feel they can contribute to register their interest via our website or in person to support future recruitment to the panel.

Our people and communities

As shall be evidenced in greater detail later in this Annual Report the Society takes its role as a regional building society seriously both as an employer and as a community partner. During the year we have supported another 22 members of staff to study for professional qualifications, including a Masters in Strategic Leadership in partnership with Loughborough University and the Building Societies Association. We have promoted the government's apprenticeship agenda, with 23 apprentices now working towards qualifications with the support of the Society, and continued an active programme of both in-house and external training.

Diversity of viewpoint is an essential ingredient of good decision-making and, as referenced the Chairman's Statement, the Society has again made strides to support the Women in Finance Charter with women now occupying 33% and 29% of positions on the Board and senior management respectively. We have also encouraged diversity and inclusion through the formation of the 'Connect' group which provides a staff diversity forum to discuss and share ideas, experiences and challenges with activities held around key cultural celebrations such as Vaisakhi, Eid, Diwali and Christmas.

Fundraising activities during the year have benefited the charity Black Country Women's Aid, which supports victims of violence and abuse.

We also recognise that our responsibility to support financial wellbeing extends beyond the products and services we offer to members and into the wider community. This is perhaps no better evidenced than through our 'Money Go Round' education initiative which aims to give the next generation of savers and borrowers an early insight into the value of money and impact of good financial management. Throughout the year this initiative led to delivery of presentations to schools within our heartland, involving circa 2,000 students, supporting the development of financial literacy and the key role this plays in how confident people feel in managing their finances.

The Society takes pride in its wider community work and encourages all staff to partake in 2 days volunteering per year. This has provided some 750 hours of work to our charity partners in support of much needed regional causes. This year we have partnered with Black Country Women's Aid as our charity of the year with activities throughout the year raising over £30,000 to help the much-needed work they do supporting the victims of domestic abuse, violence and exploitation. I would like to take this opportunity to thank everyone associated with the charity for their work during this relationship which has been a privilege for the Society.

Continuity, change and investment

The resilience of our mutual model throughout our 170 year history has been based on our ability to deliver both continuity and change. While the core of what the Society offers to members, both borrowers and savers, remains very much unchanged, the way in which we deliver products and services has changed beyond recognition. We now operate in an environment where our members expect us to be on the high street, on the telephone, accessible via post, on the internet and accessible by mobile and/or tablet. With this in mind it's important that we do not take our 170 year history for granted but continue to invest in the Society's core systems so we can continue to meet the product, service and security expectations of both current and future members long into the future.

As we look into the future, putting the immediate uncertainty of Brexit to one side, it remains likely that competition within core mortgage and savings markets will continue for some time. By way of response, the Society will, as it has done in the past 12 months, continue to take responsible decisions to encourage lending growth only in those markets where sustainable returns can be evidenced, whilst seeking all available opportunities to run our Society as efficiently as possible for the benefits of our members. In this sense our approach will remain allied fundamentally to our core building society purpose.

As a building society the West Brom exists for its members, bringing those who want to borrow and those who want to save together to achieve a common purpose – financial wellbeing. For us this purpose remains as relevant today as when the Society was founded and as we complete our 170th year, I'm confident that our delivery will remain resolute as we adapt to support further new-traditional methods of home ownership and embrace the opportunities created by digital innovation.

Jonathan Westhoff
Chief Executive
29 May 2019

Strategic Report

Our strategy remains unchanged and is focused on the simple premise of delivering our purpose – supporting the financial wellbeing of our members by providing a safe and good return on the savings they entrust with us and promoting home ownership through responsible lending.

Our strategy

Our purpose guides the development of our business model, primary activities and strategic priorities.

We continue to deliver saving, investment, mortgage and insurance products through our 36 branches, direct and online services and intermediary partnerships. Our broad range of savings and investment products aims to offer simplicity of terms, security of deposit, and a good rate of return. Savings members' deposits support the Society in its aim of promoting home ownership for borrowers who can evidence their ability to service their commitments. Providing residential mortgages, funded in the main by member deposits, remains firmly allied to our mutual model.

Our strategy recognises the importance of the role of the UK housing market to the wider economy, society and in turn to meet the home ownership ambitions of our membership. Our mortgage product range has been extended further this year to cater for individual borrower needs in the prime residential lending space, to buy their first home, self-build, remortgage an existing Help to Buy and also to support the private rented sector.

The Society also holds, via its property investment subsidiary West Bromwich Homes Limited, a portfolio of residential properties to generate rental income but also to provide quality homes for those in the rented sector, behaving as an exemplary landlord.

The Society's ability to offer high quality products and services continues to be supported by the effective management of non-core assets with further significant progress made in the financial year. Since 2009, we have been managing down these non-core exposures to achieve the most favourable economic outcome on behalf of members.

Allied to the mutual model the Society will continue to make long-term strategic investments in systems to ensure product, service and supporting capabilities continue to meet the needs of both current and future members.

Our business model

The Society's business model is aligned to its strategic objectives and the diagram below sets out the tenets of the business model which are key to delivery of our purpose - supporting the financial wellbeing of members.

Our Funding:

The vast majority of our funding comes from our retail savers, supported by funding from wholesale markets and reserves from previous years' profits.

Our Profits:

We use the difference in our income and our costs to deliver value through our products and services, investing in the future of the Society and maintaining our financial strength through our levels of capital.

Our Lending:

We use our funds to support residential lending, including first-time buyers, home moving, remortgages and borrowers supporting the private rented sector. A relatively small proportion of our funding continues to support our legacy lending books which are in run-off.

Our Income:

We generate income through the difference in the rates we charge to borrowers and savers (net interest margin), the sale of selected third-party financial products and our role as a responsible landlord.

Our Costs: We use our income to run the business efficiently; paying our people and suppliers and maintaining our branch network and head office. We also provide for any losses and pay our taxes.

To support the above business model the Group is organised into three main business segments, which allows the Society to focus strategic intent on the delivery of our purpose whilst maintaining a concentrated effort to manage the orderly run-off of non-core activity:

Retail - retail saving products offered through branch, direct and online with residential lending delivered through branch, direct and intermediary channels. We also offer a range of investment and insurance products through our third-party partnerships in support of broader financial wellbeing. This segment also includes responsible buy to let lending to limited companies in support of the UK's private rented sector.

Property - a portfolio of residential properties held by the Group to generate rental income. The Group recognises its role as a responsible landlord with the portfolio actively managed by a well-respected property management company. The Board acknowledges the inherently fluctuating nature of revaluation gains/losses associated with the portfolio to both the benefit/detriment of the Group's financial performance. The Board continues to manage the portfolio economically in the long-term interests of the membership.

Commercial real estate - the historic provision of finance for commercial real estate investment which is deemed strategically as non-core.

The above business segments are supported by central functions which provide Finance, HR, IT, Compliance, Risk Management and Change capabilities.

Funding is reviewed at a Group-wide level with Treasury and Finance functions managing the day-to-day cash flow, along with providing wholesale funding and ensuring allocation of capital and liquidity.

Key performance indicators

The Society monitors and assesses its performance against strategic objectives using a range of financial and non-financial key performance indicators (KPIs). These KPIs, and the Society's performance against each, are described below.

Key performance indicator | **Measure** | **Performance** | **2018/19 review**

Profit before tax

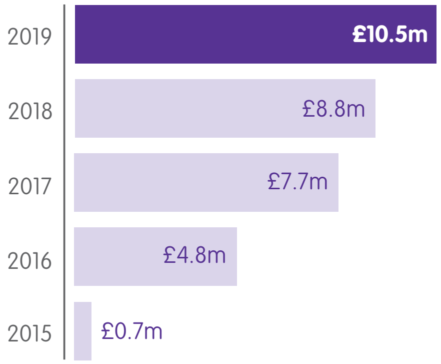
Measure

Profit before tax, as reported in the Income Statement for 2017/18 and 2018/19.

The figures for 2014/15, 2015/16 and 2016/17 show underlying profit before tax which excludes the effect of additional interest charged and subsequently reimbursed on certain buy to let mortgages.

Profit contributes to capital which provides financial resilience and facilitates investment in the future.

Performance



2018/19 review

An improving trend in underlying profitability over the last five years and a strong performance in the year, representing a 19% increase in profit before tax.

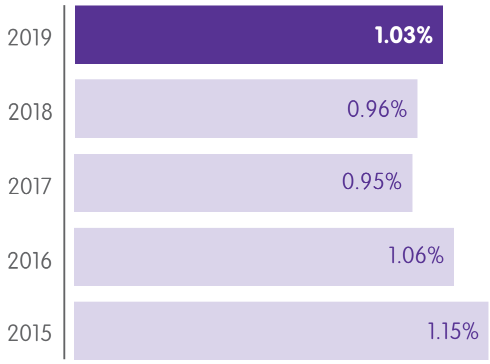
Net interest margin

Measure

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

The drivers of this measure are the level of return received from assets held and the interest paid on borrowings.

Performance



2018/19 review

Net interest margin increased in the year, following rises in Bank Rate, leading to improved earnings on free capital, and the continued benefit of low cost funding from the Term Funding Scheme.

As a mutual, it is not our objective to maximise margin but to manage interest income at a level that covers costs, enables investment in the future and maintains a strong capital position.

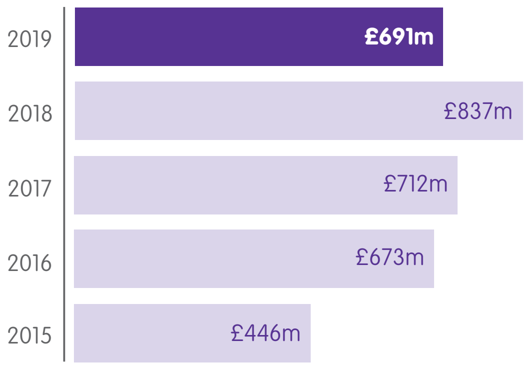
Key performance indicators (continued)

Key performance indicator | **Measure** | **Performance** | **2018/19 review**

Gross residential lending

Measure: Delivering the Society's core purpose of enabling home ownership, this is the value of residential lending advanced in the year.

Performance:



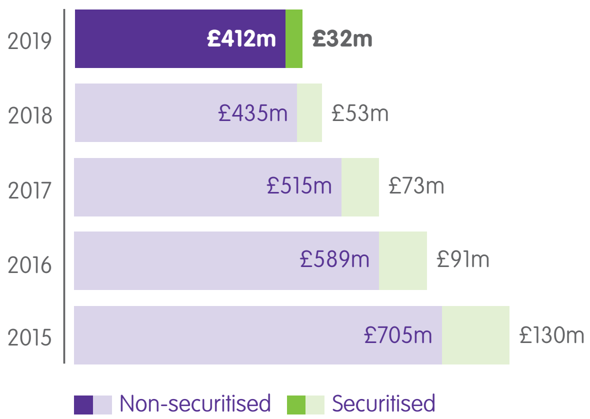
2018/19 review: Gross residential lending of £691m has contributed to an increase in prime owner occupied residential lending, which has more than doubled since the Society re-entered the mortgage markets in 2012/13.

The year on year decrease reflects intense competition in the mortgage segments, with the Society only lending at rates which deliver an appropriate level of return.

Exiting non-core positions

Measure: Exiting the commercial real estate sector has been a longstanding strategy of the Board and is measured by the reduction in the gross carrying value of non-core commercial exposures, which totalled £1,695m in 2008/9.

Performance:



2018/19 review: Non-core commercial mortgage balances have continued to reduce annually, down 9% in the year to £444m at 31 March 2019.

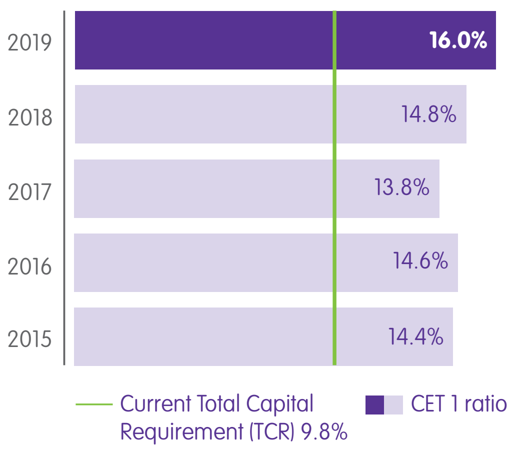
Of the remaining exposure, £32m is securitised thereby transferring the residual risk out of the Group.

Common Equity Tier 1 (CET 1) ratio

Measure: Common Equity Tier 1 (CET 1) capital is the highest quality form of capital for a financial institution, comprising retained earnings, other reserves and qualifying CET 1 capital instruments.

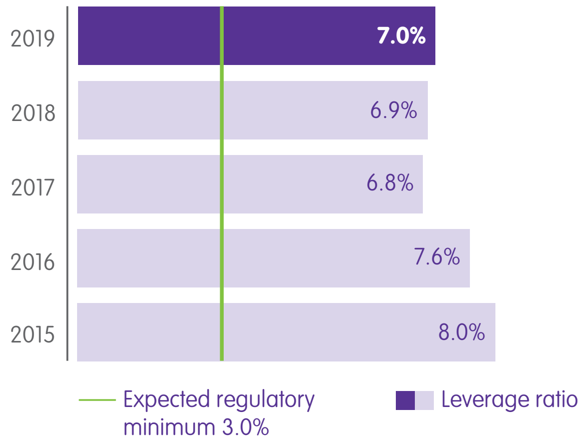
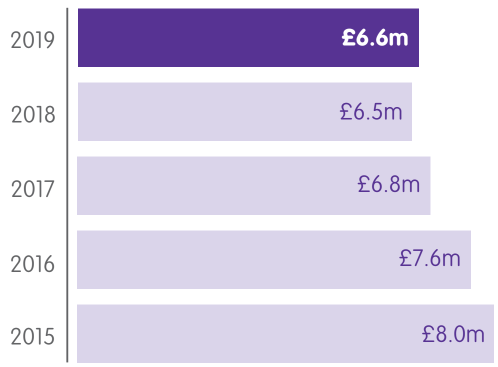
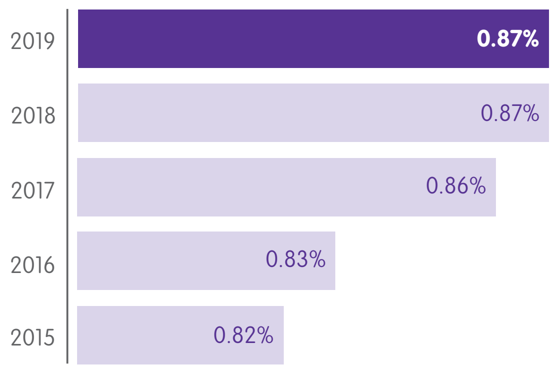
The CET 1 ratio, calculated as CET 1 capital divided by risk-weighted assets, is a measure of financial strength and is required to be maintained above a regulatory threshold.

Performance:

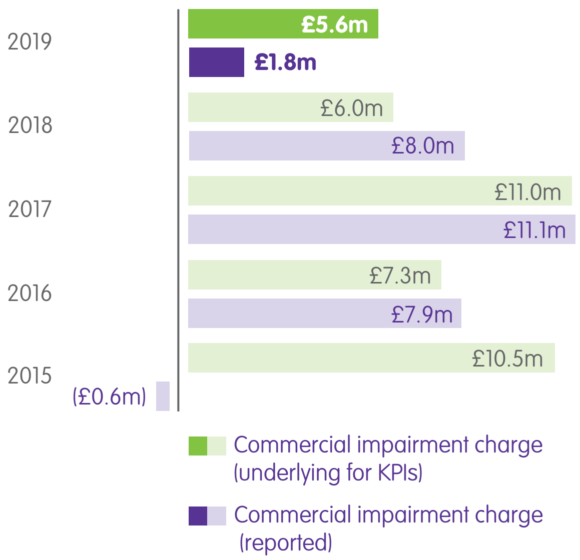
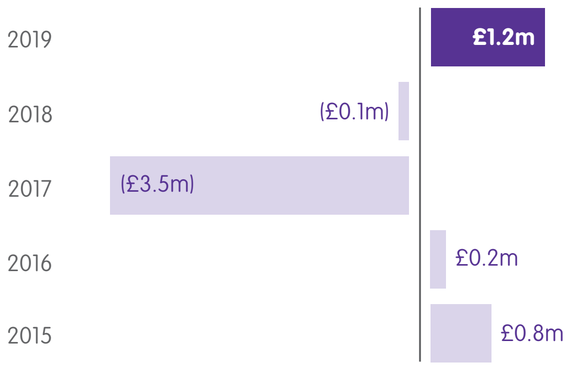


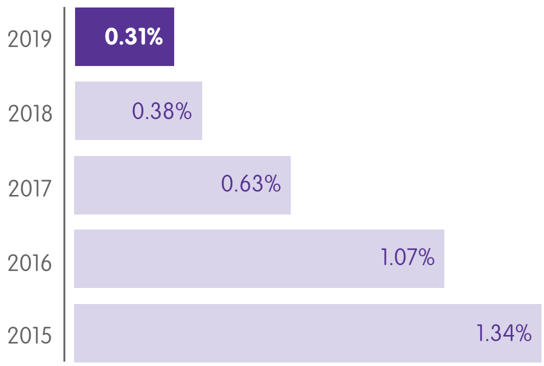
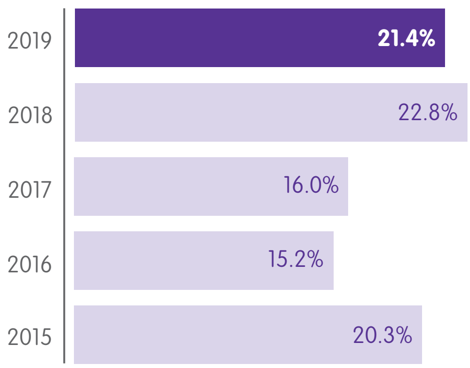
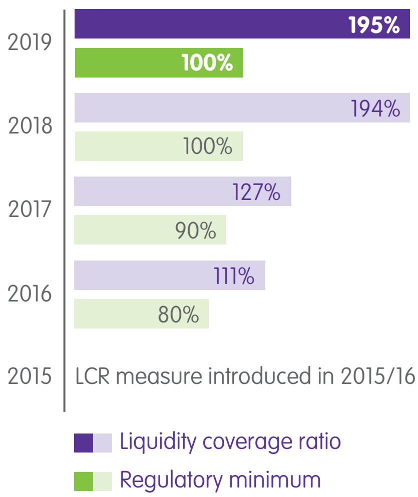
2018/19 review: CET 1 capital increased during the year, as a result of profits and the completion of a Liability Management Exercise (LME) which modernised the capital base.

Together with a reduction in risk-weighted assets, the uplift in CET 1 capital delivered an improvement in the CET 1 ratio, which is maintained comfortably in excess of our regulatory Total Capital Requirement (TCR) at all times.

Key performance indicator	Measure	Performance	2018/19 review
Leverage ratio	Measured as Tier 1 capital divided by total leverage ratio exposure, the leverage ratio provides another capital strength performance indicator which is held above the expected regulatory minimum.		At 7.0%, the leverage ratio remains significantly above the regulatory threshold and compares favourably with others in the sector.
Other income	Other income primarily represents income earned from non-margin related products. This includes commission on insurance (in particular home and contents), protection and investment products and rental income on a portfolio of residential properties held by the subsidiary West Bromwich Homes Limited.		Other income has increased by 2% in the year, as we continue to support our members with a range of financial services products, via our partnerships with industry experts, and to provide quality homes to the rented sector through West Bromwich Homes Limited.
Cost efficiency	The management expenses ratio is a measure of cost efficiency, reflecting costs (including depreciation and amortisation) as a percentage of mean total assets.		The management expenses ratio has remained stable year on year, affected by both a reduction in expenses and in total assets. Total costs reduced despite continued investment in technology and inflationary pressures. This has been achieved via a resolute focus on delivering products and services as efficiently as possible.

Key performance indicators (continued)

Key performance indicator	Measure	Performance	2018/19 review
Impairment provisions on loans and advances - commercial	The underlying commercial impairment charge is the charge for expected credit losses, net of fair value movements on derivatives used to hedge the impaired commercial loans and also, for 2018/19, before an IFRS 9 adjustment to recognise interest on stage 3 loans net of provisions. This is a measure of the expected loss inherent within the commercial mortgage book.		The current year impairment charge has been calculated on an expected loss basis as required by IFRS 9 'Financial Instruments' which the Group adopted in 2018/19. The key driver of the charge is the general worsening in the economic outlook for the retail sector, by which the commercial loan portfolio is particularly affected. Under IFRS 9, commercial provisions coverage has increased from 8.6% to 15.9% of gross exposures. Details on IFRS 9 adoption are given in note 43 to the accounts.
Impairment provisions on loans and advances - residential	The absolute residential impairment charge, now calculated on an IFRS 9 basis, measures the expected losses within the residential mortgage portfolios under a range of probability-weighted economic scenarios.		From 1 April 2018, residential impairment provisioning under IFRS 9 incorporates forecasts of future economic conditions. The residential impairment charge for the year also reflects the impact of Brexit-related uncertainty on provisions, in particular a weaker view of house price inflation than held at the time of IFRS 9 implementation. The underlying credit quality of the residential loan books remains high.

Key performance indicator	Measure	Performance	2018/19 review
Core residential arrears	The Board measure is the number of cases where the borrower has missed more than three monthly payments as a proportion of the total number of loans.		At under 40% of the published UK Finance average, core residential arrears remain at low levels and have continued to decrease annually, representative of the high quality residential mortgage portfolios and a proactive approach to credit management.
Wholesale funding ratio	The wholesale funding ratio measures the proportion of total shares and borrowings (including non-recourse finance) not in the form of retail savings products. It is used to assess relative exposure to the wholesale funding markets. It is the Board's aim to have a diversified funding strategy but to maintain this ratio at 25% or below.		The wholesale funding ratio has fallen slightly in the year to 21.4%. Wholesale funding includes mortgage-backed securitisations and Bank of England initiatives which provide longer-term funding to supplement the retail funds provided by members.
Liquidity coverage ratio (LCR)	LCR is measured as high quality liquid assets as a proportion of an assumed stressed level of outflows over a 30 day period. The current regulatory minimum is 100%.		High quality liquidity was maintained above internal and regulatory thresholds, ensuring the Society is in a position to meet its financial obligations under both normal and plausible stressed circumstances.

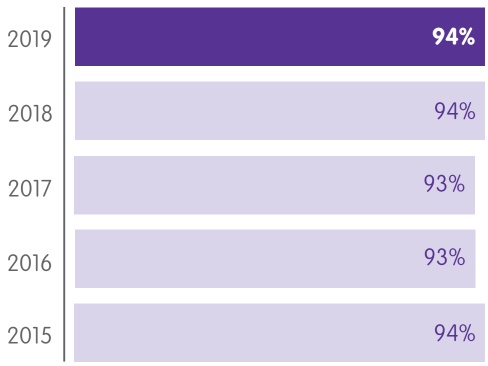
Key performance indicators (continued)

Key performance indicator | **Measure** | **Performance** | **2018/19 review**

Customer satisfaction

Measure: Following a branch visit or call to our Customer Services department, members are asked to rate us across a number of different measures, including how easy they found the West Brom to deal with. We then capture a score for satisfaction.

Performance:

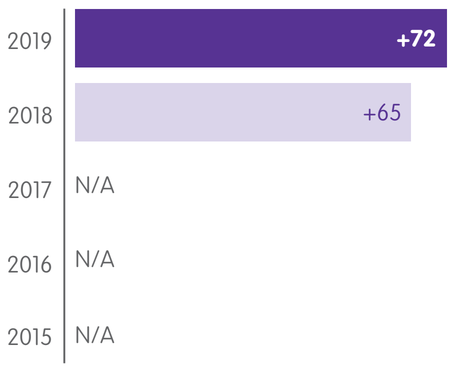


2018/19 review: Testament to the customer being at the heart of all we do, satisfaction scores have been consistently high.

Net Promoter Score® (NPS®)[1] – customer satisfaction

Measure: A measure, introduced in 2017/18 for the Society, which ranges between -100 and +100, of how likely a customer is to recommend our products and services.

Performance:

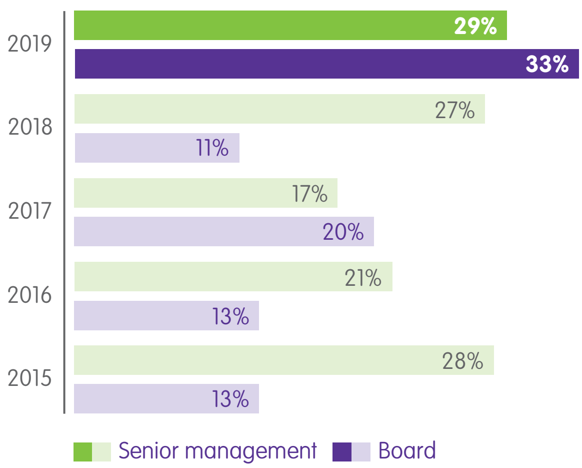


2018/19 review: An improving, positive Net Promoter Score shows that our high service standards are being recognised by our membership.

Gender diversity

Measure: The Society has signed up to the Women in Finance Charter and has targets for female representation of at least 30% on the Board and also in senior management by 2020.

Performance:



2018/19 review: The Society has already exceeded its 30% target for female representation on the Board and, with 29% of senior managers being female, is well positioned to meet its 30% target by 2020.

[1] Net Promoter Score and NPS are trademarks of Satmetrix Systems, Inc., Bain & Company, Inc., and Fred Reichheld.

Financial review

Financial performance

Summary income statement

Year to 31 March	Group 2019 £m	Group 2018 £m
Net interest income	**58.5**	55.5
Fees, commissions and other income	**6.6**	6.5
Fair value (losses)/gains on financial instruments	**(4.4)**	2.5
Total income	**60.7**	64.5
Management expenses	**(49.5)**	(50.7)
Gains on investment properties	**2.6**	3.8
Impairment on loans and advances	**(3.0)**	(7.9)
Provisions for liabilities	**(0.3)**	(0.9)
Profit before tax	**10.5**	8.8
Taxation	**(1.4)**	(0.9)
Profit for the financial year	**9.1**	7.9

Profit before tax increased by 19% to £10.5m (2017/18: £8.8m) representing a strong performance and enabling us to continue investing in products and services which meet the needs of our current and future membership. This improved level of profitability was driven by an increase in net interest income and reductions in management expenses and impairment charges, as explained in more detail below.

Net interest income

Net interest income of £58.5m (2017/18: £55.5m) increased by 5% and net interest margin improved from 0.96% to 1.03%. The reduction in asset yields driven by increased competition in the mortgage market was offset by a reduction in overall funding costs which continued to benefit from the low cost term funding made available via the Bank of England's Term Funding Scheme (which closed for new drawdowns in February 2018).

As a mutual, it is not our role to maximise the interest rate differential between borrowers and savers. Instead, we aim to offer competitive rates and manage net interest margin at a level which allows us to cover costs, maintain our robust capital position and invest in the future. This is why, when Bank Rate increased in August 2018 by 0.25% to 0.75%, with no appreciable increase (in fact relative reductions) in new mortgage market rates, we still raised savings rates, wherever possible, to deliver value to our saving members. Indeed, we paid our savers 0.29% above the market average for the 12 months to 31 March 2019 (31 March 2018: 0.16%)[1].

Intense competition in the mortgage markets during 2018/19 exerted pressure on net interest margin; however, this was partly offset by improved returns on the Society's free capital resulting from increases in Bank Rate during the year.

[1] Average market rates sourced from Bank of England Bankstats table A6.1

Fees, commissions and other income

The Society partners with a number of providers to offer home insurance, financial advice, will writing, life cover and funeral planning. Fees and commissions of £2.6m (2017/18: £2.7m) were earned on these products and services, which are made available to support our members' wider financial wellbeing.

In its capacity as responsible landlord, the Group earned net rental income of £4.1m (2017/18: £4.0m) on residential properties let through subsidiary company, West Bromwich Homes Limited.

Fair value (losses)/gains on financial instruments

The Society is exposed to income statement volatility through changes in the fair value of financial assets and liabilities which are held at fair value through profit or loss (FVTPL).

Derivative financial instruments, used for risk management purposes, mitigate the impact of fair value movements on the income statement but only where the conditions for applying hedge accounting are met.

Of the £4.4m fair value losses (2017/18: £2.5m gains) in the year:

- £1.7m (2017/18: £nil) relates to the closed equity release portfolio for which the measurement basis changed to FVTPL on adoption of the new accounting standard IFRS 9 'Financial Instruments'. A deterioration in the house price index (HPI) outlook during the year was the main driver of the fair value loss reported for the equity release book.
- £2.7m (2017/18: £2.0m gain) represents fair value movements on derivatives held to hedge impaired commercial loans for which the criteria to apply hedge accounting are not met. The volatility arises from changes in the market view of interest rates and is largely offset within impairment on commercial loans and advances.
- The remaining balance, not material for 2018/19 but a gain of £0.5m in 2017/18, mainly relates to hedge ineffectiveness where the fair value movements on hedging derivatives do not fully offset the fair value changes in the corresponding hedged assets (i.e. fixed rate mortgages) and liabilities (i.e. fixed rate savings).

Management expenses

Management expenses have reduced from £50.7m in 2017/18 to £49.5m. As a proportion of mean total assets, management expenses remained stable at 0.87% (2017/18: 0.87%).

During the year the Society identified a number of areas where services could be provided more efficiently, resulting in cost savings, after absorbing inflationary pressures, of 2.4%. Excluding a one-off past service cost of £0.4m, for the equalisation of Guaranteed Minimum Pension (GMP) benefits between men and women - an obligation impacting all UK defined benefit schemes – the reduction in costs was 3.2%.

The Society will continue to invest in IT infrastructure, in order to meet members' expectations in a dynamic digital environment, whilst maintaining its focus on providing long-term value for members by spending their money wisely.

Gains on investment properties

The Society provides residential housing for rental through its subsidiary company, West Bromwich Homes Limited. These properties are concentrated in the West Midlands, the South West and South Wales.

House price inflation, whilst fairly slow during the year, has been positive, especially in the areas where many of the properties are situated. During the year, the market value of the properties held rose by £2.6m compared with £3.8m in the previous year.

Impairment on loans and advances

Year to 31 March	IFRS 9 basis 2019 £m	IAS 39 basis 2018 £m
Equity release portfolio	**-**	0.3
Other residential loans	**1.2**	(0.4)
Commercial	**1.8**	8.0
Total impairment	**3.0**	7.9

The Group adopted IFRS 9 'Financial Instruments' from 1 April 2018. Impairment is now measured on an expected loss basis rather than the incurred loss approach prescribed by IAS 39, under which the comparative information for 2018 is reported. The impact of IFRS 9 transition is described in detail in note 43 to the accounts. Note 1 explains the accounting policies for impairment on loans and advances under IFRS 9 for 2018/19 and IAS 39 for 2017/18.

Residential impairment

Under IFRS 9, the calculation of expected credit losses (ECLs) incorporates forecasts of future economic conditions. During the year, in the wake of Brexit-related uncertainty, the economic outlook, in particular the assumptions surrounding house price inflation, worsened. Whilst the quality of the Society's residential mortgage books remains strong, under IFRS 9, the increased probability of a downturn drives the recognition of additional residential impairment charges, with £1.2m reported in 2018/19 (2017/18: £0.4m credit on an IAS 39 basis, excluding equity release impairment charge of £0.3m).

As mentioned previously, equity release mortgages are held at fair value through profit or loss under IFRS 9 and are therefore not subject to an impairment assessment, with changes in credit risk now reflected as fair value gains or losses in the income statement.

Commercial impairment

All commercial loans are individually assessed using cash flow scenario modelling, which considers a range of possible outcomes to calculate ECL requirements.

Under IFRS 9, commercial impairment charges of £1.8m were recognised for the year compared with an IAS 39 charge in 2017/18 of £8.0m. After adjusting for the offsetting movements in derivatives held to hedge the impaired loans and also a £1.1m adjustment to recognise interest net of provisions for stage 3 loans (i.e. loans in default), the charges were more comparable at £5.6m and £6.0m for the current and prior year respectively.

The implementation of IFRS 9 has increased commercial provision balances which, at £70.7m (2017/18: £42.1m), represent 15.9% of the current loan book (2017/18: 8.6%). As commented upon in previous years, the commercial property sector is especially vulnerable to economic uncertainty and, under IFRS 9, this sensitivity is captured within the calculation of the provision requirement. The charge in the year is due in particular to a weakening in the economic view for the retail sector, to which the commercial portfolio is exposed. See note 34(c)(iii) to the accounts for an analysis of the commercial portfolio by industry type.

At 31 March 2019, 58% (2017/18: 55%) of non-core commercial balances were managed by a Law of Property Act Receiver (LPAR), appointed to assist in the management of future cash flows and debt recovery.

The exit from the commercial property sector, which is deemed non-core, continues to be a strategic objective.

Provisions for liabilities

The income statement charge, in relation to provisions for liabilities, has reduced to £0.3m (2017/18: £0.9m). During the year, the Financial Services Compensation Scheme (FSCS) repaid its loan from HM Treasury and confirmed no further loan interest would be levied. An FSCS levy charge of £0.3m was recognised in the previous year.

Taxation

The corporation tax charge for the year is £1.4m (2017/18: £0.9m). The effective tax rate for the year of 13.3% (2017/18: 10.2%) is lower than the current UK rate of 19% due to the utilisation of brought forward tax losses and the recognition of deferred tax assets, based on amounts expected to be recoverable within the next five years.

The Society fully complies with HMRC's Code of Practice on Taxation for Banks and has controls in place to ensure it maintains appropriate tax accounting arrangements, with oversight provided by the Audit Committee and the Board.

The Society maintains an open, honest and transparent relationship with HMRC. The Society's tax strategy has been published on its website.

Further analysis of the tax charge is given in note 9 to the accounts.

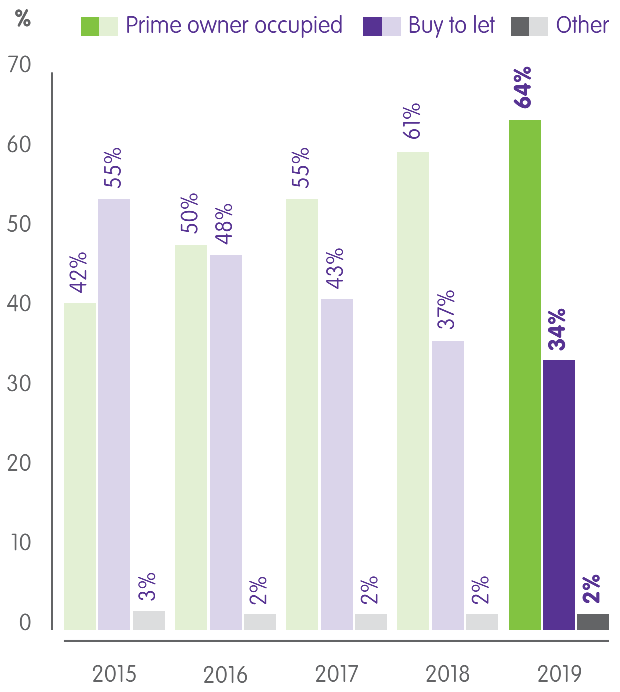
Financial position

Summary statement of financial position

At 31 March	Group 2019 £m	Group 2018 £m
Assets		
Residential loans and advances	**4,373.1**	4,359.5
Commercial loans and advances	**373.6**	445.9
Liquid assets	**598.5**	757.2
Derivative financial instruments	**6.5**	19.5
Fixed and other assets	**202.2**	199.4
Total assets	**5,553.9**	5,781.5
Liabilities		
Shares	**3,991.2**	4,051.4
Wholesale funding	**1,089.1**	1,197.7
Derivative financial instruments	**39.3**	38.7
Other liabilities	**48.1**	23.7
Total liabilities	**5,167.7**	5,311.5
Equity		
General reserves	**247.1**	215.8
Other equity instruments	**135.9**	250.0
Other reserves	**3.2**	4.2
Total equity	**386.2**	470.0
Total liabilities and equity	**5,553.9**	5,781.5

Residential loans and advances

Analysis by lending type at 31 March 2019



The total value of the residential loan book remained stable year on year, while its composition continued to rebalance in line with the Board's strategy. At 31 March 2019, the legacy buy to let portfolio had reduced to 34% of the total book compared with 37% in the prior year.

At £691m (2017/18: £837m), new prime residential mortgage lending was lower than during the comparative period. This reflects the high level of market competition and the Society's decision not to lend at rates which do not allow us to meet our risk-adjusted return on capital thresholds.

During the year, the Society expanded its product proposition to address the challenges faced by many in fulfilling their home ownership aspirations. The Society continued to help first-time buyers with their ambitions to own their own homes. 43% (2017/18: 34%) of all new borrowers, accounting for 35% (2017/18: 32%) of new mortgage advances by value, were first-time buyers. For those purchasing with the assistance of a sponsor, we launched an assisted mortgage range, while our self-build mortgages give borrowers the freedom to construct their own homes. In support of the private rented sector, we have also introduced products for portfolio buy to let landlords.

At 31 March Residential loans analysis by region	2019 %	2018 %
East Anglia	**2.9**	3.0
East Midlands	**10.5**	10.3
Greater London	**11.3**	11.9
Northern Ireland	**0.1**	0.1
North	**4.4**	4.3
North West	**12.3**	12.5
Scotland	**2.2**	2.4
South East	**16.4**	16.5
South West	**8.3**	8.3
Wales	**5.0**	5.0
West Midlands	**16.7**	16.3
Yorkshire	**9.9**	9.4
Total	**100.0**	100.0

While the branch network of the Society is based predominantly in the West Midlands, the Society provides online and intermediary distribution channels to ensure its accessibility to the rest of the United Kingdom. This also mitigates geographical concentration risk, as illustrated in the regional analysis table above.

At 31 March 2019 Group arrears	**Total balances £m**	**3 months+ %**
Prime owner occupied	**2,797.3**	**0.36**
Buy to let	**1,503.2**	**0.12**
Other	**50.9**	**2.93**
Core residential	**4,351.4**	**0.31**
Second charge lending	**12.4**	**9.48**
Total residential	**4,363.8**	**0.45**

At 31 March 2018 Group arrears	Total balances £m	3 months+ %
Prime owner occupied	2,677.5	0.45
Buy to let	1,637.1	0.17
Other	56.6	3.22
Core residential	4,371.2	0.38
Second charge lending	14.8	7.94
Total residential	4,386.0	0.53

Group arrears are measured as the number of cases where a borrower has missed more than three monthly payments as a proportion of the total number of loans. At 31 March 2019, 3 months plus arrears for the core residential book was 0.31% (2017/18: 0.38%) which compares favourably against the UK Finance average of 0.78% (2017/18: 0.81%).

The downwards trend in the level of arrears has continued and is a reflection of the Society's conservative lending policy and effective credit management practices, against a backdrop of low UK unemployment.

Commercial loans and advances

At 31 March Commercial loan portfolio	**2019 £m**	2018 £m
Non-core commercial balances excluding securitisation	**411.9**	434.8
Securitised commercial balances	**32.4**	53.2
Impairment provisions	**(70.7)**	(42.1)
	373.6	445.9

In line with the Board's strategy of exiting the commercial property sector, non-core commercial balances have reduced by 9% from £488.0m to £444.3m, of which £32.4m (2017/18: £53.2m) is held within structured entities, where there is no residual risk exposure for the Group. Within the statement of financial position, the commercial balances of £373.6m (2017/18: £445.9m) are presented net of £70.7m (2017/18: £42.1m) impairment provisions which, as detailed in notes 14 and 43 to the accounts, have increased due to the implementation of IFRS 9.

Liquid assets

At 31 March 2019 Liquidity portfolio	**£m**	**%**
Cash and balances with the Bank of England	**182.5**	**30.5**
Supranationals	**71.2**	**11.9**
Covered bonds	**143.9**	**24.0**
Mortgage backed securities	**71.1**	**11.9**
Other securities - rated single A or better	**23.1**	**3.9**
Subsidiary/other liquidity	**106.7**	**17.8**
Total liquidity	**598.5**	**100.0**

At 31 March 2018 Liquidity portfolio	£m	%
Cash and balances with the Bank of England	324.7	42.9
Supranationals	65.3	8.6
Covered bonds	139.8	18.5
Mortgage backed securities	89.6	11.8
Other securities - rated single A or better	17.1	2.3
Subsidiary/other liquidity	120.7	15.9
Total liquidity	757.2	100.0

The Society holds liquid assets to ensure it can meet its financial obligations, including lending commitments, as they fall due. Liquidity was maintained at sufficient levels and in excess of regulatory limits throughout the year.

The liquidity portfolio provides modest returns in relation to the costs incurred in generating the funds. The Society therefore holds off-balance sheet liquidity, which can be readily converted to cash, where such funding arrangements are available at a lower cost.

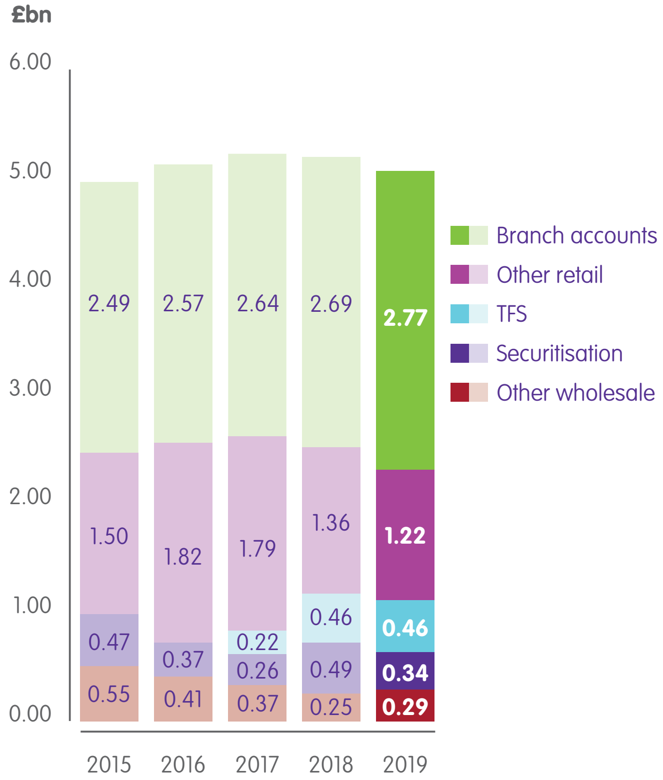
Current and prior year liquidity holdings consist solely of high quality liquid assets, with treasury investment securities rated at least single A or held with a Globally Systemically Important Counterparty. The Group has never experienced a default on its Treasury investment portfolio. Under IFRS 9, liquid asset impairment provision requirements at 31 March 2019 were negligible (2017/18: £nil under IAS 39).

The LCR ratio, the key liquidity adequacy measure, was 195% at the year-end date (2017/18: 194%), comfortably above the regulatory minimum of 100%. The Society's liquidity holdings are held at levels to cover cash outflows under both normal and stressed conditions including, but not limited to, uncertainties surrounding Brexit.

The net stable funding ratio (NSFR) measures the ratio of available stable funding to required stable funding, representing a longer-term liquidity indicator than the LCR. Based on the Society's interpretation of the new rules, the NSFR at 31 March 2019 was 132% (2017/18: 134%), compared with a regulatory requirement of 100%.

Funding

Funding balances



Retail savings balances, the primary source of funding for the Society, were £3.99bn at the year-end date (2017/18: £4.05bn). During the year, we continued to offer competitive products and saw the proportion of funds held in branch-based accounts grow from 66% to 69% of total member deposits.

At 31 March 2019, 78.6% (2017/18: 77.2%) of total funding was made up of retail savings balances, with the remainder deriving from wholesale sources of varying duration to match the Society's needs. Accessing the wholesale markets can reduce the overall cost of funding and mitigate risk by diversifying the funding pool.

During the year, the wholesale funding ratio decreased slightly to 21.4% (2017/18: 22.8%), and wholesale balances reduced to £1.1bn (2017/18: £1.2bn).

In common with other mortgage lenders, the Society has participated in Bank of England schemes which provide relatively low cost funding arrangements, utilising residential mortgage-backed securities as collateral. At the end of the year 26.4% (2017/18: 28.3%) of assets were encumbered to support Bank of England and other wholesale funding initiatives, as detailed in note 40 to the accounts.

Capital

At 31 March	Transitional CRD IV rules 2019 £m	Full implementation of CRD IV 2019 £m	Transitional CRD IV rules 2018 £m	Full implementation of CRD IV 2018 £m
Members' interests and equity	**386.2**	**386.2**	470.0	470.0
PIBS deduction	**(8.9)**	**(8.9)**	(75.0)	(75.0)
Other adjustments[1]	**5.9**	**(25.5)**	(20.8)	(20.8)
Common Equity Tier 1 (CET 1) capital	**383.2**	**351.8**	374.2	374.2
Additional Tier 1 capital	**8.9**	**-**	30.0	-
Total Tier 1 capital	**392.1**	**351.8**	404.2	374.2
Tier 2 capital[2]	**21.6**	**21.6**	16.3	16.3
Total regulatory capital resources	**413.7**	**373.4**	420.5	390.5
Risk weighted assets (RWA)	**2,400.6**	**2,321.7**	2,523.1	2,523.1
Leverage ratio exposure	**5,586.3**	**5,586.3**	5,885.2	5,885.2
Capital ratios	**%**	**%**	%	%
Common Equity Tier 1 ratio (as a percentage of RWA)	**16.0**	**15.2**	14.8	14.8
Tier 1 ratio (as a percentage of RWA)	**16.3**	**15.2**	16.0	14.8
Total capital ratio (as a percentage of RWA)	**17.2**	**16.1**	16.7	15.5
Leverage ratio	**7.0**	**6.3**	6.9	6.4

[1] Other adjustments mainly comprise deductions for intangible assets and deferred tax. For March 2019, other adjustments also include IFRS 9 transitional relief.
[2] Tier 2 capital excludes accrued interest.

Capital is held to absorb losses, thereby protecting members' interests, and must be maintained above thresholds set by the Prudential Regulation Authority (PRA). At 31 March 2019, the Society's Common Equity Tier 1 (CET 1) capital resources comprised general and other reserves and core capital deferred shares (CCDS), issued in April 2018 as part of the Liability Management Exercise (LME). The LME solidified the Society's capital position and increased members' general reserves by £52m. This transaction is further explained in note 42 to the accounts.

The combined effects of the LME, annual profits and reduction in higher risk-weighted commercial assets led to an improvement in the Common Equity Tier 1 (CET 1) ratio from 14.8% to 16.0% at 31 March 2019. The leverage ratio, a simpler capital measure which is not adjusted for relative risk, was 7.0% (2017/18: 6.9%) substantially above the expected regulatory minimum of 3%.

Transitional arrangements have been applied to phase in the capital impact of adopting IFRS 9 'Financial Instruments', which resulted in a £27.8m reduction to reserves, mainly due to increased commercial provision requirements. This transitional period is five years long and, over that time, the additional impairment provisions, recognised as a result of IFRS 9 adoption, are added back to CET 1 capital in accordance with formulae set by the Regulator. Had the transitional arrangements not been in place, the CET 1 ratio at 31 March 2019 would have been 15.2% and the leverage ratio would have been 6.5%.

The Society's current capital position satisfies the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) regulation, being phased in over a transitional period ending in 2021/22.

We are building on our risk management capabilities through an active project to progress the Society towards the Internal Ratings Based approach to credit risk. The project is progressing well and we are continuing to work towards a 2019 application date.

Further details of our capital position are given in the Pillar 3 disclosure document, published on the Society's website.

Principal risks and uncertainties

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

The separate Risk Management Report on pages 25 to 31 identifies the principal risks and uncertainties faced by the Society and describes, in detail, the West Brom's approach to risk management.

Financial outlook

The outcome of Brexit is not expected to directly impact the Society's operations, with its activities being entirely UK-based. However, there are risks that could impact the wider economy, as we leave the EU and transitional arrangements are formalised. A 'disruptive Brexit' could adversely impact consumer confidence and force interest rates to remain low for a prolonged period of time. Attracting savers and growing the mortgage book in a competitive, low interest rate environment will be challenging. Conversely, should a stable transition ensue, rates may grow modestly in an attempt to control inflation. While its aftermath is not easy to predict, Brexit is clearly a critical factor in determining the outlook for the UK economy as a whole. The potential impact on the Society has been incorporated into stress testing models, used within internal capital adequacy assessments and IFRS 9 provision calculations.

The residential mortgage market remains highly competitive, creating ongoing margin pressure. We will pursue those opportunities for growth which meet our principles of promoting home ownership and responsible lending without detrimentally impacting our savers. The Society's profitability, liquidity and modernised capital base provide financial resilience to endure a future economic downturn should it arise.

Investment in our infrastructure has remained a priority, ensuring we respond to the evolving needs of our members. This will continue into the next financial year as we continue to improve customer experiences by delivering necessary technological change. In April 2019, a new flagship branch was opened in the heart of West Bromwich, offering better access and facilities for our customers while representing a strong sign of the town's wider regeneration.

The Society has delivered results which illustrate real progress against strategic objectives. Profitability has increased, capital resources have been strengthened and balance sheet risk has reduced. The Society is well placed to face the wider economic challenges which may emerge in the coming financial year, whilst continuing to provide long-term value for its members.

Customer research and engagement

Carrying out regular research helps us to understand how well we are meeting the financial needs of our members and how we may improve. We also ensure there are a number of ways for members to give us feedback on our products and services and offer their suggestions for how we could make improvements.

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

- Mystery shopping – captured on video, mystery shops provide valuable insight into the quality of service and care our members receive;
- Voice of the customer – following a branch visit or call to our Customer Services department, members are asked to rate us across three different measures. They can also leave general comments and suggestions;
- Thematic research – we send our members surveys by post or email after they have completed certain product purchases;
- Customer panel – made up of mortgage and savings customers who respond to online questionnaires and help us with comprehension testing; and
- Members' ViewPoint – held twice a year, these events seek face to face feedback from members in a relaxed and welcoming environment.

Video mystery shopping is a powerful tool which provides a real-life view of what our members experience when they visit a branch. We are not just focusing on service in terms of friendliness; shoppers are looking for evidence of product knowledge and how well staff identify a customer's individual needs.

Every branch receives at least one mystery shop per quarter carried out by an independent specialist, with scenarios based around first-time buyer mortgages and children's savings accounts among those tested this year. We use the results to identify opportunities to improve and to recognise and share examples of good performance.

Gathering feedback from genuine customer interactions is equally important to us. Developed by the Society, Voice of the customer allows us to track sentiment 'in the moment' after customers have visited a branch or spoken to an adviser over the telephone.

We ask them how easy they found the West Brom to deal with as this underpins our proposition to customers to deliver great service. We then capture a score for satisfaction and their likelihood to recommend us.

Scores recorded for the year were encouragingly high. Satisfaction ratings averaged 9.4 out of 10 (2017/18: 9.4 out of 10), a consistently strong performance. This current year is the first where we have asked for ratings on ease and the average net score was 85 out of 100.

Our Net Promoter Score was calculated at +72 (2017/18: +65), confirming that customers are very likely to recommend the West Brom based on the quality of their own experiences.

We gather more detailed feedback on customer satisfaction by carrying out surveys after a product or service has been provided. At present, these are targeted at mortgage applicants and customers receiving independent financial advice through our partner organisation Wren Sterling.

The purpose is to understand how customers felt at all key stages of the process, from their initial recommendation through to final delivery. We ask questions around knowledge, communication and overall satisfaction. Results are monitored closely and any relevant learnings shared.

Regular insight helps us to shape our customer offering which is why we set up our customer panel, a group of more than 2,000 members who complete online questionnaires on matters related to all aspects of financial services. Recent topics include retirement planning and intergenerational lending in order to support younger people in achieving goals such as home ownership.

We also invite members of the panel to carry out comprehension testing before we release new product information or user guides.

While the customer panel embraces the speed and convenience of digital interaction, we still value meeting our members in person as often as we can. Our Members' ViewPoint feedback events continue to be well attended, with members welcoming the opportunity to put questions directly to the Chief Executive and senior management team.

Customer research is in addition to the more strategic output being offered by the Society's newly formed Member Council. Such a cross-section of opinions and experiences ensures our decision making is always well informed with full consideration for our members' needs.

Members are invited to offer feedback and ask questions at our twice-yearly ViewPoint events.

Corporate Social Responsibility

Social and community impact

Supporting local communities and working to enhance the lives of people within the Society's operating region is at the very core of our commitment to corporate social responsibility. This reflects the Society's regional identity and traditional roots, as well as our reputation as a business that actively cares for the communities we serve, including the wellbeing of our staff as individuals drawn from those communities.

Financial aid

Through the provision of grants via the Society's charitable arm – the Mercian Community Trust – we are able to target support for charities and community groups directly engaged in helping people experiencing difficulty and disadvantage at a local level.

Funding comes from our Community Account, an affinity savings product that reflects the longstanding relationship the Society has with the Diocese of Lichfield. In light of this partnership, financial aid is distributed to a range of organisations – last year that amounted to nearly 50 – encompassing a wide variety of causes such as mental and physical health, hospice care, dementia, disability, additional educational needs, foodbanks, and bereavement services. For many smaller charities, the effect of cuts in local authority provision has had a marked impact on them, making the Society's assistance even more critical.

The added benefit of this form of grassroots support is that it deepens the Society's connections with the communities where our branches are based. This enables us to explore how we might assist these organisations in other ways, for instance, through volunteering involvement from our staff, which has happened with several charities.

Fundraising

Each year, the Society's staff select a local charity as the focus for their fundraising energies. This financial year, staff chose Black Country Women's Aid, which supports women, children, and men, who have endured the trauma of domestic violence.

As its name indicates, the charity is closely aligned to the Society's heartland. By having a regional rather than a larger national charity, the relationship with the charity tends to have a more immediate impetus. That was apparent in how staff across the Society organised a number of fundraising initiatives, which illustrated their creative compassion. In addition to financial assistance, staff also launched a campaign to supply the welcome packs that women and children receive on arrival in the charity's refuges. This was enormously appreciated by the charity given that many women and children are forced to flee their homes as an emergency with hardly anything to their name.

Over the course of the year, the Society raised some £30,000 for Black Country Women's Aid, which will largely go towards the charity's modern slavery services that assists women and men, many having been the victims of sex trafficking.

As well as fundraising, the Society's choice of the charity helps raise the profile of that charity. That was again the case with Black Country Women's Aid where events not only helped raise funds but also awareness among staff and, in turn, members about the painful realities of domestic violence and the vital services offered by this much-needed charity.

Affinity partnerships

The great advantage of the Society's affinity partnerships is that customers can use them to show their support for a specific organisation, which has a particular resonance for customers. They can do this by saving with the Society through special affinity accounts where bonus payments, based on the total savings held, are allocated on a yearly basis to those preferred organisations.

The outstanding embodiment of this is the Society's affinity partnership with Birmingham Children's Hospital, a facility that enjoys a national as well as an international reputation for its treatment and care of children. Through the Society's Red Balloon Appeal, over £750,000 has been generated for the hospital since the affinity arrangement was first set up in 2005.

And the affinity relationship has yielded other positive spin-offs, as seen in the participation of the Society's staff in the Art Kart project, which aims to alleviate the anxiety felt by children and families as they wait in the hospital's outpatients department for their appointments.

Black Country Women's Aid was selected by colleagues as our nominated charity for the year.

Volunteering

This is a very visible expression of the Society's engagement in the community, enabling us to make a tangible contribution to local organisations while staff invariably derive an emotional 'feelgood factor' from volunteering.

Our volunteering programme gives all staff two days to devote to community activities. The popularity of the programme is evident in the fact that nearly 20% of the Society's staff availed themselves of this opportunity during the year. And the nature of the projects was similarly impressive. The Art Kart scheme at Birmingham Children's Hospital is one vivid example. Another, at Queen Alexandra College in Birmingham, entailed volunteers working alongside staff from the college, together with students with visual impairments and learning disabilities.

Volunteers lend a helping hand to create green spaces at Queen Alexandra College.

Financial education

Increasing numbers of schools realise the need to give their pupils an understanding of financial matters. As a response to this, the Society has developed a presentation – The Money-Go-Round – which aims to equip pupils with a rudimentary awareness of money, both at their present stage in life and as they develop into adulthood. The session incorporates information about the value of money (how much essential things cost), the meaning of money (an outline of familiar financial elements such as mortgages, savings, credit cards, loans, and insurance), and the dangers of debt (the imperative of budgeting).

This interactive presentation has been used with some 25 schools, both at primary and secondary level, demonstrating how the presentation's versatility is one of its strengths. With a number of schools the presentation has indeed become a regular feature in their yearly curriculum.

Employee diversity

The Society is committed to attracting and retaining people with ability and promise, whatever their background. This is why the principles of diversity and inclusion are integral to us as an organisation, particularly as the Society is located predominantly in one of the UK's most ethnically diverse areas.

This commitment is reflected in the composition of our workforce with over a quarter – almost 28% – coming from ethnic minority communities. In localities with a mixed ethnic profile, having staff with multi-lingual skills allows us to provide a service for customers that is culturally suitable and sensitive.

In terms of gender, the Society has again published the required report on gender pay variations and, from its findings, it appears positive progress is being made in reducing the gaps that presently exist. A further measure of the Society's efforts on gender balance concerns our achievements under the Women in Finance Charter. Here, at 33%, the Society has already exceeded the target of increasing female representation to at least 30% on our Board by 2020. The Society's senior management figure stands at 29% against the same target.

Overall, out of a staff population of 702 (including Non-Executive Directors), women comprise 435 (62%). Nearly 58% of Retail and Branch Management team is female. At divisional management level, the comparison is 6 male to 2 female managers.

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

		2019 Female	**2019 Male**	2018 Female	2018 Male
Directors	Number	**3**	**6**	1	8
	Percentage	**33%**	**67%**	11%	89%
Senior managers	Number	**6**	**15**	6	16
	Percentage	**29%**	**71%**	27%	73%
Other colleagues	Number	**425**	**246**	440	278
	Percentage	**63%**	**37%**	61%	39%

During the year, an initiative – Connect – was introduced at the Society with the purpose of promoting diversity and inclusion where everyone within the business should feel involved and valued, and their identity respected. The celebration of such festivals as Vaisakhi, Eid, Hanukah, and Diwali was intrinsic to this desire to cultivate an ethos of cultural empathy, which could be said too of events relating to gender and sexuality in the shape of International Men's Day and Pride, for example.

Connect was inspired by the notion that people are more likely to give of their best if they feel valued and respected, together with a recognition that organisations have a responsibility for the emotional and physical welfare of their staff. That belief was mirrored by a further initiative – Wellbeing @ the West Brom – which featured projects over the year on healthy eating, health checks as in breast and prostate cancer, and advice on looking after ourselves.

Environment

As an organisation that takes its environmental responsibilities seriously, the Society has adopted a series of standards and schemes that reflect this ecological commitment.

- The Society moved to a new head office in 2016, which was categorised as 'very good' by BREEAM, the world's leading sustainability method. This move to purpose-built premises has allowed us to actively implement a number of practices that epitomise the Society's determination to protect the environment and limit our carbon footprint.
- The Society subscribes to the mandatory government scheme ESOS (the Energy Savings Opportunity Scheme). As an example, all our utilities are registered under ESOS, which assists in targeting and measuring reductions in energy usage, along with LED lighting for greater energy efficiency. That also incorporates the ability to calibrate water, gas, and electricity usage. Likewise, within branches, the introduction of half-hour metres enables us to accurately measure energy usage.
- Similarly, IT equipment is configured to go into energy saving mode after periods of inactivity.
- We operate effective recycling schemes with, for instance, confidential waste, stripped down IT equipment, and day waste similarly channelled for recycling.
- The Society has also set itself a target of removing all single use plastics while, in our head office restaurant, bio-degradable vegiware products are replacing plastic packaging.
- Staff are encouraged to reduce travel impact through the promotion of car share and cycle-to-work initiatives.
- Importantly, aware of its wider business responsibilities, the Society has a Supplier Code of Conduct, which places environmental management obligations upon our respective suppliers.

Other non-financial information

The Society adheres to the highest standards with regards to anti-bribery and corruption. All colleagues are trained in recognising and understanding the associated risks and are required to complete annual mandatory training. Additionally, the Society has in place policies to comply with applicable laws, including the Bribery Act 2010 and the Criminal Finances Act 2017. The Society publishes a Modern Slavery and Human Trafficking Statement annually on its website and continually seeks to improve its vigilance in respect of modern slavery issues via its Supplier Selection and Management policy and related procedures. The Society has a zero tolerance approach to slavery and human trafficking in all its forms, both in its supply chain and its business operations.

On behalf of the Board

Ashraf Piranie
Group Finance & Operations Director
29 May 2019

Risk Management

Overview

Effective management of risks and opportunities is essential to achieving the Society's 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.

The Society operates entirely within the UK financial services market and only undertakes risks it has the capability to understand and manage effectively.

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 that the Society is inherently exposed to as a building society: business, credit, capital, liquidity, market, basis, operational, retail conduct, pension liability, information and model risk (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 nine key risk management committees/groups:

Risk Committee (RC) - Comprising of all of the Non-Executive Directors except the Chairman, this Committee 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 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, pension liability, basis and interest rate risk.

Residential Credit Committee (RCC) - This Committee is chaired by the Chief 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 Risk Officer and is responsible for monitoring the Society's exposure to credit risks in the commercial loan book.

Operational, Conduct and Information Risk Group (OCIRG) - This Group is chaired by the Chief Risk Officer and is responsible for the oversight of the management of operational and retail conduct risks arising from the Society's business activities. It also maintains oversight and governance of information risk across the Society and challenges the effectiveness of the controls in place to mitigate information risk (including cyber security). One of its purposes is to support and drive the information risk governance agenda and provide oversight that effective information governance best practice mechanisms are in place within the Society.

Capital Review Group (CRG) - This Group is chaired by the Group Finance & Operations Director and is responsible for reviewing the Group's capital requirements.

Audit Committee (AC) - Comprising five 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.

Model Risk Committee (MRC) - This Committee is chaired by the Group Finance & Operations Director and is responsible for overseeing the Society's exposure to model risk across the business.

Risk categories

The Board has identified eleven 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, systems or people, or from external events.

Retail conduct risk

The risk that inappropriate behaviours by the Society result in adverse outcomes for retail customers.

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.

Information risk

The risk that customer or Society information assets are managed or processed incorrectly or are not adequately protected. It includes inadequate data quality and failure to comply with data protection and data privacy requirements.

Model risk

The risk of adverse consequences resulting from decisions based on models that are inaccurate, sub-optimal, incorrectly implemented, or misused.

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 seven occasions.

Business conditions and the economic environment

Against the backdrop of continuing Brexit related uncertainty, early in 2019 the Bank of England warned that the UK economy was on course for its weakest year since the global financial crisis, cutting its growth forecast for 2019 from 1.7% to 1.2% and estimating the chances of a recession at 25%. However, it expected UK inflation to meet its 2% target over the year. The continuing low cost of borrowing supports improving customer affordability and continues to drive the growth of consumer debt to record levels, albeit at a slower rate than in previous years.

The cost of retail mortgages generally remains low, with the cost of higher risk loans reducing, driven by increasing competition in the market. House price growth is expected to remain subdued and while a gentle acceleration in rental growth is expected, a sell-off in buy to let is likely to persist. This will further support the growth in the volume of first-time buyers and maintain the downward pressure on competitive market pricing through the coming year.

The West Brom is exclusively focused in the UK and, therefore, the general UK macroeconomic environment is key to its success. The Society considers macroeconomic risks on a regular basis, under central, downside, stressed and upside conditions to understand and manage the impact on its business model. Until uncertainty around the outcome of Brexit is resolved, the impact on consumer and business confidence is damaging to the economy. The external factors that impact the Society include:

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

The Society is not exposed to any direct trade with the EEA and does not rely on regulatory pass-porting into the EEA and is not directly dependent on EEA based financial market infrastructure.

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 and 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 25.

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 risk appetite established by the Board and in line with approved credit policy. The Society launched a range of Buy to Let products available to Limited Companies in respect of which a robust credit policy was developed.

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 I chair and includes all other Non-Executive Directors, except the Chairman, 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, depositing 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 & Financial Risk Management 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 Building Societies Act 1986 restricts the use of derivatives strictly to hedge against the impact of fluctuating external factors, such as interest rates.

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

In line with regulatory requirements and best practice, the impact on net interest income (NII) of a parallel shift in interest rates in both directions, is considered. In addition, the impact of alternative non-parallel scenarios upon NII and market value is also considered. Both are reported monthly to ALCo.

Interest rate sensitivity also arises from the potential for different interest rates to move in different ways, e.g. Bank Rate mortgages are partially funded by LIBOR-linked liabilities. The impact of these mismatches (basis risk) is monitored by Treasury and reported to ALCo. The regulatory authorities have continued to encourage firms to transition away from using LIBOR as a benchmark in all their operations before the end of 2021 and various industry bodies continue to progress possible solutions to this issue.

The Society's main exposure to equities is through the defined benefit pension scheme. There is no direct 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 exposes the Society to movements in house prices.

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 30 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 liquid 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 Internal 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 is 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 Net Stable Funding Ratio (NSFR) is a longer-term stable funding metric, which measures the sustainability of the Society's long-term funding. It was introduced from 1 January 2018. The Society's NSFR is in excess of 100%, and the Society holds sufficient stable funding to meet this requirement.

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 Risk Committee 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 Internal 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 its Total Capital Requirement.

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

The detailed breakdown of the Society's capital position can be found on page 20.

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 and Conduct Risk team, which has regular dialogue with function managers and collates management information for review by executive management, the Operational, Conduct and Information Risk Group and the Risk Committee.

The Operational and Conduct 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

Conduct risk is deemed so important that the Financial Conduct Authority (FCA) was created to increase the regulatory focus on it. This is intended to go beyond the previous focus on compliance with rules, on process and on treating customers fairly, to embrace a holistic approach of how a firm organises itself and does business in order to ensure good customer outcomes.

The management of conduct risk is a key component in the successful delivery of the Society's strategy and objectives, and protection of its members and customers.

Information risk

Understanding and managing information risk is imperative to the successful achievement of the Society's business objectives.

Effective policies, procedures and processes complemented by technological defences and detection tools, provide for successful information risk management.

To this end the Society has determined a risk management strategy based on the following principles:

- A clearly articulated and Board approved Information Risk Appetite Statement;
- A clearly articulated and Board approved information risk definition;
- An embedded and compliant Information Risk Management Framework, underpinned by robust processes and tools;
- A Board approved Cyber Resilience Strategy Plan;
- A Three Lines of Defence model with clearly articulated responsibilities for the management of information risk;
- Appropriate processes, systems and controls that support the effective management of information risks across the Society;
- Committee oversight within an appropriate governance structure; and
- An appropriate member of the senior management team with overall accountability for information risk management.

The General Data Protection Regulation (GDPR) came into force in May 2018, extending the rights of consumers in respect of their personal data and the Society established a programme of activities to ensure compliance.

Model risk

Increasingly, across the sector, models are developed to assess, control and monitor risk more effectively, consistently and accurately. As businesses place more reliance upon the outputs of such models, particularly in reporting and decision-making processes, it becomes increasingly important that an effective framework is in place to manage model risk. The Society continues to develop its modelling capabilities and has integrated models into key business activities such as loan decisioning, loss assessment, strategic planning, product pricing and the assessment of capital requirements. The Society continues to progress its project to migrate to Internal Ratings Based credit risk models and still plans to submit an application to the Prudential Regulation Authority in 2019. In recognition of this, model risk was elevated to a principal risk in 2018. A process of governance has been established applicable throughout the model life cycle, from initiation, through development, approval, implementation to ongoing monitoring and validation. In the development of its approach to model risk, the Society has ensured full compliance with applicable regulation.

Principal risks and uncertainties

Set out in the following table 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 the general uncertainty in the UK economy, as a result of implementing Brexit, leading to: • A reduction in interest rates from the current historical low, or a series of rapid and large increases in interest rates to counter inflation; • Reduced activity in the housing market and possible adverse impact from both lower lending and a potential fall in house prices; • Increased competition and cost of retail funding; • Low or flat economic growth; and • Increasing regulatory costs.	Business plans continue to model the impact of a range of scenarios and stress tests, which have been expanded to include potential Brexit outcomes. This is reflected within the IFRS 9, ICAAP and ILAAP assessments. These outcomes have Board visibility and are reviewed by a number of risk management committees. The Society is based in the UK and has no EU operations limiting its exposure to Brexit related operational risks.
Credit risk	Higher unemployment and/or an increase in Bank Rate (leading to increased arrears and losses).	The Society's IFRS 9 provisioning and stress testing models assume a range of unemployment levels and varying interest rate scenarios, including a stressed outcome. Should an increase in arrears accounts occur, the Society would expand its credit services resource.
	Reduction in property prices (leading to a higher incidence of voluntary possessions and elevated shortfalls when properties sold).	The Society is committed to work with its borrowers to avoid possession wherever possible. In the event that possessions were to increase the Society's regular reviews of its IFRS 9 provisions would reflect this increase.
	Low or flat economic growth (leading to further commercial property 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 and agents 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 and compliance with the relevant rules.
Liquidity risk	Intensification of competition for retail and wholesale funding.	The Society has demonstrated the ability to attract new retail deposits this year, despite intense competition. The Society also has access to a diverse range of other funding sources, including wholesale options and funding provided through the Bank of England's Sterling Monetary Framework.
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 and is managing down its Bank Rate Tracker book, replacing this with administered rate, LIBOR or SONIA-linked assets.
Market risk	The risk of a reduction in the Society's net interest margin as a result of rising competition amongst deposit takers.	The Society operates within Board approved limits and monitors the exposure to increases in funding rates through ALCo.
	Falling HPI, leading to a reduction in the book value of West Bromwich Homes Limited properties.	No new homes have been added, containing the exposure.

Risk category	Principal external threats	Society response and mitigants
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.
	Investment in core technology introduces execution risk with the benefits being delayed or not delivered.	The Society has a robust change management framework in place with regular updates provided to the Board.
	Single points of failure are identified, potentially impacting on critical services (mortgages and savings).	The Society is strengthening its operational resilience framework to facilitate greater alignment across the resilience disciplines to provide critical services to meet members' requirements and expectations.
Information risk	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 and threaten the security of members' information, and the availability of the services offered to them. Cyber attacks remain a significant risk for financial institutions.	The Society recognises the need to maintain and develop its defences and responses in this area in order to protect the Society and maintain the trust of customers and the confidence of regulators. External specialist advice has been received and actions implemented on system design. During 2018/19, the Society invested significantly in cyber security infrastructure and training and will continue to do so in 2019/20, in line with the Cyber Resilience Strategy and Information Risk Management Framework. This will require the Society to remain vigilant to the latest cyber attack trends and protection defences.
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.
Model risk	Regulatory requirements are amended by PRA/EBA with limited time/resource available for compliance.	The Society maintains close monitoring of regulatory publications and is involved with industry user groups to ensure appropriate visibility of emerging regulation on the horizon.

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.

Mark Preston
Chairman of Risk Committee
29 May 2019

Board of Directors

Left to right: **Mark Nicholls, Victoria Mitchell, Ashraf Piranie, Lynne Shamwana** and **Martin Ritchley.**

Julie Hopes MBA, ACIB
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 the Police Mutual Assurance Society, Saga plc and is Chair of Saga Services Ltd. Julie chairs the Remuneration Committee and is a member of the Nominations and Risk Committees.

Victoria Mitchell LLB (Hons)
Non-Executive Director Appointed April 2018
Victoria joined the Board on 1 April 2018 and is a legally trained businesswoman who brings to the West Brom a broad experience across operations and risk within the financial services sector. Prior to taking on the Non-Executive Director role at the West Brom, Victoria held the position of Chief Operating Officer at Capital One Europe plc. Victoria is a member of the Audit and Risk Committees.

Mark Nicholls MA (Cantab), MBA
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 also has a longstanding commitment to the charitable and public sector. Mark chairs the Nominations Committee and is a member of the Remuneration Committee.

Ashraf Piranie FCCA, MBA
Group Finance & Operations Director Appointed March 2017
Ashraf has worked in financial services for most of his working life, including the positions of Finance Director and Joint Managing Director at the Islamic Bank of Britain and Director of Finance at Alliance & Leicester Plc. Prior to joining the West Brom, he was Deputy Chief Executive & Finance Director at Nottingham Building Society. Ashraf is also Deputy Chair of the PRA Practitioner Panel. Ashraf chairs the Society's Assets & Liabilities Committee.

Left to right: **James Turner, Julie Hopes, Mark Preston** and **Jonathan Westhoff.**

Mark Preston BA (Hons), ACIB
Non-Executive Director Appointed May 2011
Mark has been involved in financial markets for over 30 years, most recently as Chief Executive at Exotix Partners. He was previously Chief Executive Officer for the Products and Markets Division of Lloyds TSB and Co-Head of the Bank's Corporate Markets. He is a member of the governing council for the University of Kent. Mark chairs the Risk Committee and is a member of the Audit, Nominations and Remuneration Committees.

Martin Ritchley FCA, FCIB, Hon DBA (Coventry)
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 is a member of the Remuneration, Audit, Nominations and Risk Committees. Martin will be stepping down from the Board at the Board meeting immediately following the Annual General Meeting after serving a full nine years as a member of the Board.

Lynne Shamwana BA FCA
Non-Executive Director Appointed February 2019
Lynne is Chief Financial Officer at Virgin Care. Lynne was previously Global Finance Director of Christie's, the international art auction house. She has held a variety of senior finance and management roles at Centrica plc, British Gas, Goldfish Bank plc and Alliance & Leicester plc. A fellow of the Institute of Chartered Accountants in England and Wales, Lynne is a member of the Audit and Risk Committees.

James Turner FCA, FCSI, BA (Hons)
Non-Executive Director Appointed April 2017
James is the Group Chief Risk Officer and an Executive Director on the Prudential Board. Before joining the Board James was the Director of Group Finance. Prior to Prudential, James was the Deputy Head of Compliance for Barclays. He also held a number of senior internal audit roles across the Barclays Group. James chairs the Audit Committee and is a member of the Risk Committee.

Jonathan Westhoff BA (Hons) Financial Services, FCMA, CGMA, ACIB
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 a past Chairman of the Building Societies Association and remains a Council Member. He chairs the Executive Committee, the Member and Employee Councils, 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 2019.

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 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 pages 2 to 3, the Chief Executive's Review on pages 4 to 6 and the Strategic Report on pages 7 to 24.

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 7 to 24.

Profit and capital

Profit before tax (on continuing operations) was £10.5m (2017/18: £8.8m).

The capital position is set out in the Strategic Report on page 20 and the Annual Business Statement on page 138. Detailed Pillar 3 capital disclosures for the current year will be available on the Society's website.

Country-by-country reporting

Information in respect of the Capital Requirements (Country-by-Country Reporting) Regulations 2013, which place certain reporting obligations on financial institutions that are within the scope of the Capital Requirements Directive (CRD IV), is given in note 41 to the accounts.

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 25 to 31.

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 and liquidity 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 33 to 36 to the Accounts.

Mortgage arrears

At 31 March 2019 there were 15 (2017/18: 18) 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 £77.2m (2017/18: £72.8m), representing 1.61% (2017/18: 1.51%) of mortgage balances, and the amount of arrears was £16.3m (2017/18: £15.7m). 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:

Julie Hopes
Victoria Mitchell (appointed 1 April 2018)
Mark Nicholls (Chairman)
Ashraf Piranie*
Mark Preston
Martin Ritchley
Lynne Shamwana (appointed 1 February 2019)
Richard Sommers (stepped down 30 July 2018)
James Turner
Colin Walklin (stepped down 31 December 2018)
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 2019, the creditor days figure was 30 days (2017/18: 29 days). This conforms with the aim of paying creditors promptly.

Charitable donations

During the year the Society donated £2,625 (2017/18: £1,849) to charitable organisations. The Society also raised significant sums through its community programme, affinity accounts and voluntary staff initiatives. These are outlined on pages 22 to 23 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 was one of the first signatories to the Women in Finance initiative, which is a government sponsored initiative to increase the numbers of female staff in financial services. The Society produced a diversity strategy during 2017 to increase its representation of people from all backgrounds.

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 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 operates.

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 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. Accredited safety representatives are afforded every opportunity to effect this consultation and to receive training. 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 1986 (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;
- assess the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

In addition to the Annual Accounts the Act requires the Directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Group 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 7 to 31 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 are responsible for such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and Society 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.

Going concern and business viability

The Directors' responsibilities in respect of going concern are set out below. In addition, the Directors have elected, with regard to the UK Corporate Governance Code, to publish a business viability statement which states whether there is a reasonable expectation the Society and the Group will be able to continue in operation and meet their liabilities as they fall due. The period assessed under the business viability statement is required to be significantly longer than the minimum period of 12 months over which going concern is assessed.

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 4 to 6 and the Strategic Report on pages 7 to 24. 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 7 to 24 and the Risk Management Report on pages 25 to 31.

In addition, note 12 and notes 33 to 36 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 planning period. Furthermore, the Group's capital is in excess of the PRA requirement under each of the scenarios considered, including a range of potential Brexit outcomes.

After making enquiries, the Directors are satisfied that the Group has adequate resources to continue in business for the next 12 months and that, therefore, it is appropriate to adopt the going concern basis in preparing the Annual Accounts.

Business viability statement

The Directors have assessed the viability of the Group over a longer period than the 12 months required by the 'going concern' provision noted above.

The Directors' assessment is based on a robust review of the Group's principal risks, the Strategic Plan and the risk management framework including risk appetite and risk culture described within the Risk Management Report. This assessment is further supported by the ICAAP, ILAAP, reverse stress testing, Recovery Plan and Resolution Pack. In particular the completion of the Society's LME in April 2018 resulted in a modernised capital base and has removed the potential uncertainty with respect to the classification of CET 1 capital instruments, leaving an improved capital position.

The assessment covers a period of three years as this is within the period covered by the Group's Medium Term Plan (the MTP), ICAAP, ILAAP and regulatory and internal stress testing. The time period chosen reflects the consideration that the level of uncertainty relating to the assessment increases the longer the period chosen. The pace of change of the economic, market and regulatory environments in which the Group operates may undermine the reliability of longer forecasts.

The MTP projects the Society's ongoing financial performance, capital and funding positions as satisfactory to the end of the three year plan period even in a range of adverse scenarios. Inherent uncertainty with regard to a number of factors, including geopolitical, economic and regulatory, inevitably increases over the planning period. Scenarios tested showed that the Society would be able to maintain viability over the three year period under assessment, after taking account of the actions available to management to mitigate the impacts on capital and liquidity in such scenarios.

Subject to the uncertainty in the outer years noted above and based upon the assessment set out above, the Directors therefore have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to March 2022.

Auditor

The auditor, KPMG LLP, has expressed its willingness to continue in office. In accordance with Section 77 of the Building Societies Act 1986, a resolution for its 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
29 May 2019

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 UK Corporate Governance Code (the Code).

The Society is not required to comply with the Code, as it applies to publicly listed companies, but where it is considered relevant, the Society does have regard to 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.

As noted in my Chairman's Statement, the Financial Reporting Council (FRC) published an updated version of the Code and whilst this report demonstrates compliance with the 2016 Code applicable to this reporting period, I am pleased to also report that we have taken great strides to ensure we will be able to report positively against the new 2018 Code's requirements for our next reporting period.

With regard to key changes in the Code, in my opening Statement I already describe the formation of both our Member and Employee Councils; cornerstones to the principle of stakeholder engagement. Both Councils have met and provided views on a range of topics before those topics were presented to the Board.

One such topic that was presented to both Councils, before submission to the Board, was the approach to Executive Directors' pension contribution rates. Both Councils supported the approach which is detailed in the Remuneration Report (see page 47).

The 2016 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 nine 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 2016 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. The consideration of independence included the recognition that the tenure of the Chairman is entering its tenth year. The current Chairman was appointed to the Board on the 1st January 2010. Consequently, his tenure would, in the absence of explanation, finish in January 2019. However, as the entire Board was refreshed in 2010 it would not be appropriate to completely change the Board again at the same time, i.e. every nine years. Therefore the Society has, for some time, executed a succession plan which has seen new Board members join on a regular basis replacing a planned step down of several Board members who joined in 2010. This activity, led by the Chairman, has taken time to execute and continued with Lynne Shamwana joining the Board in February and Martin Ritchley standing down in July this year. Now that this plan of rolling succession has been successfully implemented the Society Board will look to find a new Chair whilst continuing to review and confirm the current Chairman's independence. Our current Chairman is committed to serving the Board until a replacement has been found.
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 Victoria Mitchell joined the Board in the role of NED on 1 April 2018. During the latter part of the financial year the search began for a NED to join the Board. The process involved the support of a specialist recruitment firm in the search and interview process. Initially, all individuals identified by the recruitment firm were reviewed by members of the Nominations Committee to identify a shortlist of potential candidates to interview. 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 Lynne Shamwana who joined the Board on 1 February 2019. The terms of reference of the Nominations Committee, which is made up of NEDs only, 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 letter of appointment for Notified NEDs sets out that at least 30 days per annum is the expected time commitment and explains what is required if there is any material change to their commitments. The time commitment for the Chairman and Chairs of Board Committees is expected to be much greater.
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 and 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 effectiveness was undertaken in the latter part of the 2018/19 financial year. This evaluation was conducted internally led by the Chairman and supported by the Group Secretary. The process involved all Board members responding to a questionnaire issued by the Group Secretary. The process culminated in feedback to the Board. The annual 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 all Directors will stand for election each year. 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. Lynne Shamwana, appointed on 1 February 2019, will stand for election in July 2019. The Rules also state that any Director reaching the age of 70 should stand for re-election. Mark Nicholls reaches the age of 70 on 5 May 2019 and, following the Board meeting (without the Chairman present) where his independence and performance was reviewed, has been put forward for re-election this year.

The 2016 Code's Main Principles	What the Society does to meet the Principles
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 34 to 36 includes statements detailing the Directors' responsibilities. The Chief Executive's Review on pages 4 to 6, the Strategic Report on pages 7 to 24 and the Risk Management Report on pages 25 to 31, give an extensive report on the Society's performance, financial position and the key risks that will impact performance and risk management going forward.
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 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 only 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 are 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 the two reports made under the 'Open Door' Policy. Both reports were fully investigated and neither report was regarding possible improprieties of financial reporting or other issues covered by the Public Interest Disclosure Act 1998. There have been five meetings of the Committee during the financial year 2018/19. 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 Risk Officer, Divisional Director Treasury & Finance 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 only 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 44 to 51 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 • Reviewed the terms of appointment and benefits of Code Staff.

The 2016 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: • 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 • Customer Panel to canvass views on products and services and give feedback on how the Society can improve the way it operates. • In January 2019 the Society held its first Member Council. This Council, along with an Employee Council have been formed to further enhance key stakeholder engagement.
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 Chairs 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 five 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, including NED recruitment.

The terms of reference of the Committee, which is made up of NEDs only, 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	9 (9)	5 (5)			4 (4)
Julie Hopes	9 (9)	3 (3)		7 (7)	4 (4)
Victoria Mitchell	8 (9)		2 (2)	7 (7)	
Ashraf Piranie	9 (9)				
Mark Preston	9 (9)	3 (3)	5 (5)	7 (7)	4 (4)
Martin Ritchley	9 (9)	5 (5)	5 (5)	7 (7)	4 (4)
Lynne Shamwana (joined 1.2.2019)	1 (2)		1 (1)	0 (1)	
Richard Sommers (retired 30.7.2018)	3 (3)	2 (2)	1 (1)	2 (2)	
James Turner	8 (9)		4 (5)	6 (7)	
Colin Walklin (retired 31.12.2018)	6 (7)		4 (4)	6 (6)	
Jonathan Westhoff	9 (9)				

Mark Nicholls
Chairman
29 May 2019

Audit Committee Report

Membership and attendees

The Audit Committee is appointed by the Board and, at 31 March 2019, comprised five Non-Executive Directors:

- James Turner (Chairman);
- Martin Ritchley;
- Victoria Mitchell;
- Mark Preston; and
- Lynne Shamwana.

The Chairman, Chief Executive, Group Finance & Operations Director, Chief Risk Officer, Group Secretary, Divisional Director Treasury & 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 five times during the year, with attendance as detailed on page 40. 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').

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 Annual General Meeting (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 focuses its attention on 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 takes note of the work conducted by the external auditor, KPMG LLP, with a view to ensuring that suitable accounting policies have been implemented and appropriate judgements have been made by management.

The key matters that the Committee considered in reviewing the 2018/19 financial statements were:

- **IFRS 9 implementation**
  The Group and Society adopted IFRS 9 'Financial Instruments' on 1 April 2018, resulting in revised accounting policies for the classification, measurement and impairment of financial assets.

  The Audit Committee has reviewed the judgements applied in the business model and contractual cash flow assessments which determine the classification of financial assets.

  The Committee received regular updates on the Group's approach to calculating expected credit losses in accordance with IFRS 9. It considered management's methodologies for identifying a significant increase in credit risk and the key macroeconomic drivers of credit losses by portfolio. The Committee also reviewed the governance arrangements surrounding the impairment models and assumptions therein and was satisfied that IFRS 9 has been effectively implemented.

- **Loan impairment provisions**
  For each mortgage portfolio in the scope of IFRS 9, the Committee confirmed the suitability of the approach to calculating expected credit losses. The Committee had the opportunity to review and challenge the impairment model assumptions, including probability-weighted forecasts of future economic conditions (with sensitivity analysis) and, for the non-core commercial loan book, account-specific scenario data. Based on this review, the Committee agreed that the loss provision requirements, arising on IFRS 9 transition and subsequently, were suitably calculated and adequately disclosed.

- **Other provisions**
  The main element of other provisions is an allowance for the estimated costs of payment protection insurance (PPI) redress through to the FCA deadline of 29 August 2019. Audit Committee has satisfied itself that the reported PPI provision at 31 March 2019 is reflective of the Society's claims experience to date.

- **Income recognition**
  In accordance with IFRS 9, the Group applies the effective interest method to recognise mortgage interest at a constant yield over the expected behavioural lives of the loans, with the key assumption being the expected loan redemption profile. The Committee reviewed analysis comparing key model assumptions with observed data, in order to determine that interest has been appropriately recognised in the financial statements.

- **Investment property valuations**
  The Group applies IAS 40 'Investment Properties' under which the residential properties held by the Society's subsidiary, West Bromwich Homes Limited, are measured at fair value. The Audit Committee has reviewed the methodology adopted to determine the fair value of the properties and concluded that the carrying value of the portfolio at the year-end date is appropriately supported by market data and a sample validation exercise conducted by an independent firm of specialist valuers.

- **Financial instruments at fair value through profit or loss and hedge accounting**
  Following the rules and guidance of IFRS 9, the Society classifies certain assets and liabilities as fair value through profit or loss. This category includes derivatives, employed to mitigate interest rate risk, and the closed portfolio of equity release mortgages. The Committee has ratified the derivative valuation methodology and the application of IAS 39 to qualifying hedge relationships, which has not changed during the year.

  For equity release loans, where market observable data is not readily available, the calculation of fair value is based on a combination of historic redemption profile data and forecasts of economic variables such as house price growth. The Audit Committee noted the approach and assumptions used in the fair value calculations, confirming consistency with other accounting models where relevant. Based on this evaluation, the Committee is satisfied with the fair value of the equity release portfolio recorded in the Society's Statement of Financial Position at 31 March 2019.

- **Deferred taxation**
  Following a detailed evaluation of the Group's Medium Term Plan, the Committee confirmed that the year-end deferred tax asset, in relation to carried forward tax losses, has been recognised at an amount expected to be recoverable within the next five years.

- **Defined benefit pension liability**
  With respect to the Society's funded defined benefit pension scheme, the Audit Committee considered the key actuarial assumptions, as disclosed in note 32 to the accounts, and deemed them suitable for calculating the retirement benefit obligation at 31 March 2019. Based on information provided by the qualified independent actuary, the Committee is satisfied that an appropriate allowance has been made for the equalisation of Guaranteed Minimum Pension benefits between males and females, an obligation falling on all UK defined benefit schemes during the year.

- **Accounting standard updates**
  The Committee confirmed the reasonableness of the disclosures with regards to new or amended accounting standards. In particular, the Committee agreed that the impact of adopting IFRS 9 'Financial Instruments' in 2018/19 was properly disclosed. In addition, the Audit Committee was satisfied with the information given about the Group's implementation of IFRS 16 'Leases' with effect from 1 April 2019.

- **Going concern and viability statement**
  The Committee performed a thorough review of evidence supporting the going concern and longer-term viability assumptions. In doing so, it examined the Group's strategy and business model, together with capital and liquidity adequacy assessments under current market conditions and stressed scenarios. Thereafter the Committee approved the preparation of the accounts on a going concern basis and considered the longer-term viability statement given in the Directors' Report to be appropriate.

- **Fair, balanced and understandable**
  The Committee considers that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the necessary information for members to assess the Group's position, performance, business model and strategy.

- **External audit**
  The Committee considered matters communicated by the statutory external auditor and concluded that no material adjustments to the financial statements were required.

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 25 to 31. Through the Committee, the Society's Internal Audit function provides independent assurance to the Board on the effectiveness of the internal control framework. The information received and considered by the Committee during the 2018/19 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 UK Corporate Governance 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, KPMG LLP performs testing over certain controls supporting the preparation of the financial statements, and reports any deficiencies to the Audit Committee. During the year, KPMG LLP did not highlight any material control weaknesses.

The Committee recommends an external 'effectiveness review' of Internal Audit every three years. A review was carried out during the financial year 2017/18, 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 (and updated in September 2017), 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. KPMG was due to rotate off the audit following the year ended 31 March 2021, as required by EU audit legislation. The Committee, in planning for an effective transition, considered the timing of audit firm rotation and agreed to commence a tender process during 2019. It is therefore expected that a new external auditor will be appointed for the financial year commencing 1 April 2020.

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 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.

The audit of the Group's financial statements for the year ended 31 March 2018 by KPMG was the subject of an in-depth review by the Financial Reporting Council (FRC) during the year. The findings of this review have been considered by the Committee and discussed with KPMG, who have presented their action plan to address the FRC's recommendations to the Committee.

Having considered the FRC report and the representations made by KPMG, the Committee concluded that these matters would not prevent KPMG's reappointment as auditors at this stage.

Audit Committee effectiveness

The effectiveness of the Committee was assessed by an external firm in February 2018. 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

James Turner
Chairman of Audit Committee
29 May 2019

Directors' Remuneration Report

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

Annual Statement by the Chair of the Remuneration Committee

I was appointed Chair of the Remuneration Committee in October 2018, replacing Martin Ritchley, and would like to start by thanking Martin for chairing the Committee so effectively over the past 5 years.

The Board has decided to adopt voluntarily the relevant requirements of the UK Corporate Governance Code (the Code), in so far as they are considered appropriate for a building society. During the year the Committee undertook a detailed review of the latest update to the Code, published in July 2018 and effective for accounting periods beginning on or after 1st January 2019, to ascertain if changes were required to the Remuneration Policy and/or current practice. The Committee was confident that the majority of current remuneration practices remain aligned to the Code. However, one area of non-compliance with the July update relates to pension contribution rates for executive directors. Following a detailed review of existing arrangements (including the extent to which pension contribution rates contribute towards total remuneration), the Board has concluded that no changes to existing arrangements are appropriate. A full explanation of this and the rationale for the decision is detailed within page 47 of this report. The Committee will however continue to review this practice to ensure it remains appropriate.

The tables marked 'audited' in this report meet the requirements of the Building Societies Act 1986. The report also complies with EU Capital Requirements Directive IV and the detailed requirements of the Financial Conduct Authority's (FCA's) Remuneration Code (the Remuneration Code). Details of the Remuneration Code can be found at www.fca.org.uk.

Under the Remuneration 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. No changes are proposed to the policy, therefore, in line with the members' binding vote at the 2018 AGM, the policy will remain in place for the remainder of the three year term agreed, and will be subject to a further binding vote in 2021, unless any further changes to policy are proposed in the interim period, in which case a vote would be required before the changes were implemented.

- The Annual Remuneration Report – detailing the amounts earned by Directors in respect of the financial year ended 31 March 2019 and how the policy will operate for the year ending 31 March 2020.

All eligible members receive a copy of the Remuneration Report and are entitled to participate in the advisory vote on the Annual Remuneration Report at the 2019 AGM.

The Chief Executive's Review reported that the Society performed strongly in 2018/19 with underlying profitability up 19% to £10.5m. New residential lending of £691m contributed to a 5% increase in the prime owner occupied book, while the Society's exposure to riskier commercial lending, an exposure that is in run-off, was down 9% year on year. This commercial exposure has reduced by 74% since the strategy was introduced in March 2008.

As reported in 2018, Mr Ashraf Piranie took up the role of Group Finance & Operations Director as of 13 March 2017. The package offered to Mr Piranie was in line with that detailed in the Remuneration Policy. In accordance with this Policy, the Board agreed to compensate Mr Piranie, who was required to forego an element of his performance-related pay awards from his previous employer. It was agreed that this compensation would replicate, as far as possible, the amount and terms that he would have received had he stayed in post. Accordingly, during the 2018/19 financial year, Mr Piranie received a payment of £31,568. Subject to checking with the previous employer that no reduction in the amount of the deferred variable amount attributable to 'unvested variable remuneration' is expected, the outstanding amount of this compensation is expected to total circa £55k, payable over the next two years.

Salary increases

For the financial year 2018/19 the Chief Executive and Group Finance & Operations Director received a pay increase of 2.25%, the same as the increase given to all other eligible staff. On 1 April 2019 both Executive Directors received an increase of 2.25%, again matching the general increase given to other eligible staff. This decision followed full discussion with both the Employee and Member Councils, which also provided overall support for the proposal.

Performance-related pay awards

The Executive Director Performance-Related Pay Award payable to the Chief Executive and Group Finance & Operations Director generated awards of 42.9% and 41.7% of salary respectively. These payments reflect the delivery of both personal and Society objectives including financial measures, the management of risk, customer and people measures and new and enhanced operational capabilities. Further detail on the Society objectives is provided within page 50 of this report.

Deferred performance-related payments in relation to 2015/16, 2016/17 and 2017/18 for the Chief Executive, Group Finance & Operations Director, and former Group Finance & Operations Director have been approved for payment since the end of the 2018/19 financial year.

Fees for the Chairman and other Non-Executive Directors were reviewed for the 2018/19 financial year and no increases were applied. A further review for the 2019/20 financial year also resulted in no increase in fees for the Chairman or any Non-Executive Director. Non-Executive Director fees (other than the Chairman) have remained unchanged for the last nine financial reporting periods.

Gender pay

In March 2019 the Society published its update report on the gender pay gap, showing improvements in all measures from the 2018 report. Whilst there is still some way to go and some improvements were marginal, these results are encouraging and evidence the right direction of travel. A full copy of the report can be found on the Society's website at www.westbrom.co.uk.

Julie Hopes
Chair of Remuneration Committee
29 May 2019

Remuneration Committee membership and responsibilities

Membership

The members of the Remuneration Committee during the financial year 2018/19 were: Julie Hopes, Martin Ritchley, Mark Nicholls 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 Finance & Operations Director, 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 Chair 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 four 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, where appropriate;
- Determining the pay and benefits for staff;
- Determining the level of performance-related pay in relation to the 2017/18 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 2018/19 financial year;
- Undertaking a full review of compliance with the remuneration section of the latest UK Corporate Governance Code, published in July 2018;
- Considering the approach to be adopted in respect of disclosure requirements in relation to this report; and
- Considering the approach for the Gender Pay Regulations.

The Committee receives annual confirmation jointly from the Group Secretary, Chief Risk Officer and the Divisional Director Internal Audit that no activity or behaviour by any individual has been identified or observed which should affect their eligibility to participate in performance-related pay arrangements. Confirmation of such has been received this year.

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

The Terms of Reference for the Committee were last updated in February 2019. The Terms of Reference are available on request from the Group Secretary.

Advisors

The Remuneration Committee seeks the advice of independent, external consultants, as required. However, during the 2018/19 year the Committee had no need of such support.

Broader stakeholder views

As a mutual, we are committed to taking on board the views of our members and employees, ensuring the topics discussed at the Board are inclusive of these broader stakeholder perspectives. This also applies to remuneration practices, and during the year the Chair of Remuneration Committee held discussions with the newly formed Member and Employee Councils in respect of Executive Director remuneration including pension arrangements in the context of the revised Code of July 2018, seeking views on application of the policy for 2019/20, in particular regarding salary review and maximum performance-related pay applicable. The resultant views expressed were communicated to the Remuneration Committee.

Section 1 – The Remuneration Policy

Background

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

The Policy is designed to promote appropriate behaviours and practices consistent 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, employees 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;
- The Society's focus is on improving the underlying business position where management can influence performance. The Society's performance-related pay schemes may therefore exclude the impact of specific one-off items which would be agreed at the outset by the Society's Board following a recommendation by the Remuneration Committee;
- 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 Committee also has discretion to recover payments previously made (clawback), should information come to light subsequent to the payment being made, that would have resulted in the Committee withholding the payment, had this information been known.

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	Operation and 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, salary increases awarded across the Society, and benchmarking comparisons against organisations of a similar size/complexity, and roles of similar responsibilities.	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 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 Committee has discretion to make a reduction in the level of award (down to zero) or recover awards if necessary including withholding vested awards (malus arrangements) and recovering payments (clawback arrangements). The annual review prior to payment of a deferred element will take into account a number of factors, making sure management has operated within the risk appetite of the Society, not exposed the Society to regulatory or control failings, or taken other such actions that would represent a poor outcome for members. All awards are non-pensionable. Based on a number of measures, including: financial, customer, people, risk and 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, which the Committee has the authority to increase to 75% for financial years commencing 2019/20 should it be considered appropriate. The right to increase from 50% to 75% was approved by voting members at the 2018 AGM.

Component	Operation and performance metrics	Opportunity
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 (for example, where they have exceeded the annual or lifetime allowance).	A cash allowance of up to 25% of basic salary for the Executive Directors.*
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 or cash allowance, private medical care for themselves and their family, and life assurance (4 X basic salary). Other benefits may be provided in individual circumstances.	Set at a level considered appropriate, as part of a review of total compensation arrangements.

*The UK Corporate Governance Code, updated in July 2018, includes a new provision that pension contributions for Executive Directors, or payments in lieu, should be 'aligned with' those available to the workforce. The Remuneration Committee reviewed this proposal against current practice on behalf of the Board, and the Board agreed to maintain pension contribution levels for Executive Directors for the following reasons:

- Compensation arrangements for Executive Directors are agreed on the basis of externally benchmarked 'total remuneration', and the Board is satisfied that total pay is at a level sufficient to attract and retain the quality of individuals required.
- Whilst Executive Directors have a relatively high pension contribution, their base salaries are low when benchmarked externally, hence the focus on total remuneration arrangements.
- Pension contributions are not included within the calculation for performance-related pay (PRP).

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

Component	Operation	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.	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. Reimbursement is also made for reasonable travel expenses for attending meetings/Society business.

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 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
Basic 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.

Component	Application
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 or pension allowance	An Executive 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 (with the latter subject to tax and national insurance).
Recruitment compensation	Compensation arrangements are only considered if the new Director was required to forego an arrangement from their previous employer. In such instances the award would be no more in terms of amount than the award due to be foregone. The timing and vesting requirements of any payment would be replicated as far as possible.

Section 1 – The Remuneration Policy (continued)

The Remuneration Committee has the right to exercise discretion within the Policy, and recommend to the Board an over-ride of any formulaic approach laid out in the PRP Scheme Rules should it be deemed appropriate in line with good corporate governance.

In recommending remuneration arrangements for new hires, the Committee will consider the value of the total 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 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 the Director's 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 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 the Society's 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.

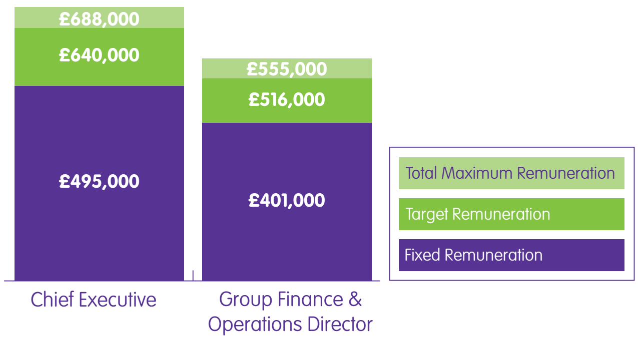
Employment conditions elsewhere in the Society

The pay and benefits of staff 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, employee car scheme and performance-related pay. In April 2018 an increase in salary of 2.25% was agreed for staff, plus a 0.6% increase in employer contributions for those participating in the stakeholder pension scheme. In April 2019 a further increase in base salary of 2.25% was agreed.

Remuneration scenarios

The following charts show the breakdown of the component parts of the remuneration package for Executive Directors for 2018/19 on the following basis:

- Fixed remuneration – comprising of basic salary, pension and benefits (excluding compensation for the Group Finance & Operations Director in respect of performance-related pay foregone from his previous employer, as explained on page 49).
- Target remuneration – the anticipated annual remuneration incorporating a performance-related award.
- Maximum remuneration – the maximum remuneration that could be awarded.



When developing the scenarios, the following assumptions were made:

- Fixed remuneration includes basic salary, pension and benefits (excluding compensation for the Group Finance & Operations Director in respect of performance-related pay foregone from his previous employer, as explained on page 49) 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 basic salary (as stated on page 46 the Remuneration Committee has the right to propose an increase in performance-related award to 75% if deemed appropriate, with effect from financial year 2019/20).

Section 2 – Annual Report on Remuneration

Non-Executive Director fees (audited)

Non-Executive Director	Date appointed	2018/19 Fees [2] £000	2018/19 Benefits [1] £000	2017/18 Fees [2] £000	2017/18 Benefits [1] £000
Mark Nicholls (Society Chairman)	01/01/10	**120**	**3**	120	3
Claire Hafner until 27/07/17	01/09/11	**-**	**-**	16	1
Julie Hopes (Remuneration Committee Chair from 01/10/18)	01/04/16	**55**	**3**	50	3
Mark Preston (Risk Committee Chair from 01/09/17)	18/05/11	**60**	**3**	55	4
Martin Ritchley (Deputy Chairman & Remuneration Committee Chair until 30/09/18)	01/09/09	**70**	**2**	70	2
Richard Sommers - until 30/07/18 (Risk Committee Chair until 31/08/17)	01/10/09	**17**	**1**	55	4
Colin Walklin - until 31/12/18 (Audit Committee Chair until 31/07/18)	20/07/11	**41**	**2**	60	4
James Turner (Audit Committee Chair from 01/08/18)	01/04/17	**57**	**1**	50	3
Victoria Mitchell	01/04/18	**50**	**1**	-	-
Lynne Shamwana	01/02/19	**8**	**-**	-	-
Total		**478**	**16**	476	24

Notes:

1. In addition to the payment of fees, Non-Executive Directors receive expenses for travel and accommodation in relation to their attendance at meetings.
2. Fees for Non-Executive Directors, at the rate shown above, have been in place since April 2010. Fees for the Society's Chairman were last increased in April 2014.

Executive Director remuneration – 2018/19 (audited)

Executive Director		Basic salary £000	Performance-related pay [1] £000	Pension £000	Other benefits £000	Total £000
Jonathan Westhoff	(Chief Executive)	386	166	97	12	**661**
Ashraf Piranie	(Group Finance & Operations Director)	307	128	77	49[2]	**561**
Total		**693**	**294**	**174**	**61**	**1,222**

Executive Director remuneration – 2017/18 (audited)

Executive Director		Basic salary £000	Performance-related pay [1] £000	Pension £000	Other benefits £000	Total £000
Jonathan Westhoff	(Chief Executive)	378	164	94	9	645
Ashraf Piranie	(Group Finance & Operations Director)	300	125	75	74[3]	574
Total		678	289	169	83	1,219

Notes:

1. Includes an element that is subject to deferral. The subsequent table 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.
2. Mr Piranie received compensation of £31,568 which was determined with reference to the amount of performance-related pay award that he would have received from his previous employer if he had stayed in post.
3. Mr Piranie received compensation of £56,800 which was determined with reference to the amount of performance-related pay award that he would have received from his previous employer if he had stayed in post.

Section 2 – Annual Report on Remuneration (continued)

For 2018/19 a review of performance against objectives agreed at the start of the year has generated awards for Executive Directors of 42.9% and 41.7% resulting in the amounts shown in the 'Executive Director remuneration – 2018/19' table. These payments are based on performance against both Society and personal objectives.

Society overall objectives for the year include:

Objectives	% of overall award weighting
Financial • Profitability • Net interest margin • Cost efficiency	**15%**
Customer • Gross residential lending • Retention of lending • Customer satisfaction	**20%**
Change • System enhancement and implementation	**20%**
Risk • Developing an internal ratings based approach to risk • Development of risk/reward capability	**15%**
People • Strengthening diversity	**10%**
Overall assessment by the Board of executive performance	**20%**

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**	**2018/19 £000**	**2019/20 £000**	**2020/21 £000**	**2021/22 £000**
Jonathan Westhoff	2015/16	20	-	-	-
	2016/17	19	19	-	-
	2017/18	22	22	22	-
	2018/19	-	22	22	22
Total		**61**	**63**	**44**	**22**
Mark Gibbard	2015/16	16	-	-	-
	2016/17	17	17	-	-
Total		**33**	**17**	**-**	-
Ashraf Piranie	2017/18	17	17	17	-
	2018/19	-	17	17	17
Total		**17**	**34**	**34**	**17**

Deferred elements due after the year ending 2018/19 (shown in the table) have subsequently been approved by the Board for payment.

Statement on member voting at the 2018 AGM

At the 2018 AGM members voted on two resolutions, the results of which are shown below:

(i) Approval of the Directors' Remuneration Report (advisory vote, i.e. not conditional on resolution being passed):

Vote	Votes for	% of votes	Votes against	Withheld*
To approve the Directors' Remuneration Report	15,809	90.28%	1,702	364

(ii) Approval of the Remuneration Policy for Executive Directors (binding vote, i.e. conditional on resolution being passed):

Vote	Votes for	% of votes	Votes against	Withheld*
To approve the Director's Remuneration Policy	15,671	89.5%	1,839	364

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

Application of the Remuneration Policy for 2019/20

The Remuneration Committee is required annually to review the salaries of the Executive Directors.

The Remuneration Committee undertook a benchmarking exercise of all Director remuneration to include the Executive Directors, Non-Executive Directors and the Chairman during the 2017/18 financial year. In light of the benchmarking report, a recommendation was made by the Committee, and approved by the Board, to allow the Board discretion to increase the maximum potential performance-related pay award for Executive Directors from up to 50% to up to 75% of basic salary for 2019/20. This proposal was subject to member approval by way of a binding vote at the 2018 AGM, and approved by 89.5% of voting members.

A recommendation was also made by the Remuneration Committee (after full discussion with the Employee and Member Councils) and subsequently approved by the Board, to increase the basic annual salary of the Chief Executive from £386,162 to £394,851 and Group Finance & Operations Director from £306,750 to £313,651 from 1 April 2019, representing a 2.25% award.

The annual salary review for eligible staff, which provided an increase of 2.25%, was applied from 1 April 2019.

Non-Executive Directors, including the Chairman, received no increase in fees from April 2019.

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.

Julie Hopes
Chair of Remuneration Committee
29 May 2019

KPMG

Independent auditor's report

to the members of West Bromwich Building Society

1. Our opinion is unmodified

We have audited the Group and Society annual accounts of West Bromwich Building Society for the year ended 31 March 2019 which comprise the Income Statements, Statements of Comprehensive Income, Statements of Financial Position, Statements of Changes in Members' Interests and Equity, Statements of Cash Flows, and the related notes, including the accounting policies in note 1.

In our opinion the annual accounts:

- give a true and fair view of the state of affairs of the Group and of the Society as at 31 March 2019 and of the income and expenditure of the Group and of the Society for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it and, as regards the Group annual accounts, Article 4 of the IAS Regulation.

Basis for opinion

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

We were first appointed as auditor by the members in 1993. The period of total uninterrupted engagement is for the 27 financial years ended 31 March 2019.

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

Overview	
Materiality: Group financial statements as a whole	£1,000k (2018: £350k) 0.8% of Group interest receivable (2018: 4.0% of Group profit before tax)
Coverage	100.0% of Group interest receivable (2018: 100% of Group profit before tax)

Key audit matters		**vs 2018**
Recurring risks	Expected credit losses on loans and advances FSOL	▲
	Expected credit losses on loans and advances FSRP	▲
	Revenue recognised on the effective interest rate method	◄►
	Valuation of investment properties	◄►
Event driven	**New:** The impact of uncertainties due to the UK exiting the European Union on our audit	▲

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

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

	The risk	Our response
The impact of uncertainties due to the UK exiting the European Union on our audit *Refer to page 21 (Strategic Report) and page 26 (Risk Management Report)*	**Unprecedented levels of uncertainty:** All audits assess and challenge the reasonableness of estimates, in particular as described in expected credit losses on loans and advances FSOL, expected credit losses on loans and advances FSRP and revenue recognised on an effective interest rate basis below, and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements (see below). All of these depend on assessments of the future economic environment and the Group's future prospects and performance. Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: — **Our Brexit knowledge:** We considered the directors' assessment of Brexit-related sources of risk for the Group's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks; — **Sensitivity analysis:** When addressing expected credit losses on loans and advances FSOL, expected credit losses on loans and advances FSRP, revenue recognised on an effective interest rate basis and other areas that depend on forecasts, we compared the directors' analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecast cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty; — **Assessing transparency:** As well as assessing individual disclosures as part of our procedures on expected credit losses on loans and advances FSOL, expected credit losses on loans and advances FSRP and revenue recognised on an effective interest rate basis, we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risk. **Our results** As reported under expected credit losses on loans and advances FSOL, expected credit losses on loans and advances FSRP and revenue recognised on an effective interest rate basis, we found the resulting estimates and related disclosures of expected credit losses on loans and advances FSOL, expected credit losses on loans and advances FSRP and revenue recognised on an effective interest rate basis and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

	The risk	Our response
Expected credit losses on loans and advances fully secured on land ('FSOL') (Group: £70.7 million) *Refer to page 42 (Audit Committee Report), pages 72 to 73 (accounting policy) and page 88 (financial disclosures)*	**Subjective estimate:** IFRS 9 requires that impairment of financial assets is recognised on a forward-looking, expected credit loss ('ECL') basis. The measurement of ECLs depends on the change in credit quality of each loan since initial recognition. ECLs are determined relative to the stage of changes in credit quality. ECLs in a 12 month period are recognised on loans where there has been no significant increase in credit risk since the loan was originally recognised (stage 1). A lifetime ECL is recognised where there has been a significant increase in credit risk since initial recognition of the loan (stage 2) or where there is objective evidence of impairment and the loan is considered to be in default, or otherwise credit impaired (stage 3). The Directors determine the stage applicable to each loan through a slotting assessment taking account of arrears status, loan-to-value ratios, repayment type and further management discretion. The ECL for FSOL or commercial loans is derived from a model which determines the present value of estimated future cash flows attributable to the individual loans. Given the subjectivity inherent in estimating the recoverability of loan balances on a forward-looking basis, the assessment of ECLs is highly judgemental. In particular, judgement is required on the key assumptions of: — Collateral valuation and property yields; — Rental yields and income forecasts; — Interest rates; and — Forward-looking economic forecasts. The effect of these matters is that, as part of our risk assessment, we determined that the expected credit loss on loans and advances FSOL has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and potentially many times that amount. The financial statements (note 1) disclose the sensitivities estimated by the Group.	Our procedures included: — **Benchmarking assumptions:** We compared the key assumption of exit yields to externally available data on market yields for equivalent property types to critically assess the assumptions applied. — **Our market expertise:** Our in-house valuation specialists critically assessed the interest rate curve applied in the impairment assessment against market data and forecasts. — **Tests of details:** We challenged the appropriateness of assumptions regarding collateral values, rental yields and other cash flows on individual accounts by comparing these to supporting documentation, such as lease agreements, market valuations and other evidence. — **Our valuations expertise:** Our in-house real estate specialists critically assessed the collateral value for a sample of loans using market research and sector knowledge. — **Historical comparisons:** We considered the appropriateness of assumptions regarding rental yields and other cash flows on individual accounts by comparing these to actual rental or other income received in recent periods. — **Benchmarking assumptions:** We assessed management's economic assumptions by comparing these against market forecasts and other comparable information to consider their reasonableness. — **Assessing transparency:** We evaluated the adequacy of the Group's disclosures in note 1 regarding the degree of estimation involved in arriving at the expected credit loss amount and its sensitivity to key assumptions. **Our results** We found the resulting estimate of expected credit losses on loans and advances FSOL to be acceptable.

2. Key audit matters: including our assessment of risks of material misstatement (continued)

	The risk	Our response
Expected credit losses on loans and advances fully secured on residential property ('FSRP') (Group: £6.0 million; Society: £1.2 million) *Refer to page 42 (Audit Committee Report), pages 72 to 73 (accounting policy) and page 88 (financial disclosures)*	**Subjective estimate:** Under IFRS 9, the Group's incurred credit loss models used under IAS 39 are replaced with forward-looking expected credit loss ('ECL') models. The measurement of the ECLs depends on the change in credit quality of each loan since initial recognition. ECLs are determined relative to the stage of changes in credit quality. ECLs in a 12 month period are recognised on loans where there has been no significant increase in credit risk since the loan was originally recognised (stage 1). A lifetime ECL is recognised where there has been a significant increase in credit risk since initial recognition of the loan (stage 2) or where there is objective evidence of impairment and the loan is considered to be in default, or otherwise credit impaired (stage 3). The Directors use models to determine the level of ECL required to be recognised on each loan. Given the subjectivity inherent in estimating the recoverability of loan balances on a forward-looking basis, the assessment of ECLs becomes highly judgemental. In particular, there is subjectivity in the following key assumptions and judgements: — The determination of a 'significant increase in credit risk'; — The probability of an account falling into arrears and subsequently defaulting; — Loss given default; and — Forward-looking economic forecasts. The effect of these matters is that, as part of our risk assessment, we determined that the expected credit loss on loans and advances FSRP has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and potentially many times that amount. The financial statements (note 1) disclose the sensitivities estimated by the Group.	Our procedures included: — **Our sector experience:** We critically assessed the assumptions inherent in the models against our understanding of the different loan portfolios across the Group, their recent performance and industry developments. — **Historical comparisons:** We critically assessed certain assumptions used in the model, being loss given default and probability of default, against the Group's historical experience. — **Benchmarking assumptions:** We compared assumptions and judgements made by management, for example regarding significant increase in credit risk criteria and the definition of default, against comparable peers to assess their reasonableness. — **Our market expertise:** Our economics specialists assessed the forward economic guidance applied by the Group in the ECL models to consider the reasonableness of assumptions against market data, our own independent assumptions and peer experience. This included considering the potential impacts of Brexit on the market and economy. — **Sensitivity analysis:** We performed stress testing on the key assumptions to assess the sensitivity of the resulting expected credit loss to these. — **Assessing transparency:** We evaluated the adequacy of the Group's disclosures in note 1 regarding the degree of estimation involved in arriving at the expected credit loss amount and its sensitivity to key assumptions. **Our results** We found the resulting estimate of expected credit losses on loans and advances FSRP to be acceptable.

2. Key audit matters: including our assessment of risks of material misstatement (continued)

	The risk	Our response
Revenue recognised on an effective interest rate basis (Group: £101.2 million; 2018: £93.7 million; Society: £72.6 million; 2018: £65.6 million) *Refer to page 42 (Audit Committee Report), page 69 (accounting policy) and page 80 (financial disclosures)*	**Subjective estimate:** Using a model, interest earned and fees earned and incurred on loans and advances to customers are recognised using the effective interest rate method that spreads directly attributable expected income over the expected lives of the loans. The directors apply judgement in assessing the expected repayment profiles used to determine the EIR period. The most critical element of judgement is the estimation of the future redemption profiles of the loan. This judgement is informed by product mix and past borrower behaviour of when loans are repaid. The effect of these matters is that, as part of our risk assessment, we determined that revenue recognised on an effective interest rate basis has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 1) disclose the sensitivities estimated by the Group.	Our procedures included: — **Benchmarking assumptions:** We critically assessed the expected customer lives against our own knowledge of industry experience and trends, including benchmarking with comparable lenders. — **Sensitivity analysis:** We observed sensitivity analysis performed using parameters determined by us for judgemental assumptions, being expected lives, to critically assess which of these the EIR asset is most sensitive to. — **Historical comparison:** We critically assessed the expected life assumptions against the Society's historical experience of customer behaviour by product type. — **Methodology implementation:** We assessed the methodology applied by management against IFRS 9 requirements and performed recalculations. This included considering the ongoing appropriateness of fees and costs included or excluded from the EIR calculation. — **Assessing transparency:** We assessed the adequacy of the Society's disclosures in note 1 regarding the degree of estimation involved in arriving at the interest income recognised and its sensitivity to key assumptions. **Our results** We found the resulting estimate of revenue recognised on an effective interest rate basis to be acceptable (2018: acceptable).

2. Key audit matters: including our assessment of risks of material misstatement (continued)

	The risk	Our response
Valuation of investment properties (Group: £134.7 million; 2018: £132.2 million) *Refer to page 42 (Audit Committee Report), page 69 (accounting policy) and page 91 (financial disclosures)*	**Subjective valuation:** A portfolio of residential investment properties is held by West Bromwich Homes Ltd. These investment properties are carried at fair value, with changes in the fair value recognised in the Income Statement. The Directors use a third party firm to assess the fair value of the properties with reference to current market prices, including the use of internal and external valuers. Particularly given the number and location of properties in the portfolio, there is significant uncertainty in the calculation of fair value of the properties and the associated assumptions over house price movements. The effect of these matters is that, as part of our risk assessment, we determined that the valuation of investment properties has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 1) disclose the sensitivities estimated by the Group.	Our procedures included: — **Benchmarking assumptions:** We challenged the valuations applied by comparing the movement in value of the portfolio to externally available house price indices at both a national and regional level; — **Tests of details:** For each of the investment properties, we agreed valuation records to values provided by the Group's appointed external valuers and assessed the reasons for the valuations selected by management; — **Tests of details:** For a sample of properties our specialists independently provided a reasonable range of values against which we compared the valuation used by WB Homes; — **Historical comparison:** We critically assessed the accuracy of the valuation applied by comparing historical valuations to actual sales prices achieved in the year; — **Assessing valuers' credentials:** We evaluated the competence, objectivity and independence of experts engaged by the Directors to perform property valuations; — **Assessing transparency:** We assessed the adequacy of the Group's disclosures about the judgements made in determining a valuation and the sensitivity to key assumptions. **Our results** We found the resulting valuation of investment properties to be acceptable (2018: acceptable).

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

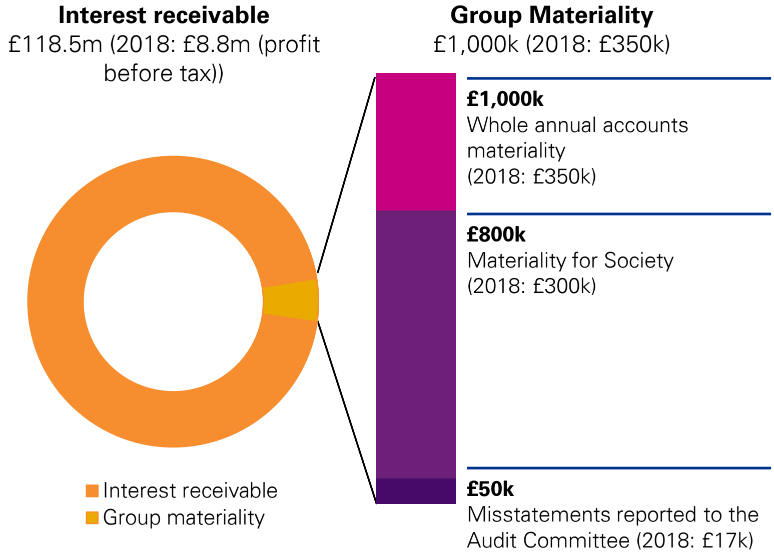
Materiality for the Group annual accounts as a whole was set at £1,000k (2018: £350k), determined with reference to a benchmark of Group interest receivable of £118.5m, of which it represents 0.8% (2018: 4.0% of Group profit before tax).

Materiality for the Society annual accounts as a whole was set at £800k (2018: £300k), determined with reference to a benchmark of Society interest receivable of £117.1m, of which it represents 0.7% (2018: 3.0% of Society profit before tax normalised to exclude dividend income and impairment of investments in subsidiaries).

Our 2018 materiality for both the Group and Society annual accounts was determined with reference to a benchmark of profit before tax. Given the comparatively low levels of profit generated by the Group, it was considered that a benchmark of interest receivable provided a more consistent and comparable benchmark for determining materiality.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £50k, in addition to other identified misstatements that warranted reporting on qualitative grounds.

We subjected all Group entities to full scope audits therefore accounting for a scope in line with the percentages illustrated opposite.



4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Society or the Group or to cease their operations, and as they have concluded that the Society's and the Group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Group and the Society will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and the Society's business model and analysed how those risks might affect the Group's and the Society's financial resources or ability to continue operations over the going concern period. The risk that we considered most likely to adversely affect the Company's available financial resources over this period was the impact of Brexit on the Society's liquidity and capital resources.

As these were risks that could potentially cast significant doubt on the Group's and the Society's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second order impacts, such as the impact of Brexit on loan collateral valuations.

Based on this work, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

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

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

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

Annual Business Statement and Directors' Report

In our opinion:

— the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations thereunder;

— the information given in the Directors' Report for the financial year is consistent with the accounting records and the annual accounts; and

— the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

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

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

— adequate accounting records have not been kept by the Society; or

— the annual accounts are not in agreement with the accounting records; or

— we have not received all the information and explanations and access to documents we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on pages 35 to 36, the directors are responsible for: the preparation of annual accounts which give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

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

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Group's regulatory correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related building society legislation) and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation. We identified the following areas as those most likely to have such an effect: health and safety, anti-bribery, employment law, regulatory capital and liquidity and certain aspects of building society legislation recognising the financial and regulated nature of the Group's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

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

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

Andrew Walker

(Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

One Snowhill
Snow Hill Queensway
Birmingham
B4 6GH

29 May 2019

Income Statements

for the year ended 31 March 2019

	Notes	Group 2019 £m	Group 2018* £m	Society 2019 £m	Society 2018* £m
Interest receivable and similar income					
Calculated using the effective interest method		**118.5**	113.3	**117.1**	108.3
On instruments measured at fair value through profit or loss		**(6.9)**	(16.0)	**(5.3)**	(15.0)
Total interest receivable and similar income	2	**111.6**	97.3	**111.8**	93.3
Interest expense and similar charges	3	**(53.1)**	(41.8)	**(53.6)**	(41.2)
Net interest receivable		**58.5**	55.5	**58.2**	52.1
Fees and commissions receivable		**2.6**	2.7	**3.1**	2.9
Other operating income	4	**4.0**	3.8	**(0.1)**	9.6
Fair value (losses)/gains on financial instruments	5	**(4.4)**	2.5	**(6.4)**	4.0
Total income		**60.7**	64.5	**54.8**	68.6
Administrative expenses	6	**(42.6)**	(43.5)	**(39.5)**	(40.0)
Depreciation and amortisation	16,18	**(6.9)**	(7.2)	**(6.9)**	(7.2)
Operating profit before revaluation gains, impairment and provisions		**11.2**	13.8	**8.4**	21.4
Gains on investment properties	17	**2.6**	3.8	**-**	-
Impairment on loans and advances	14	**(3.0)**	(7.9)	**(0.1)**	(0.6)
Provisions for liabilities	25	**(0.3)**	(0.9)	**-**	(0.9)
Provisions against investments in subsidiary undertakings	15	**-**	-	**(5.5)**	(14.2)
Profit before tax		**10.5**	8.8	**2.8**	5.7
Taxation	9	**(1.4)**	(0.9)	**(0.7)**	0.1
Profit for the financial year		**9.1**	7.9	**2.1**	5.8

The profit for the year derives wholly from continuing operations.

*As explained in note 43, the Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The Income Statements are therefore presented on an IFRS 9 basis for the financial year ended 31 March 2019 and an IAS 39 basis for the year ended 31 March 2018.

The notes on pages 68 to 137 form part of these accounts.

Statements of Comprehensive Income

for the year ended 31 March 2019

	Notes	Group 2019 £m	Group 2018* £m
Profit for the financial year		**9.1**	7.9
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss			
Available for sale investments			
Valuation losses taken to equity		**-**	(1.1)
Fair value through other comprehensive income investments			
Valuation losses taken to equity		**(1.1)**	-
Cash flow hedge gains taken to equity		**-**	0.8
Taxation	31	**0.2**	0.1
Items that will not subsequently be reclassified to profit or loss			
Actuarial losses on defined benefit obligations	32	**(2.5)**	(1.6)
Taxation	31	**0.5**	0.4
Other comprehensive income for the financial year, net of tax		**(2.9)**	(1.4)
Total comprehensive income for the financial year		**6.2**	6.5

	Notes	Society 2019 £m	Society 2018* £m
Profit for the financial year		**2.1**	5.8
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss			
Available for sale investments			
Valuation losses taken to equity		**-**	(1.1)
Fair value through other comprehensive income investments			
Valuation losses taken to equity		**(1.1)**	-
Taxation	31	**0.2**	0.2
Items that will not subsequently be reclassified to profit or loss			
Actuarial losses on defined benefit obligations	32	**(2.5)**	(1.6)
Taxation	31	**0.5**	0.4
Other comprehensive income for the financial year, net of tax		**(2.9)**	(2.1)
Total comprehensive income for the financial year		**(0.8)**	3.7

The notes on pages 68 to 137 form part of these accounts.

*As explained in note 43, the Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The Statements of Comprehensive Income are therefore presented on an IFRS 9 basis for the financial year ended 31 March 2019 and an IAS 39 basis for the year ended 31 March 2018.

Statements of Financial Position

at 31 March 2019

	Notes	Group 2019 £m	Group 2018* £m	Society 2019 £m	Society 2018* £m
Assets					
Cash and balances with the Bank of England	10	**182.5**	324.7	**182.5**	324.7
Loans and advances to credit institutions		**106.7**	120.6	**59.0**	49.2
Investment securities	11	**309.3**	311.9	**934.2**	1,029.4
Derivative financial instruments	12	**6.5**	19.5	**5.9**	19.5
Loans and advances to customers	13	**4,746.7**	4,805.4	**3,096.7**	2,956.8
Deferred tax assets	19	**18.9**	15.3	**10.3**	12.1
Trade and other receivables	20	**3.7**	6.4	**3.6**	6.4
Investments	15	**-**	-	**1,215.8**	1,350.6
Intangible assets	16	**16.5**	15.3	**15.9**	14.7
Investment properties	17	**134.7**	132.2	**-**	-
Property, plant and equipment	18	**28.4**	30.2	**28.4**	30.2
Total assets		**5,553.9**	5,781.5	**5,552.3**	5,793.6
Liabilities					
Shares	21	**3,991.2**	4,051.4	**3,991.2**	4,051.4
Amounts due to credit institutions		**667.3**	571.3	**667.3**	571.3
Amounts due to other customers	22	**77.7**	133.1	**415.6**	625.8
Derivative financial instruments	12	**39.3**	38.7	**35.5**	31.5
Debt securities in issue	23	**344.1**	493.3	**1.0**	-
Current tax liabilities		**1.1**	-	**1.1**	-
Deferred tax liabilities	19	**5.8**	4.5	**1.6**	0.8
Trade and other payables	24	**12.1**	12.0	**10.5**	10.9
Provisions for liabilities	25	**1.4**	2.1	**0.9**	2.0
Retirement benefit obligations	32	**4.9**	5.1	**4.9**	5.1
Subordinated liabilities	29	**22.8**	-	**22.8**	-
Total liabilities		**5,167.7**	5,311.5	**5,152.4**	5,298.8
Members' interests and equity					
Profit participating deferred shares	27	**-**	175.0	**-**	175.0
Core capital deferred shares	28	**127.0**	-	**127.0**	-
Subscribed capital	26	**8.9**	75.0	**8.9**	75.0
General reserves		**247.1**	215.8	**260.8**	240.6
Revaluation reserve		**3.3**	3.4	**3.3**	3.4
Available for sale reserve		**-**	0.8	**-**	0.8
Fair value reserve		**(0.1)**	-	**(0.1)**	-
Total members' interests and equity		**386.2**	470.0	**399.9**	494.8
Total members' interests, equity and liabilities		**5,553.9**	5,781.5	**5,552.3**	5,793.6

The accounting policies and notes on pages 68 to 137 form part of these accounts.

*As explained in note 43, the Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The Statements of Financial Position are therefore presented on an IFRS 9 basis at 31 March 2019 and an IAS 39 basis at 31 March 2018.

Approved by the Board of Directors on 29 May 2019 and signed on its behalf by:

Mark Nicholls
Chairman

Jonathan Westhoff
Chief Executive

Ashraf Piranie
Group Finance & Operations Director

Statements of Changes in Members' Interests and Equity

for the year ended 31 March 2019

Group	Profit participating deferred shares £m	Core capital deferred shares £m	Subscribed capital £m	General reserves £m	Revaluation reserve £m	Available for sale reserve £m	Fair value reserve £m	Total £m
At 1 April 2018	**175.0**	**-**	**75.0**	**215.8**	**3.4**	**0.8**	**-**	**470.0**
Changes on initial application of IFRS 9*	-	-	-	(27.8)	-	(0.8)	0.8	**(27.8)**
At 1 April 2018 including impact of IFRS 9 adoption	**175.0**	**-**	**75.0**	**188.0**	**3.4**	**-**	**0.8**	**442.2**
Profit for the financial year	-	-	-	9.1	-	-	-	**9.1**
Other comprehensive income for the period (net of tax)								
Retirement benefit obligations	-	-	-	(2.0)	-	-	-	**(2.0)**
Realisation of previous revaluation gains	-	-	-	0.1	(0.1)	-	-	**-**
Fair value through other comprehensive income investments	-	-	-	-	-	-	(0.9)	**(0.9)**
Total other comprehensive income	**-**	**-**	**-**	**(1.9)**	**(0.1)**	**-**	**(0.9)**	**(2.9)**
Total comprehensive income for the year	**-**	**-**	**-**	**7.2**	**(0.1)**	**-**	**(0.9)**	**6.2**
Capital restructuring (note 42)	**(175.0)**	**127.0**	**(66.1)**	**51.9**	**-**	**-**	**-**	**(62.2)**
At 31 March 2019	**-**	**127.0**	**8.9**	**247.1**	**3.3**	**-**	**(0.1)**	**386.2**

for the year ended 31 March 2018*

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 2017	173.0	75.0	211.0	3.5	1.7	(0.7)	463.5
Profit for the financial year	2.0	-	5.9	-	-	-	7.9
Other comprehensive income for the period (net of tax)							
Available for sale investments	-	-	-	-	(0.9)	-	(0.9)
Retirement benefit obligations	-	-	(1.2)	-	-	-	(1.2)
Realisation of previous revaluation gains	-	-	0.1	(0.1)	-	-	-
Cash flow hedge gains	-	-	-	-	-	0.7	0.7
Total other comprehensive income	-	-	(1.1)	(0.1)	(0.9)	0.7	(1.4)
Total comprehensive income for the year	2.0	-	4.8	(0.1)	(0.9)	0.7	6.5
At 31 March 2018	175.0	75.0	215.8	3.4	0.8	-	470.0

*As explained in note 43, the Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The Statements of Changes in Members' Interests and Equity are therefore presented on an IFRS 9 basis for the financial year ended 31 March 2019 and an IAS 39 basis for the year ended 31 March 2018.

Statements of Changes in Members' Interests and Equity

for the year ended 31 March 2019

Society	Profit participating deferred shares £m	Core capital deferred shares £m	Subscribed capital £m	General reserves £m	Revaluation reserve £m	Available for sale reserve £m	Fair value reserve £m	Total £m
At 1 April 2018	**175.0**	**-**	**75.0**	**240.6**	**3.4**	**0.8**	**-**	**494.8**
Changes on initial application of IFRS 9*	-	-	-	(31.9)	-	(0.8)	0.8	**(31.9)**
At 1 April 2018 including impact of IFRS 9 adoption	**175.0**	**-**	**75.0**	**208.7**	**3.4**	**-**	**0.8**	**462.9**
Profit for the financial year	-	-	-	2.1	-	-	-	**2.1**
Other comprehensive income for the period (net of tax)								**-**
Retirement benefit obligations	-	-	-	(2.0)	-	-	-	**(2.0)**
Realisation of previous revaluation gains	-	-	-	0.1	(0.1)	-	-	**-**
Fair value through other comprehensive income investments	-	-	-	-	-	-	(0.9)	**(0.9)**
Total other comprehensive income	**-**	**-**	**-**	**(1.9)**	**(0.1)**	**-**	**(0.9)**	**(2.9)**
Total comprehensive income for the year	**-**	**-**	**-**	**0.2**	**(0.1)**	**-**	**(0.9)**	**(0.8)**
Capital restructuring (note 42)	**(175.0)**	**127.0**	**(66.1)**	**51.9**	**-**	**-**	**-**	**(62.2)**
At 31 March 2019	**-**	**127.0**	**8.9**	**260.8**	**3.3**	**-**	**(0.1)**	**399.9**

for the year ended 31 March 2018*

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 2017	173.0	75.0	237.9	3.5	1.7	491.1
Profit for the financial year	2.0	-	3.8	-	-	5.8
Other comprehensive income for the period (net of tax)						
Available for sale investments	-	-	-	-	(0.9)	(0.9)
Retirement benefit obligations	-	-	(1.2)	-	-	(1.2)
Realisation of previous revaluation gains	-	-	0.1	(0.1)	-	-
Total other comprehensive income	-	-	(1.1)	(0.1)	(0.9)	(2.1)
Total comprehensive income for the year	2.0	-	2.7	(0.1)	(0.9)	3.7
At 31 March 2018	175.0	75.0	240.6	3.4	0.8	494.8

*As explained in note 43, the Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The Statements of Changes in Members' Interests and Equity are therefore presented on an IFRS 9 basis for the financial year ended 31 March 2019 and an IAS 39 basis for the year ended 31 March 2018.

The notes on pages 68 to 137 form part of these accounts.

Statements of Cash Flows

for the year ended 31 March 2019

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Net cash inflow/(outflow) from operating activities (below)	**30.7**	(323.4)	**(285.5)**	(332.0)
Cash flows from investing activities				
Purchase of investment securities	**(120.1)**	(155.6)	**(120.1)**	(188.7)
Proceeds from disposal of investment securities	**87.8**	267.7	**179.9**	341.1
Proceeds from disposal of investment properties	**0.1**	0.5	**-**	-
Purchase of property, plant and equipment and intangible assets	**(6.7)**	(7.1)	**(6.7)**	(7.1)
New funding to subsidiaries	**-**	-	**(34.1)**	(52.9)
Dividends received	**-**	-	**-**	9.8
Repayment of funding from subsidiaries	**-**	-	**132.8**	205.2
Net cash flows from investing activities	**(38.9)**	105.5	**151.8**	307.4
Cash flows from financing activities				
Issue of debt securities	**1.0**	348.5	**1.0**	-
Repayment of debt securities in issue	**(149.2)**	(113.4)	**-**	-
Capital restructuring (note 42)	**(36.2)**	-	**(36.2)**	-
Interest paid on subordinated liabilities	**(1.2)**	-	**(1.2)**	-
Net cash flows from financing activities	**(185.6)**	235.1	**(36.4)**	-
Net (decrease)/increase in cash	**(193.8)**	17.2	**(170.1)**	(24.6)
Cash and cash equivalents at beginning of year	**492.5**	475.3	**421.1**	445.7
Cash and cash equivalents at end of year	**298.7**	492.5	**251.0**	421.1

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

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Cash in hand (including Bank of England Reserve account)	**172.0**	318.1	**172.0**	318.1
Loans and advances to credit institutions	**106.7**	120.6	**59.0**	49.2
Investment securities	**20.0**	53.8	**20.0**	53.8
	298.7	492.5	**251.0**	421.1

The Group is required to maintain certain mandatory balances with the Bank of England which, at 31 March 2019, amounted to £10.5m (2017/18: £6.6m). The movement in these balances is included within cash flows from operating activities.

Statements of Cash Flows (continued)

for the year ended 31 March 2019

	Group 2019 £m	Group 2018* £m	Society 2019 £m	Society 2018* £m
Cash flows from operating activities				
Profit before tax	**10.5**	8.8	**2.8**	5.7
Adjustments for non-cash items included in profit before tax				
Impairment on loans and advances	**3.0**	7.9	**0.1**	0.6
Depreciation and amortisation	**6.9**	7.2	**6.9**	7.2
Revaluations of investment properties	**(2.6)**	(3.8)	**-**	-
Changes in provisions for liabilities	**(0.7)**	(1.0)	**(1.1)**	(1.0)
Provisions against investments in subsidiary undertakings	**-**	-	**5.5**	14.2
Interest on subordinated liabilities	**2.4**	-	**2.4**	-
Fair value losses on equity release portfolio	**1.7**	-	**1.7**	-
Other non-cash movements	**(12.3)**	24.1	**(14.3)**	20.6
	8.9	43.2	**4.0**	47.3
Changes in operating assets and liabilities				
Loans and advances to customers	**30.0**	(69.5)	**(128.7)**	(316.9)
Loans and advances to credit institutions	**(3.9)**	0.6	**(3.9)**	0.6
Derivative financial instruments	**13.6**	(43.5)	**17.6**	(41.5)
Shares	**(59.9)**	(373.2)	**(59.9)**	(373.2)
Deposits and other borrowings	**42.0**	123.1	**(114.2)**	356.5
Trade and other receivables	**2.4**	(2.9)	**2.5**	(3.1)
Trade and other payables	**0.3**	1.7	**(0.2)**	1.2
Retirement benefit obligations	**(2.7)**	(3.0)	**(2.7)**	(3.0)
Tax received	**-**	0.1	**-**	0.1
Net cash inflow/(outflow) from operating activities	**30.7**	(323.4)	**(285.5)**	(332.0)

The notes on pages 68 to 137 form part of these accounts.

*Comparatives have been recategorised, where applicable, to align to the current period presentation of cash flows from operating activities.

Notes to the Accounts

1. Accounting policies

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

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 2019; 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 fair value through other comprehensive income 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 next 12 months.

The Directors, therefore, consider that the Society and Group have adequate resources to continue in operational existence for the next 12 months. Accordingly they continue to adopt the going concern basis in preparing the financial statements. For further details see page 36 of the Directors' Report.

New or amended accounting standards

- IFRS 9 'Financial Instruments'
  IFRS 9 'Financial Instruments' has been adopted by the Group with effect from 1 April 2018. The standard replaces IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 introduces new rules for classification and measurement, impairment and hedge accounting for financial instruments and also establishes new disclosure requirements under IFRS 7 'Financial Instruments: Disclosures'. The impact of IFRS 9 on the financial statements is disclosed further in this note and in note 43. As permitted by the new standard, comparative figures have not been restated.

  The Group has made the accounting policy choice, allowed under IFRS 9, to continue applying IAS 39 for all hedge relationships until such time as the new macro hedging rules (carved out as a separate IASB project) are finalised.

The following new or amended accounting standards and interpretations, which are relevant to the Group, have been adopted during 2018/19 but have not had a material impact on the Annual Accounts:

- IFRS 15 'Revenue from Contracts with Customers'
  IFRS 15 replaces IAS 18 'Revenue', which 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 majority of the Society's income is within the scope of IFRS 9. Only fees, commissions receivable and certain components of other operating income are in scope of IFRS 15, for which there have been no material changes in the timing of revenue recognition.

- Amendments to IAS 40 'Investment Property'
  The amendments to IAS 40 'Investment Property' clarify the requirements on transfers to, or from, investment property.

- Annual improvements to IFRSs 2014-2016 Cycle
  The improvements include amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards', IAS 28 'Investments in Associates and Joint Ventures' and IFRS 12 'Disclosure of Interests in Other Entities'.

Future accounting developments

The following new or amended accounting standards and interpretations have been issued but are not effective for the twelve months ended 31 March 2019. The Group are monitoring developments and considering the associated impact:

- Annual improvements to IFRSs 2015-2017 Cycle
  These amendments are effective for annual periods beginning on or after 1 January 2019 and the improvements include amendments to IFRS 3 'Business Combinations', IFRS 11 'Joint Arrangements', IAS 12 'Income Taxes' and IAS 23 'Borrowing Costs'.

- IFRIC 23 'Uncertainty of Income Tax Treatments'
  These interpretations are effective for annual periods beginning on or after 1 January 2019 and clarify application of the recognition and measurement in IAS 12 'Income Taxes' when there is uncertainty over income tax treatments.

- IFRS 16 'Leases'
  This standard is effective for accounting periods beginning on or after 1 January 2019 and replaces the existing requirements of IAS 17 'Leases'. IFRS 16 provides a single lessee accounting model requiring a lessee to recognise a right-of-use asset, representing its right to use the underlying asset, and a lease liability, representing its obligation to make lease payments. The Group has identified that IFRS 16 will apply mainly to its branch network.

  The Group will apply the modified retrospective approach on transition, by measuring the right-of-use asset as equal to the lease liability, adjusted for any prepaid or accrued lease payments on the date of initial application which will be recognised in reserves. Comparative information will not be restated. The Group will apply the practical expedients available for short term leases (less than or equal to 12 months in duration) and for low value assets, for which right-of-use assets and lease liabilities will not be recognised.

  Adopting the new standard is expected to result in the recognition of circa £3m right-of-use assets and £3m lease liabilities, with no material impact on reserves at 1 April 2019.

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.

Intercompany 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 IFRS 9 (and previously under 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.

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 IFRS 10, the structured entities are included as subsidiaries in the consolidated financial statements.

The Society has entered into securitisation transactions in which it sold residential mortgages to structured entities. In accordance with IFRS 9 (and previously under 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 39.

Interest receivable and expense

Interest receivable and expense are recognised in the Income Statement for all instruments measured at amortised cost or fair value through other comprehensive income using the effective interest method. Interest income on defaulted loans categorised as 'stage 3' under IFRS 9 is recognised by applying the effective interest rate to the balances net of the provisions for expected credit losses.

Accounting policy for the year ended 31 March 2018

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 rate is the method used to calculate the amortised cost of financial instruments and to recognise interest receivable or payable over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash flows or receipts through the expected life of the instrument, or where appropriate, a shorter period, to its carrying amount. 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 and subject to review by independent specialist valuers. 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

a) Financial assets

Under IFRS 9, financial assets are classified as amortised cost or fair value (through other comprehensive income or through profit or loss), based on the business model under which they are held and the characteristics of their contractual cash flows.

Amortised cost

Financial assets are measured at amortised cost if they are held for the purpose of collecting contractual cash flows and have contractual terms which give rise on specified dates to cash flows which are solely payments of principal and interest (SPPI) on the outstanding amount.

This category includes cash and balances with the Bank of England, loans and advances to credit institutions and the majority of the Group's loans and advances to customers. All of the Group's mortgage portfolios were originated or purchased for the purposes of collecting contractual cash flows. With the exception of the closed equity release portfolio, the contractual terms of the Group's mortgage books indicate that the cash flows to be collected comprise capital and interest on the outstanding balance.

For the Society, loans to subsidiary undertakings and holdings of certain investment securities issued by Group entities are also measured at amortised cost based on the business model and SPPI assessments. In the case of mortgage-backed securities, the SPPI criteria are only met where the underlying asset pools contain mortgages which are SPPI and the exposure to credit risk inherent in the tranches held by the Society is equal to or lower than the exposure to credit risk of the underlying mortgage pools.

1. Accounting policies (continued)

Assets measured at amortised cost are initially recognised at fair value, being the cash consideration to originate or purchase the asset including any directly attributable transaction costs, and measured subsequently using the effective interest method.

Fair value through other comprehensive income (FVOCI)
Financial assets are classified as FVOCI where the associated business model objective is achieved by both collecting contractual cash flows and selling the assets. The contractual terms of FVOCI assets give rise on specified dates to cash flows which are solely payments of principal and interest on the outstanding balance.

This category comprises the Group's portfolio of investment securities held for liquidity management purposes. Consistent with the criteria for FVOCI, the Group collects contractual cash flows which, without exception, meet the IFRS 9 SPPI definition and periodically sells a proportion of the portfolio to evidence the liquidity of the investment assets. In the case of mortgage-backed securities, the SPPI criteria are only met where the underlying asset pools contain mortgages which are SPPI and the exposure to credit risk inherent in the tranches held by the Society is equal to or lower than the exposure to credit risk of the underlying mortgage pools.

FVOCI assets are initially recognised at fair value, which is the cash consideration including any directly attributable transaction costs, and measured subsequently at fair value. Gains and losses from changes in fair value are recorded in other comprehensive income via the fair value reserve, except for impairment losses which are recognised in the Income Statement. Gains or losses arising on sale, including any cumulative gains and losses previously recognised in other comprehensive income, are recognised in the Income Statement. Interest is calculated using the effective interest method.

The fair values of FVOCI 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.

Fair value through profit or loss (FVTPL)
Financial assets which do not meet the classification criteria to be held at amortised cost or FVOCI are measured at FVTPL.

This category includes derivative assets and the closed equity release portfolio (presented within loans and advances to customers). An assessment of the contractual terms of the equity release loans concluded that the SPPI criteria, which must be satisfied to carry an asset at amortised cost or FVOCI, were not met. In the Society's Statement of Financial Position, certain investment securities issued by Group structured entities are measured at FVTPL.

The fair values of derivatives are based on level 2 valuation techniques, as described in section (f) below. Changes in the fair value of derivative assets are presented within fair value gains/(losses) on financial instruments in the Income Statement offset, where the derivatives are hedging instruments in a qualifying IAS 39 fair value hedge relationship, by the fair value movements on the corresponding hedged items. Interest arising on derivative financial instruments is recognised within net interest on an accruals basis.

Due to the bespoke nature of equity release books, relevant market pricing data is not available. The fair value of the equity release portfolio is therefore determined using an internal discounted cash flow model which estimates the amount and timing of future cash flows arising on redemption and discounts them back at assumed market rates to calculate the fair value of the mortgages. Model inputs are informed by a combination of the Society's historic experience (e.g. redemption rates) and economic forecast data (e.g. house price inflation indices). Under IFRS 13 'Fair Value Measurement' and Amendments to IFRS 7 'Financial Instruments: Disclosures' the fair value measurement of equity release mortgages is categorised as level 3.

An entity may, at initial recognition or on adoption of IFRS 9, make an irrevocable designation to measure a financial asset at FVTPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would arise if the asset were to be held at amortised cost or FVOCI. The Group and Society have not designated any financial assets as FVTPL on transition to IFRS 9 or subsequently.

Accounting policy for the year ended 31 March 2018
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. 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 future cash flow or forecast transaction is ultimately recognised 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 or losses on financial instruments designated at fair value through profit or loss.

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 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 is reported as a deduction from the carrying value of the investment and recognised in the Income Statement.

b) Financial liabilities

In accordance with IFRS 9, all of the Group and Society's financial liabilities are classified as subsequently measured at amortised cost except for financial liabilities at fair value through profit or loss.

Amortised cost
This category includes shares, amounts due to credit institutions, amounts due to other customers, debt securities in issue and subordinated liabilities.

Liabilities subsequently measured at amortised cost are recognised initially at fair value, being the issue proceeds, net of premia, discounts and directly attributable transaction costs incurred. They are subsequently measured at amortised cost using the effective interest method.

1. Accounting policies (continued)

Fair value through profit or loss (FVTPL)

This category includes derivative liabilities for which changes in fair value are presented within fair value gains/(losses) on financial instruments in the Income Statement offset, where the derivatives are hedging instruments in a qualifying IAS 39 fair value hedge relationship, by the fair value movements on the corresponding hedged items. Interest arising on derivative financial instruments is recognised within net interest on an accruals basis.

The fair values of derivative liabilities are determined in accordance with the three tier valuation hierarchy as defined within IFRS 13 'Fair Value Measurement' and in section (f) below.

An entity may, at initial recognition or on adoption of IFRS 9, make an irrevocable designation to measure a financial liability (that would otherwise be held at amortised cost) at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency. The Group and Society have not designated any financial liabilities as FVTPL on transition to IFRS 9 or subsequently.

Accounting policy for the year ended 31 March 2018

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.

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. Designations 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 30 sets out the amount of each class of financial asset or liability that was designated at fair value through profit or loss under IAS 39.

c) Impairment of financial assets

Impairment of financial assets

Expected credit losses (ECLs) are recognised for all financial assets carried at amortised cost or FVOCI under IFRS 9, and also for undrawn loan commitments where a mortgage offer has been made but the loan is yet to be advanced and recognised in the Statement of Financial Position.

Staging

At each reporting date, financial assets subject to the impairment requirements of IFRS 9 are categorised into one of three stages:

Stage 1

On initial recognition, financial assets which are not credit impaired are categorised as stage 1 and provision is made for 12 month ECLs, being the losses from default events expected to occur within the next 12 months. Assets remain in stage 1 until such time as they meet the criteria for another stage or are derecognised.

Stage 2 (significant increase in credit risk)

Financial assets which are not in default, but have experienced a significant increase in credit risk since initial recognition, are categorised as stage 2. The loss allowance recognised is equivalent to lifetime ECL, being the loss arising from default events expected to occur over the lifetime of the financial asset.

Determining whether a significant increase in credit risk has occurred is a critical aspect of the IFRS 9 methodology and one which involves judgement, based on a combination of quantitative and qualitative measures. As described in the ECL calculation sections which follow, the criteria applied vary across portfolios depending on the nature of the portfolio and availability of relevant credit risk information but all include the IFRS 9 'backstop' of 30 days past due as a stage 2 trigger.

Stage 3 (default)

Defaulted or credit-impaired financial assets are categorised stage 3, requiring recognition of lifetime ECLs.

Transfers to lower stages (curing)

Financial assets in stages 2 or 3 can transfer back to stages 1 or 2, respectively, once the criteria for significant increase in credit risk or default cease to be met for a period of time defined within the ECL methodology for that portfolio, sometimes known as the 'cure' period. In practice, this means that a stage 2 or 3 loan which ceases to breach the threshold(s)/criteria for that stage will remain in the higher stage for a pre-determined number of months. The use of cure periods gives assurance that accounts have rehabilitated before re-entering lower stages and reduces the level of volatility that might otherwise arise from accounts regularly migrating between stages.

Forward-looking ECL approach

ECL is measured as the present value of the difference between the cash flows contractually due on a financial asset or undrawn commitment and the cash flows expected to be received. In the Statement of Financial Position, the loss allowance is presented as a reduction in the carrying value of the financial asset. In the case of an undrawn loan commitment, the impairment provision is instead presented within provisions for liabilities.

For each of the Group and Society's financial asset portfolios in the scope of IFRS 9 impairment, the estimate of ECL is unbiased and probability-weighted, taking into account a range of possible outcomes.

In accordance with IFRS 9, forecasts of future economic conditions are integral to the ECL calculations for each portfolio. The Group currently models four forward-looking macroeconomic scenarios: a central forecast with economic assumptions aligned to the Society's Medium Term Plan (and therefore assigned the highest probability), together with upside, downside and stress scenarios. The stress scenario has been developed with due regard to market data available in relation to the UK's planned exit from the European Union.

ECL calculation – core residential mortgages

For the core residential mortgage books, the impairment model employs industry-accepted statistical techniques to address the complex requirements of IFRS 9, with model assumptions and parameters initially determined by regression analysis of historical default data. The assumptions are validated using 'out of time' samples, across a range of economic scenarios, enabling the predictive capabilities of the models to be confirmed.

The model incorporates quantitative factors for identifying a significant increase in credit risk by comparing reporting date lifetime probability of default (PD) with residual origination lifetime PD. For the purposes of this quantitative staging assessment, mortgages are segmented by lending type (owner occupied or buy to let). Residual origination PD curves and (relative and absolute) threshold levels are established via an iterative process involving statistical analysis of the Group's default data. In addition, a range of internally monitored potential impairment indicators has been selected as qualitative criteria for classifying an individual loan as stage 2. Examples of qualitative indicators include cancelled direct debit instructions, certain forbearance measures and evidence of impaired credit history obtained from external agencies.

The default criteria for core residential loans are entirely aligned with those used for capital and credit risk management purposes. Loans are considered to be in default or credit-impaired if they are in arrears by three or more months, in litigation, possession or LPA receivership or meet one of a range of internal 'unlikely to pay' indicators.

Within the core residential model ECL is calculated by multiplying forward-looking probability of default (PD), exposure at default (EAD) and loss given default (LGD). The model outputs monthly ECLs, which are aggregated over the first 12 months to obtain 12-month ECL and over the life of the loan to calculate lifetime ECL.

The model combines a number of account-specific variables and forecasts of future economic conditions within the calculation of PD. Macroeconomic variable inputs to the model are reviewed quarterly and include house price index (HPI), interest rates, unemployment and GDP. The variables were selected based on statistical tests and other analysis which evidenced their correlation with credit risk.

The core residential impairment model aligns the Group's capital and accounting approaches to the estimation of credit losses as closely as possible.

ECL calculation – undrawn commitments

The loss allowance for undrawn commitments is inferred from the core residential mortgage impairment model outputs for existing loans with similar risk characteristics.

All undrawn commitments are currently allocated to stage 1 such that a 12-month ECL calculation is appropriate.

The Group's IFRS 9 provision requirements for undrawn commitments at 1 April 2018 and 31 March 2019 were negligible.

ECL calculation – second charge residential mortgages

For the closed second charge loan book, a significant increase in credit risk is assessed using external credit agency PD indicators. Absolute thresholds have been set based on analysis of monthly PD scores from origination (or earliest available date) to point of default.

Second charge mortgages are considered to be in default if they are in arrears by three or more months or in bankruptcy, litigation or possession.

Impairment provisions for the closed second charge mortgage book are determined using a simple discounted cash flow model which segregates accounts by payment status. Estimated future cash flows, which consider the forced sale property valuation and level of first charge debt remaining, are discounted to their present value using the effective interest rate of the loan and compared with the account balance at the reporting date. This estimated loss on possession is multiplied by the probability of possession occurring to calculate the ECL requirement.

The key macroeconomic variable affecting the level of second charge impairment losses is HPI, as forecast within the Group's central, upside, downside and stress scenarios.

ECL calculation – commercial mortgages

The key indicator of a significant increase in credit risk for a commercial loan is a downward migration in internal credit rating, determined via an established internal credit risk assessment process. The internal grade is determined at an individual account level, combining expert judgement with prescriptive measures including, but not limited to, loan to value and income/debt service coverage ratios.

Commercial loans are categorised as default if they are in arrears by greater than or equal to three months or past scheduled maturity with no formal extension having been agreed. Loans not meeting these criteria may be classified as stage 3 based on expert management judgment of the perceived risk of non-payment.

The ECL requirements for commercial mortgages are assessed on an individual loan basis, using cash flow scenario modelling. This involves estimating the timing and amount of future cash flows, in the event of default, for one or more probability weighted account-specific scenarios based on the Group's central forecast of economic conditions. Applying the Group's upside, downside and stress macroeconomic scenarios effectively creates a range of alternative outcomes.

Estimated future cash flows, comprising rental receipts and final sales proceeds (each net of costs), are discounted at the effective interest rate of the loan and compared with its carrying value to determine the ECL under each combination of account-specific and macroeconomic scenarios. The relevant probability weightings are then applied to calculate the overall provision requirement at the reporting date.

ECL calculation – liquid assets

For liquid assets, comprising cash and balances with the Bank of England, loans and advances to credit institutions and investment securities, a significant increase in credit risk is determined by counterparty type and adverse movements in counterparty credit rating beyond specified thresholds. None of the Group's liquid assets are categorised as stage 2 at the reporting date.

Liquid assets are in default if categorised as such by external credit rating agencies. The Group has never experienced an impairment loss or default on its Treasury investment portfolio.

The ECL calculation for liquid assets multiplies the carrying value of the asset by a PD applicable to its credit rating at the reporting date. The PD is obtained from publically available external credit rating agency data tables. The probability-weighted macroeconomic scenarios are translated to shifts in counterparty credit ratings thereby changing the PDs applied in the calculation.

The Group's liquid asset provision requirements at 1 April 2018 and 31 March 2019 were negligible.

ECL calculation – investments in subsidiary undertakings

Investments in subsidiary undertakings comprise (minimal) share capital and intercompany loans. Intercompany loans are financial assets of the Society which are measured at amortised cost and therefore subject to the impairment requirements of IFRS 9.

1. Accounting policies (continued)

For lending companies, the impairment provision requirement is determined by comparing the present value of future cash flows arising on the subsidiary's mortgage assets, net of probability-weighted expected credit losses, with the amount owed to the Society. Cash flows are discounted at the effective interest rate of the intercompany loan.

For West Bromwich Homes Limited, the IFRS 9 provision requirement is assessed by comparing the present value of future cash flows arising on the investment property portfolio with the amount owed to the Society. Cash flows are discounted at the effective interest rate of the intercompany loan. The key macroeconomic variable affecting the calculation is HPI, as forecast within the Group's central, upside, downside and stress scenarios. The assessment has concluded that no impairment provision is required at the reporting date.

Write off of financial assets
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.

Accounting policy for the year ended 31 March 2018

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.

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 year end 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.

d) 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.

e) Modification of contractual cash flows

The Group may, in certain circumstances, renegotiate or otherwise modify the contractual cash flows of loans and advances to customers. If qualitative and quantitative assessments conclude that the new cash flows are substantially different to the original cash flows, the original loan is derecognised and a new financial asset recognised in the Statement of Financial Position. If the modified cash flows are not substantially different, a modification gain or loss is recognised in profit or loss, calculated by adjusting the loan's gross carrying amount to the present value of the modified contractual cash flows discounted at the asset's original effective interest rate.

Where contractual terms are modified due to financial difficulties of the borrower (forbearance), the modification gain or loss is included within impairment on loans and advances; otherwise it is presented within interest receivable.

For residential mortgages, a change of product at the end of a fixed rate deal period is not considered to be a modification to the contract but instead a repricing to market interest rates which was envisaged at the start of the customer relationship.

f) Determination of fair value

The Group determines fair values by the three tier valuation hierarchy as defined within IFRS 13 'Fair Value Measurement' 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) and broker quotes (for example, from Bloomberg).

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, 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 interest rate 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.

h) Derivative financial instruments and hedge accounting

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 and Financial Risk Management 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 be offset in the Income Statement.

i) Fair value hedges – The Group undertakes hedges of the fair value of recognised assets or liabilities (fair value hedges) provided that certain criteria are met. 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.

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.

ii) 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.

1. Accounting policies (continued)

Equity instruments

Equity instruments, comprising core capital deferred shares (CCDS), subscribed capital and, in previous years, profit participating deferred shares (PPDS) are financial instruments issued which do not give rise to a contractual obligation to deliver cash or another financial asset to the holder. Where such an obligation exists, the instrument is classified as a financial liability.

The proceeds of issuing equity instruments are recognised within equity, net of directly attributable costs and tax.

Distributions to holders of equity instruments are recognised directly in equity as a deduction from general reserves.

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 10 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, except specialised administration buildings, is stated at valuation less depreciation. Specialised administration buildings and plant and equipment are 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:

Freehold branches and non-specialised buildings	Up to 50 years
Specialised administration buildings	Up to 25 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 from the date of acquisition.

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 or directly in equity.

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 in other comprehensive income, as an increase or decrease in general reserves.

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 expenses 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

In the process of applying accounting policies, the Group makes various judgements, estimates and assumptions which affect the amounts recognised in the financial statements. 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.

Significant judgements in applying accounting policies

Classification and measurement of financial assets

Significant judgements made in applying IFRS 9 accounting policies (other than those involving estimations) include the business model and contractual cash flow assessments which determine the measurement basis for financial assets in the scope of IFRS 9. These assessments are not limited to one factor but involve a detailed review of relevant evidence including asset management strategy, performance reporting and contractual documentation such as mortgage terms and conditions. For investment securities, past sales activity and, where relevant (e.g. holdings of mortgage backed securities), the contractual cash flow characteristics of underlying asset pools have been assessed in arriving at the FVOCI classification.

Impairment

For IFRS 9 impairment, judgement is required to define the staging criteria, i.e. what constitutes a significant increase in credit risk (stage 2) and what circumstances give rise to a default (stage 3). Where assets meet the stage 2 or 3 criteria, lifetime ECL must be recognised.

In accordance with IFRS 9, forecasts of future macroeconomic conditions are integral to the impairment modelling processes. The selection of economic variables which are genuine drivers of credit risk and adequately capture the impact of changes in the economic outlook involves a degree of judgement.

The staging methodologies and macroeconomic scenario selection processes for each portfolio are detailed within the financial assets (impairment) accounting policy in this note. Model monitoring and model validation procedures are used to continually evaluate the appropriateness of the staging criteria and macroeconomic variable inputs.

Securitisation transactions

In order to determine whether the Group controls a structured entity or not, the Group 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 following the rules and guidance of IFRS 10 'Consolidated Financial Statements'.

For each structured entity created as part of its securitisation activities, the Group has concluded that it does, in substance, control the entity to which financial assets have been transferred. Therefore the structured entity is included in these consolidated financial statements and the transferred assets are recognised in the Group's Statement of Financial Position. Where the securitised assets were originated by the Society, they continue to be recognised in the Society's Statement of Financial Position.

Sources of estimation uncertainty

Impairment on loans and advances - forward-looking ECL approach

The estimation of ECLs is inherently uncertain and the IFRS 9 impairment models incorporate a number of assumptions and estimates, changes in which could materially affect the carrying amounts of assets and liabilities within the next financial year. The IFRS 9 requirements to incorporate forward-looking information within the ECL calculation, including forecasts of future macroeconomic conditions, necessitate judgement thereby increasing the potential for volatility in future periods.

The Group's impairment models incorporate four macroeconomic forecasts (central, upside, downside and stress), each comprising a number of economic variables considered to be credit risk drivers.

1. Accounting policies (continued)

Impairment on loans and advances - residential mortgages (core and second charge)
The following table indicates the main economic variables included within the IFRS 9 macroeconomic scenarios at 31 March 2019 and the associated probability weightings.

	Scenario			
	Central %	**Upside %**	**Downside %**	**Stress %**
Scenario probability weighting	**50**	**10**	**30**	**10**
Economic variables (three year compound increase/(decrease))				
HPI	7.5	10.1	(4.9)	(13.4)
Economic variables (three year average)				
GDP	1.5	2.0	1.0	(1.0)
Unemployment	4.2	4.6	5.1	5.2
Bank Rate	1.00	1.50	0.75	0.50

Key assumptions for the residential portfolios are the probability weightings of the macroeconomic forecasts, which each incorporate a different outlook for the economic variables shown in the table above, the forecast of future house price inflation and the relative threshold used to identify a significant increase in credit risk. The sensitivity of the residential provision calculations to the key assumptions is as follows:

Assumption	**Change to current assumption**	**Increase/(Decrease) in impairment provision 2019 £m**
Central scenario weighting	Increase weighting from 50% to 100%	**(1.0)**
Upside scenario weighting	Increase weighting by 10% (with a corresponding reduction to the central scenario)	**(0.1)**
Downside scenario weighting	Increase weighting by 10% (with a corresponding reduction to the central scenario)	**0.2**
Stress scenario weighting	Increase weighting by 10% (with a corresponding reduction to the central scenario)	**0.3**
HPI growth	Increase of 1.0%	**(0.1)**
HPI growth	Decrease of 1.0%	**0.1**
Quantitative threshold for identifying a significant increase in credit risk	Relative decrease of 35%	**0.3**

Impairment on loans and advances - commercial mortgages
Consistent with residential mortgages, the IFRS 9 ECL calculation for the commercial portfolio incorporates central, upside, downside and stress economic scenarios with probability weightings of 50%, 10%, 30% and 10% respectively.

In addition to the scenario probability weightings and account-specific factors, the key model assumption for commercial provisioning is considered to be the exit yield requirement, which is used to estimate the cash flows arising from realisation of the property values on sale. (While interest rates also have a significant impact on the ECL, via the discount factor applied in the model, compensating economic hedge arrangements would substantially offset the movement in profit or loss terms). Compared with the central economic forecast, the exit yield requirement for each loan increases by 1.2% and 2.8% in the downside and stress scenarios respectively and reduces by 0.5% in the upside scenario.

The table below illustrates the sensitivity of the commercial ECL calculation to the central scenario weighting and exit yield requirement.

Assumption	**Change to current assumption**	**Increase/(Decrease) in impairment provision 2019 £m**
Central scenario weighting	Increase weighting from 50% to 100%	**(11.5)**
Upside scenario weighting	Increase weighting by 10% (with a corresponding reduction to the central scenario)	**(0.7)**
Downside scenario weighting	Increase weighting by 10% (with a corresponding reduction to the central scenario)	**2.5**
Stress scenario weighting	Increase weighting by 10% (with a corresponding reduction to the central scenario)	**5.3**
Exit yield requirement	Increase of 0.5% across all scenarios	**5.1**

Impairment losses on investment in West Bromwich Commercial Limited (WBCL)
In the Society's financial statements, the recoverable amount of the intercompany loan to WBCL 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, taking into account the IFRS 9 probability-weighted expected credit losses on WBCL's mortgage portfolio. 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. The most critical element is the discount rate used to arrive at the present value of future cash flows. A 0.1% increase in the discount rate would increase provisions by £3.7m.

Fair value of equity release mortgages
Under IFRS 9, the mature and closed book of equity release mortgages is held at FVTPL with fair values determined using a discounted cash flow model which incorporates a number of judgemental assumptions to determine the amount and timing of future cash flows arising on mortgage redemption. Certain model inputs, such as redemption rates, are informed by historic experience, with observed closure curves extrapolated to give an expected maturity profile for the remaining book. Other model assumptions, such as house price indices, are based on the Group's view of future economic conditions. The discount factor used to calculate the present value of the future cash flows has been determined with due regard to credit, market and liquidity risk.

Key sensitivities are in relation to HPI, discount rate and time to redemption as shown in the table below.

Assumption	Change to current assumption	Increase in fair value loss 2019 £m
HPI growth	Decrease of 0.5% p.a	**0.2**
Discount rate	Increase of 0.25%	**0.1**
Time to redemption	Increase of 1 year	**0.4**

Effective interest rate
The calculation of an effective interest rate requires the Group to make assumptions around the expected lives of mortgages. 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 increase by £3.8m with a corresponding increase in interest income.

Investment properties
Independent specialist valuers have undertaken a valuation review of the portfolio of residential investment properties on an open market value for existing use basis, calculated on the net income allowing for reversionary potential. In making the judgment, consideration has been given to assumptions that are mainly based on market conditions existing at the Statement of Financial Position date. These estimates are regularly compared to actual market data and actual transactions entered into by the Company. 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 £6.7m with a corresponding change to income.

Pensions
The Group operates a defined benefit pension scheme. The year-end valuation of the scheme assets and liabilities relies on estimates of future interest, inflation and mortality rates informed by external advice from the scheme actuaries. The main assumptions used in the valuation, together with sensitivity analysis of the impact of movements in key variables, are outlined in note 32 to the Accounts.

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

Management has made detailed forecasts of future taxable income in order to determine that profits will be available to offset the deferred tax asset. These projections are based on business plans, future capital requirements and 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 rates between 17% and 19%, being the rates substantively enacted at the date of the Statement of Financial Position and expected to apply when the deferred tax assets are realised.

2. Interest receivable and similar income

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
On financial assets not at fair value through profit or loss:				
Loans fully secured on residential property	**101.2**	93.7	**72.6**	65.6
Other loans				
Connected undertakings	**-**	-	**32.1**	31.0
Loans fully secured on land	**12.7**	15.0	**1.0**	1.2
Investment securities	**3.0**	3.5	**10.0**	9.5
Other liquid assets	**1.6**	1.1	**1.4**	1.0
On financial assets at fair value through profit or loss:				
Loans fully secured on residential property	**1.0**	-	**1.0**	-
Loans fully secured on land	**-**	0.4	**-**	-
Investment securities	**-**	-	**0.3**	-
Net expense on derivative financial instruments	**(7.9)**	(16.4)	**(6.6)**	(15.0)
Total interest receivable and similar income	**111.6**	97.3	**111.8**	93.3
Interest receivable includes:				
Income from fixed income securities	**0.5**	1.6	**0.5**	1.6

During the year ended 31 March 2019, the total interest receivable and similar income calculated using the effective interest method was Group £115.5m and Society £114.1m for financial assets held at amortised cost and Group £3.0m and Society £3.0m for financial assets held at fair value through other comprehensive income.

Included within interest receivable and similar income is interest accrued on impaired residential mortgage assets: Group £1.7m (2017/18: £1.2m) and Society £0.7m (2017/18: £1.0m) and interest accrued on impaired commercial mortgage assets: Group £4.7m (2017/18: £5.5m) and Society £nil (2017/18: £nil). For the purposes of this disclosure, impaired mortgage assets are those which have been categorised as stage 3 under IFRS 9 (2017/18: those for which an individual impairment provision was held under IAS 39).

3. Interest expense and similar charges

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
On financial liabilities not at fair value through profit or loss:				
Shares held by individuals	**37.0**	32.6	**37.0**	32.6
Deposits from banks and other deposits	**7.9**	5.5	**7.8**	5.5
Debt securities in issue	**6.7**	3.5	**-**	-
Subordinated liabilities	**2.4**	-	**2.4**	-
Deemed loans	**-**	-	**7.3**	3.6
On financial liabilities at fair value through profit or loss:				
Net income on derivative financial instruments	**(0.9)**	(0.5)	**(0.9)**	(0.5)
Debt securities in issue	**-**	0.7	**-**	-
Total interest expense and similar charges	**53.1**	41.8	**53.6**	41.2

4. Other operating income

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Other operating income includes:				
Rent receivable on investment property	**6.7**	6.4	**-**	-
Operating expenses on investment property	**(2.6)**	(2.4)	**-**	-
Pension fund net interest (note 32)	**(0.1)**	(0.1)	**(0.1)**	(0.1)
Dividends received from Group undertakings	**-**	-	**-**	9.8
Other	**-**	(0.1)	**-**	(0.1)
Total other operating income	**4.0**	3.8	**(0.1)**	9.6

5. Fair value (losses)/gains on financial instruments

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Fair value hedges				
Derivatives designated as fair value hedges	**(10.7)**	31.8	**(12.3)**	30.6
Adjustments to hedged items in fair value hedge relationships	**10.7**	(32.6)	**12.3**	(31.0)
Fair value losses on hedge accounting	**-**	(0.8)	**-**	(0.4)
Other derivatives	**(2.7)**	4.7	**(4.9)**	4.4
Financial instruments mandatorily at fair value through profit or loss	**(1.7)**	-	**(1.5)**	-
Financial instruments designated at fair value through profit or loss	**-**	(1.4)	**-**	-
Total fair value (losses)/gains on financial instruments	**(4.4)**	2.5	**(6.4)**	4.0

6. Administrative expenses

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Staff costs				
Wages and salaries	**23.5**	24.5	**23.0**	23.8
Social security costs	**2.4**	2.3	**2.3**	2.3
Other pension costs	**2.1**	1.6	**2.1**	1.6
Rental charges payable under operating leases	**0.5**	0.5	**0.5**	0.5
Other administrative expenses	**14.1**	14.6	**11.6**	11.8
	42.6	43.5	**39.5**	40.0
Other administrative expenses include:				
Remuneration of auditor (excluding VAT element)				
Audit of these financial statements	**0.2**	0.2	**0.2**	0.2
Audit of the subsidiary financial statements	**0.1**	0.1	**-**	-

Wages and salaries include £0.6m (2017/18: £0.1m) redundancy costs paid as part of the restructuring and rationalisation undertaken during the year.

Other assurance services provided by the external auditor comprise £5,200 (2017/18: £5,100) in respect of audit-related assurance services and £22,900 (2017/18: £22,000) in respect of other assurance services, in each case excluding VAT.

7. Employee numbers

	Group and Society 2019	Group and Society 2018
The average number of employees employed throughout the year was:		
Full time	**551**	595
Part time	**169**	158
	720	753
Building Society		
Central administration (Society and subsidiaries)	**515**	545
Branches	**205**	208
	720	753

All employees were employed within the United Kingdom.

8. Directors' emoluments

Total Directors' emoluments including expenses amounted to £1.716m (2017/18: £1.719m). Full details are given in the Directors' Remuneration Report on pages 44 to 51.

9. Taxation

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
Current tax				
UK corporation tax at 19% (2017/18: 19%)	**(2.3)**	0.6	**(2.3)**	0.6
Deferred tax				
Current year	**4.6**	0.5	**3.4**	(0.6)
Adjustment in respect of prior periods	**(0.3)**	(0.1)	**0.1**	-
Effect of changes in tax rates	**(0.6)**	(0.1)	**(0.5)**	(0.1)
Tax on profit on ordinary activities	**1.4**	0.9	**0.7**	(0.1)

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

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

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
Profit before tax	**10.5**	8.8	**2.8**	5.7
Profit before tax multiplied by the UK standard rate of tax of 19% (2017/18: 19%)	**2.0**	1.7	**0.5**	1.1
Effects of:				
Income not taxable and expenses not deductible for tax purposes	**(0.1)**	0.6	**1.3**	1.2
Changes to tax rate	**(0.6)**	(0.1)	**(0.5)**	(0.1)
Adjustment in respect of prior years	**(0.3)**	(0.1)	**0.1**	-
Transfer pricing adjustments	**-**	-	**(1.2)**	(1.2)
Write down/(Utilisation and recognition) of deferred tax assets	**0.5**	(0.5)	**0.5**	(1.1)
Revaluation	**(0.1)**	(0.7)	**-**	-
Tax charge	**1.4**	0.9	**0.7**	(0.1)

10. Cash and balances with the Bank of England

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Cash in hand	**3.2**	3.2	**3.2**	3.2
Cash ratio deposit with the Bank of England	**10.5**	6.6	**10.5**	6.6
Other deposits with the Bank of England	**168.8**	314.9	**168.8**	314.9
	182.5	324.7	**182.5**	324.7

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 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Listed transferable investment securities:				
Fair value through other comprehensive income [1]	**309.3**	311.9	**309.3**	311.9
Amortised cost	**-**	-	**623.7**	717.5
Fair value through profit or loss [2]	**-**	-	**1.2**	-
Total investment securities	**309.3**	311.9	**934.2**	1,029.4

The movement in investment securities may be summarised as follows:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
At beginning of year	**311.9**	385.0	**1,029.4**	1,195.5
Changes on initial application of IFRS 9 [3]	**-**	-	**(0.8)**	-
At beginning of year including impact of IFRS 9 adoption	**311.9**	385.0	**1,028.6**	1,195.5
Additions	**140.1**	155.6	**140.1**	188.7
Disposals (sale and redemption)	**(141.6)**	(227.6)	**(233.7)**	(353.7)
Losses from changes in fair value	**(1.1)**	(1.1)	**(0.8)**	(1.1)
At end of year	**309.3**	311.9	**934.2**	1,029.4

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.

1 Fair value through other comprehensive income relates to assets classified as such under IFRS 9 with effect from 1 April 2018. In prior periods, these assets were classified as available for sale under IAS 39.
2 Fair value through profit or loss relates to assets reclassified from the held to maturity category on IFRS 9 transition at 1 April 2018.
3 The impact of IFRS 9 adoption is further explained in note 43 to the accounts.

12. Derivative financial instruments and hedge accounting

(a) Use of derivative financial instruments for interest rate risk management purposes

The Group is exposed to the risk that movements in interest rates change the value of, or income arising from, its assets and liabilities. This type of market risk is known as interest rate risk.

The Group has an integrated approach to interest rate risk management, taking advantage of natural hedges which exist within the Group Statement of Financial Position and using derivatives where no such natural hedges exist. Derivatives are financial 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 derivatives currently held by the Group comprise interest rate swaps with highly rated counterparties. Counterparty credit risk is mitigated by the posting of collateral and the use of central clearing counterparties. In accordance with the Building Societies Act 1986, derivatives are solely used for risk mitigation and never for trading purposes. From an accounting perspective, where the IAS 39 criteria are met, the derivatives are designated as hedging instruments in fair value hedge relationships and hedge accounting is adopted. Otherwise, the derivatives are held as economic hedges and valued at fair value through profit or loss. The accounting policies for derivatives and hedge accounting are described in note 1 to the accounts.

The following table describes the significant activities undertaken by the Group, the associated risks, the type of derivatives typically used in managing such risks and related hedge relationships.

Activity	Risk	Derivative type	Hedge relationship	Hedge accounting
Fixed rate mortgage lending	Sensitivity to changes in interest rates	Pay fixed receive floating interest rate swaps	Fair value hedge	Yes
Fixed rate investment securities	Sensitivity to changes in interest rates	Pay fixed receive floating interest rate swaps	Fair value hedge	Yes
Fixed rate savings products	Sensitivity to changes in interest rates	Receive fixed pay floating interest rate swaps	Fair value hedge	Yes
Variable rate debt securities in issue	Sensitivity to fluctuations in interest rates between quarterly reset dates	Pay floating receive floating interest rate swaps	Economic hedge	No
Commercial mortgage loss provisions	Sensitivity to changes in interest rates	Pay fixed receive floating interest rate swaps	Economic hedge	No

These arrangements have been established solely for the mitigation of interest rate risk. Other risks, such as credit risk, are separately managed but not hedged. The interest rate risk component of the hedge relationship is ascertained with reference to the benchmark rate of interest being hedged.

(b) Derivative financial instruments in the Statement of Financial Position

The following tables show the notional and carrying amounts of derivative financial instruments at the year-end date.

		Carrying value in the Statement of Financial Position	
Group	**Notional amount 2019 £m**	**Assets 2019 £m**	**Liabilities 2019 £m**
Interest rate swaps			
Designated as fair value hedges	**1,691.6**	**4.3**	**(33.8)**
Economic hedges	**1,440.0**	**2.2**	**(5.5)**
Total derivatives held for hedging purposes	**3,131.6**	**6.5**	**(39.3)**

		Carrying value in the Statement of Financial Position	
Group	Notional amount 2018 £m	Assets 2018 £m	Liabilities 2018 £m
Interest rate swaps			
Designated as fair value hedges	1,623.2	15.7	(34.5)
Economic hedges	1,169.7	3.8	(4.2)
Total derivatives held for hedging purposes	2,792.9	19.5	(38.7)

Society	Notional amount 2019 £m	Carrying value in the Statement of Financial Position Assets 2019 £m	Liabilities 2019 £m
Interest rate swaps			
Designated as fair value hedges	**1,684.2**	**4.3**	**(31.3)**
Economic hedges	**1,102.1**	**1.6**	**(4.2)**
Total derivatives held for hedging purposes	**2,786.3**	**5.9**	**(35.5)**

Society	Notional amount 2018 £m	Carrying value in the Statement of Financial Position Assets 2018 £m	Liabilities 2018 £m
Interest rate swaps			
Designated as fair value hedges	1,606.3	15.7	(30.3)
Economic hedges	798.5	3.8	(1.2)
Total derivatives held for hedging purposes	2,404.8	19.5	(31.5)

(c) Hedge accounting

(i) Fair value hedges
Hedges of the fair value of recognised assets or liabilities are termed 'fair value hedges'. Hedge accounting is applied where the IAS 39 criteria for doing so are met. Under hedge accounting rules, changes in the fair value of derivatives (hedging instruments) are offset against changes in the fair value of hedged assets or liabilities (hedged items) in the Income Statement. The hedging ratio is the ratio of the notional value of the derivatives to the principal of the assets or liabilities being hedged.

(ii) Hedge effectiveness
For a fair value hedge of interest rate risk, hedge effectiveness is determined by comparing changes in the fair value of the derivative with changes in the fair value of the hedged asset or liability attributable to changes in interest rates.

The primary sources of ineffectiveness for the Society's fair value hedge relationships are:

- Differences in the timing of cash flows between the interest rate swaps and the hedged mortgages or savings products.
- Differences between actual and expected prepayment profiles of the hedged items.
- Differences between the contractual maturity dates of the derivatives and the hedged items.
- Differences in the benchmark rates of interest used to calculate the fair value of the derivatives and hedged items.

(iii) Portfolio hedges
The Society designates fair value 'macro' hedge relationships in which derivative financial instruments hedge a portfolio of fixed rate mortgages or savings products, reducing the Income Statement volatility that would otherwise arise from the derivatives being measured at fair value through profit or loss and the related hedged items at amortised cost.

The Society's macro hedging approach is dynamic, as the mortgage portfolios are constantly changing due to new advances, contractual repayments and early redemptions. To manage the interest rate risk inherent within fixed rate mortgage lending, the Society frequently enters into and closes interest rate swap arrangements. It assesses hedging ratios and hedge effectiveness on a monthly basis.

(iv) Micro hedges
The Group holds derivatives to hedge individual fixed rate commercial mortgages and investment securities within fair value 'micro' hedge relationships. In this case, the IAS 39 hedge accounting rules are applied until such time as the mortgage/investment security and swap mature or the hedge relationship becomes ineffective and must be dedesignated.

(v) Derivatives not in a designated hedge relationship
In cases where the Group holds derivatives for hedging purposes, but the prescriptive IAS 39 criteria for application of hedge accounting are not met, the derivatives are held at fair value through profit or loss. Changes in the fair value of these derivatives are included within 'Fair value (losses)/gains on financial instruments' on the Income Statement. Depending on the nature of the economic hedging relationship, offsetting movements are reported either within the same line or another line of the Income Statement.

12. Derivative financial instruments and hedge accounting (continued)

The following tables analyse the notional value and average fixed rate of interest rate swaps in designated hedge relationships by contractual maturity.

At 31 March 2019

Group and Society	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years
Fair value macro hedge of fixed rate residential loans				
Interest rate swap notional (£m)	42.5	186.1	1,295.3	22.4
Average fixed rate	1.96%	0.64%	0.90%	0.92%
Fair value micro hedge of fixed rate investment securities				
Interest rate swap notional (£m)	-	3.0	-	-
Average fixed rate	-	1.18%	-	-
Fair value macro hedge of fixed rate savings products				
Interest rate swap notional (£m)	-	16.0	-	-
Average fixed rate	-	1.88%	-	-
Group				
Fair value micro hedge of fixed rate commercial loans				
Interest rate swap notional (£m)	-	-	41.7	84.6
Average fixed rate	-	-	4.62%	4.87%
Society				
Fair value micro hedge of intercompany loans*				
Interest rate swap notional (£m)	-	-	41.7	77.2
Average fixed rate	-	-	4.62%	4.84%

The impact of hedge accounting on the Group and Society Income Statement and Statement of Financial Position (SOFP) is indicated in the tables which follow.

Hedging instruments at 31 March 2019

Interest rate swaps Group and Society	Notional amount £m	Carrying value in the SOFP Assets £m	Carrying value in the SOFP Liabilities £m	SOFP line	Change in fair value used for recognising ineffectiveness £m	Ineffectivess charge/(credit) in the Income Statement £m	Income Statement line
Fair value macro hedge of fixed rate residential loans	1,546.3	4.1	(5.1)	Derivative financial instruments	(14.1)	0.3	Fair value (losses)/gains from financial instruments
Fair value micro hedge of fixed rate investment securities	3.0	-	-	Derivative financial instruments	-	-	Fair value (losses)/gains from financial instruments
Fair value macro hedge of fixed rate savings products	16.0	0.2	-	Derivative financial instruments	(0.3)	-	Fair value (losses)/gains from financial instruments
Group							
Fair value micro hedge of fixed rate commercial loans	126.3	-	(28.7)	Derivative financial instruments	3.7	(0.3)	Fair value (losses)/gains from financial instruments
Society							
Fair value micro hedge of intercompany loans*	118.9	-	(26.1)	Derivative financial instruments	2.1	(0.3)	Fair value (losses)/gains from financial instruments

Hedged items at 31 March 2019

Hedged assets and liabilities Group and Society	Carrying value in the SOFP £m	Accumulated fair value adjustments £m	SOFP line	Change in fair value used for recognising ineffectiveness £m
Fixed rate residential loans	1,432.1	0.5	Loans and advances to customers	13.8
Fixed rate investment securities	3.2	-	Investment securities	-
Fixed rate savings products	(13.6)	-	Shares	0.3
Group				
Fixed rate commercial loans	146.2	30.0	Loans and advances to customers	(3.4)
Society				
Intercompany loans*	138.7	27.9	Loans and advances to customers	(1.8)

*The Society holds interest rate swaps to mitigate interest rate risk on commercial mortgages originated by its subsidiary West Bromwich Commercial Limited (WBCL). At Group level the derivatives and commercial mortgages are in designated IAS 39 hedge relationships. In the Society's individual financial statements, the interest rate swaps are held in a hedge relationship against intercompany loans with equivalent terms to the third party commercial mortgages.

13. Loans and advances to customers

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Amortised cost				
Loans fully secured on residential property	**4,383.2**	4,403.9	**3,066.5**	2,960.1
Loans fully secured on land	**394.9**	428.3	**12.2**	13.8
	4,778.1	4,832.2	**3,078.7**	2,973.9
At fair value through profit or loss				
Loans fully secured on residential property	**14.8**	-	**14.8**	-
Loans fully secured on land	**-**	8.5	**-**	-
	4,792.9	4,840.7	**3,093.5**	2,973.9
Fair value adjustment for hedged risk	**30.5**	20.0	**4.4**	(8.7)
Less: impairment provisions	**(76.7)**	(55.3)	**(1.2)**	(8.4)
	4,746.7	4,805.4	**3,096.7**	2,956.8

The Group adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018. Balances in the table above are presented on an IFRS 9 basis at 31 March 2019 and an IAS 39 basis at 31 March 2018.

Included within loans and advances to customers are £444.3m (2017/18: £488.0m) of commercial lending balances of which £32.4m (2017/18: £53.2m) have been sold by the Group to bankruptcy remote structured entities. A further £930.4m (2017/18: £1,172.1m) of residential mortgage balances, included within loans and advances, have also been sold by the Group to structured entities. The structured entities have been funded by issuing mortgage backed securities (MBSs), a proportion of which are held by the Society at a carrying value of £624.9m (2017/18: £717.5m).

14. Allowance for losses on loans and advances

The Group adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018. In the table below, impairment provisions are calculated under IAS 39 at 31 March 2018 and under IFRS 9 at 31 March 2019.

	Group			Society
Group	**Loans fully secured on residential property £m**	**Loans fully secured on land £m**	**Total £m**	**Loans fully secured on residential property £m**
At 1 April 2018 (IFRS 9 basis)	7.8	74.4	**82.2**	**1.5**
Amounts written off	(3.0)	(7.2)	**(10.2)**	**(0.4)**
Charge for the year comprising:				
Provision for loan impairment	2.0	3.6	**5.6**	**0.6**
Change in carrying value of debt securities in issue	-	(1.7)	**(1.7)**	**-**
Adjustments to provisions resulting from recoveries	(0.8)	(0.1)	**(0.9)**	**(0.5)**
Charge for the year	1.2	1.8	**3.0**	**0.1**
Non-recourse finance on securitised advances	-	1.7	**1.7**	**-**
At 31 March 2019	**6.0**	**70.7**	**76.7**	**1.2**

	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 2017	8.1	8.2	25.5	13.9	33.6	22.1	55.7
Amounts written off	(3.0)	-	(12.8)	-	(15.8)	-	(15.8)
Charge/(Credit) for the year comprising:							-
Provision for loan impairment	3.9	(3.3)	18.0	(2.5)	21.9	(5.8)	16.1
Change in carrying value of debt securities in issue	-	-	(7.5)	-	(7.5)	-	(7.5)
Adjustments to provisions resulting from recoveries	(0.7)	-	-	-	(0.7)	-	(0.7)
Charge/(Credit) for the year	3.2	(3.3)	10.5	(2.5)	13.7	(5.8)	7.9
Non-recourse finance on securitised advances	-	-	7.5	-	7.5	-	7.5
At 31 March 2018	8.3	4.9	30.7	11.4	39.0	16.3	55.3

During the year there were impairment charges of £1.7m (2017/18: £7.5m) against loans in structured entities, Sandwell Commercial Finance No.1 Plc: £0.3m credit (2017/18: £0.2m credit) and Sandwell Commercial Finance No. 2 Plc: £2.0m charge (2017/18: £7.7m charge). The gains or losses from these impairments are borne by the external loan note holders as they exceed the first loss exposure held by the Group. Impairment provisions at the end of the year include £6.1m (2017/18: £8.5m) against loans in structured entity, Sandwell Commercial Finance No. 2 Plc. The carrying value of the external loan notes has been adjusted by an equivalent amount.

	Loans fully secured on residential property		Loans fully secured on land		Total		
Society	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Total £m
At 1 April 2017	5.7	3.1	-	-	5.7	3.1	8.8
Amounts written off	(1.0)	-	-	-	(1.0)	-	(1.0)
Charge/(Credit) for the year comprising:							
Provision for loan impairment	1.1	(0.1)	-	-	1.1	(0.1)	1.0
Adjustments to provisions resulting from recoveries	(0.4)	-	-	-	(0.4)	-	(0.4)
Charge/(Credit) for the year	0.7	(0.1)	-	-	0.7	(0.1)	0.6
At 31 March 2018	5.4	3.0	-	-	5.4	3.0	8.4

15. Investments

Society	Shares in subsidiary undertakings 2019 £m	Shares in subsidiary undertakings 2018 £m	Loans to subsidiary undertakings 2019 £m	Loans to subsidiary undertakings 2018 £m	Total 2019 £m	Total 2018 £m
Cost						
At beginning of year	**0.6**	0.6	**1,442.4**	1,604.5	**1,443.0**	1,605.1
Decrease for the year	**-**	-	**(98.7)**	(162.1)	**(98.7)**	(162.1)
At end of year	**0.6**	0.6	**1,343.7**	1,442.4	**1,344.3**	1,443.0
Provisions						
At beginning of year	**-**	-	**92.4**	78.2	**92.4**	78.2
Changes on initial application of IFRS 9	**-**	-	**30.6**	-	**30.6**	-
At beginning of year including impact of IFRS 9 adoption	**-**	-	**123.0**	78.2	**123.0**	78.2
Charge for the year	**-**	-	**5.5**	14.2	**5.5**	14.2
At end of year	**-**	-	**128.5**	92.4	**128.5**	92.4
Net book value at end of year	**0.6**	0.6	**1,215.2**	1,350.0	**1,215.8**	1,350.6

Investments in subsidiary undertakings are financial fixed assets held at amortised cost and therefore subject to the impairment requirements of IFRS 9 which the Society adopted with effect from 1 April 2018. In the table above, impairment provisions are presented on an IFRS 9 basis at 31 March 2019 and an IAS 39 basis at 31 March 2018. All subsidiary loans are provided at open market rates.

The value of the Society's investment in WBCL has been assessed 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 discounted at the interest rate applicable to the intra-group loan account. Following continued contraction of the commercial mortgage book and the additional losses recognised within West Bromwich Commercial Limited (on IFRS 9 transition and subsequently), it has been necessary to write down the value of the investment by £36.1m of which £30.6m (2017/18: £nil) has been recognised in equity, being the additional provision required at 1 April 2018 on IFRS 9 adoption, and £5.5m (2017/18: £14.2m) in the Society's Income Statement.

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	Residential mortgage lending	Ordinary £1 shares	100%
West Bromwich Commercial Limited	Commercial mortgage lending	Ordinary £1 shares	100%
CL Mortgages Limited (1)	Residential mortgage lending	Ordinary £1 shares	100%
West Bromwich Homes Limited	Investment in property for rental	Ordinary £1 shares	100%
Insignia Finance Limited	Holding company	Ordinary £500 shares	100%
White Label Lending Limited (2)	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) The entire share capital of White Label Lending Limited is held by Insignia Finance Limited.

The registered office of the subsidiary undertakings listed above is the Group's registered office as detailed in note 38.

15. Investments (continued)

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 Asset Co Limited	United Kingdom	Securitisation entity
Hawthorn Finance Limited	Jersey	Securitisation entity
Kenrick No. 1 Holdings Limited (3)	United Kingdom	Holding company
Kenrick No. 1 Plc (4)	United Kingdom	Securitisation entity
Kenrick No. 2 Holdings Limited (5)	United Kingdom	Holding company
Kenrick No. 2 Plc (6)	United Kingdom	Securitisation entity
Kenrick No. 3 Holdings Limited	United Kingdom	Holding company
Kenrick No. 3 Plc	United Kingdom	Securitisation entity

(3) Kenrick No. 1 Holdings Limited was dissolved on 3 April 2018.
(4) Kenrick No. 1 Plc was dissolved on 4 August 2018.
(5) Kenrick No. 2 Holdings Limited was dissolved on 2 April 2019.
(6) Kenrick No. 2 Plc was dissolved on 10 April 2019.

Sandwell Finance Holdings Limited did not trade during the year and is exempt from the requirement to have its accounts for the year ended 31 March 2019 audited under Section 480 of the Companies Act 2006.

The registered office of Sandwell Finance Holdings Limited, Sandwell Commercial Finance No.1 Plc, Sandwell Commercial Finance No. 2 Plc and Hawthorn Asset Co Limited is Third Floor, 1 King's Arms Yard, London, EC2R 7AF.

The registered office of Hawthorn Finance Limited is 26 New Street, St. Helier, Jersey, JE2 3RA.

The registered office of Kenrick No. 3 Plc and Kenrick No. 3 Holdings Limited is 11th Floor 200 Aldersgate Street, London, EC1A 4HD.

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.

16. Intangible assets

Group	Goodwill 2019 £m	Purchased software 2019 £m	Development costs 2019 £m	Total 2019 £m	Goodwill 2018 £m	Purchased software 2018 £m	Development costs 2018 £m	Total 2018 £m
Cost								
At beginning of year	0.6	14.3	19.1	34.0	0.6	11.4	15.7	27.7
Additions	-	1.1	4.0	5.1	-	2.9	3.4	6.3
Disposals	-	-	(1.5)	(1.5)	-	-	-	-
At end of year	0.6	15.4	21.6	37.6	0.6	14.3	19.1	34.0
Aggregate amortisation								
At beginning of year	-	8.3	10.4	18.7	-	6.8	7.6	14.4
Charge for the year	-	2.1	1.8	3.9	-	1.5	2.8	4.3
Disposals	-	-	(1.5)	(1.5)	-	-	-	-
At end of year	-	10.4	10.7	21.1	-	8.3	10.4	18.7
Net book value at end of year	0.6	5.0	10.9	16.5	0.6	6.0	8.7	15.3
Net book value at beginning of year	0.6	6.0	8.7	15.3	0.6	4.6	8.1	13.3

Society	Goodwill 2019 £m	Computer software 2019 £m	Development costs 2019 £m	Total 2019 £m	Goodwill 2018 £m	Computer software 2018 £m	Development costs 2018 £m	Total 2018 £m
Cost								
At beginning of year	-	14.3	19.1	33.4	-	11.4	15.7	27.1
Additions	-	1.1	4.0	5.1	-	2.9	3.4	6.3
Disposals	-	-	(1.5)	(1.5)	-	-	-	-
At end of year	-	15.4	21.6	37.0	-	14.3	19.1	33.4
Aggregate amortisation								
At beginning of year	-	8.3	10.4	18.7	-	6.8	7.6	14.4
Charge for the year	-	2.1	1.8	3.9	-	1.5	2.8	4.3
Disposals	-	-	(1.5)	(1.5)	-	-	-	-
At end of year	-	10.4	10.7	21.1	-	8.3	10.4	18.7
Net book value at end of year	-	5.0	10.9	15.9	-	6.0	8.7	14.7
Net book value at beginning of year	-	6.0	8.7	14.7	-	4.6	8.1	12.7

The goodwill has been assessed as having an indefinite life based on the acquired entity's forecast contribution to the Group. 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 pre-tax rate used to discount projected cash flows is 12.5% (2017/18: 12.5%), reflecting management's estimate of the required return.

17. Investment properties

	Group 2019 £m	Group 2018 £m
Valuation		
At beginning of year	132.2	128.9
Disposals	(0.1)	(0.5)
Revaluation gains	2.6	3.8
At end of year	134.7	132.2

The Group applies the fair value model to its investment property portfolio.

Independent specialist valuers have undertaken a valuation review of the residential investment properties held by West Bromwich Homes Limited. The complete portfolio has been passed through an automated valuation model (AVM). A separate firm of independent valuers have valued a 10% sample of the portfolio using drive by methods. The valuations have been used, in combination with the AVM output, to arrive at a portfolio valuation of £134.7m at 31 March 2019.

This fair value measurement is categorised as a Level 3 fair value measurement, based on an assessment of the inputs to the valuation methodology.

If the land and buildings were carried at cost, the carrying amount would be £84.4m (2017/18: £84.4m).

The Group leases investment properties to non-commercial individuals for a contract period of up to 12 months. The future minimum lease receipts under non-cancellable operating leases that end within 12 months are £2.9m (2017/18: £2.8m). The Group has not recognised any contingent rent in the period (2017/18: £nil).

18. Property, plant and equipment

Group	Land and buildings: Freehold branches and non-specialised buildings £m	Land and buildings: Specialised administration buildings £m	Land and buildings: Held for sale £m	Land and buildings: Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost or valuation						
At 1 April 2018	5.4	21.2	-	1.0	23.4	**51.0**
Additions	-	-	-	-	1.2	**1.2**
Transfers	(0.5)	-	0.5	-	-	**-**
Disposals	-	-	-	-	(0.3)	**(0.3)**
At 31 March 2019	**4.9**	**21.2**	**0.5**	**1.0**	**24.3**	**51.9**
Accumulated depreciation						
At 1 April 2018	0.1	1.7	-	0.6	18.4	**20.8**
Charge for the year	0.1	1.0	-	-	1.9	**3.0**
Disposals	-	-	-	-	(0.3)	**(0.3)**
At 31 March 2019	**0.2**	**2.7**	**-**	**0.6**	**20.0**	**23.5**
Net book value						
At 31 March 2019	**4.7**	**18.5**	**0.5**	**0.4**	**4.3**	**28.4**

Group	Land and buildings: Freehold branches and non-specialised buildings £m	Land and buildings: Specialised administration buildings £m	Land and buildings: Held for sale £m	Land and buildings: Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost or valuation						
At 1 April 2017	5.4	20.8	-	1.0	22.8	50.0
Additions	-	0.4	-	-	0.6	1.0
At 31 March 2018	5.4	21.2	-	1.0	23.4	51.0
Accumulated depreciation						
At 1 April 2017	-	0.9	-	0.6	16.4	17.9
Charge for the year	0.1	0.8	-	-	2.0	2.9
At 31 March 2018	0.1	1.7	-	0.6	18.4	20.8
Net book value						
At 31 March 2018	5.3	19.5	-	0.4	5.0	30.2

Society	**Land and buildings** **Freehold branches and non-specialised buildings £m**	**Specialised administration buildings £m**	**Held for sale £m**	**Short leasehold £m**	**Equipment, fixtures, fittings and vehicles £m**	**Total £m**
Cost or valuation						
At 1 April 2018	5.4	21.2	-	1.0	23.2	**50.8**
Additions	-	-	-	-	1.2	**1.2**
Transfers	(0.5)	-	0.5	-	-	**-**
Disposals	-	-	-	-	(0.3)	**(0.3)**
At 31 March 2019	**4.9**	**21.2**	**0.5**	**1.0**	**24.1**	**51.7**
Accumulated depreciation						
At 1 April 2018	0.1	1.7	-	0.6	18.2	**20.6**
Charge for the year	0.1	1.0	-	-	1.9	**3.0**
Disposals	-	-	-	-	(0.3)	**(0.3)**
At 31 March 2019	**0.2**	**2.7**	**-**	**0.6**	**19.8**	**23.3**
Net book value						
At 31 March 2019	**4.7**	**18.5**	**0.5**	**0.4**	**4.3**	**28.4**

Society	Land and buildings Freehold branches and non-specialised buildings £m	Specialised administration buildings £m	Held for sale £m	Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost or valuation						
At 1 April 2017	5.4	20.8	-	1.0	22.6	49.8
Additions	-	0.4	-	-	0.6	1.0
At 31 March 2018	5.4	21.2	-	1.0	23.2	50.8
Accumulated depreciation						
At 1 April 2017	-	0.9	-	0.6	16.2	17.7
Charge for the year	0.1	0.8	-	-	2.0	2.9
At 31 March 2018	0.1	1.7	-	0.6	18.2	20.6
Net book value						
At 31 March 2018	5.3	19.5	-	0.4	5.0	30.2

The net book value of land and buildings occupied for the Society's own activities at 31 March is £24.1m (2017/18: £25.2m).

The Group's freehold branches and non-specialised buildings were last revalued at 31 March 2017 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 were incorporated into the financial statements and the resulting revaluation adjustments taken to the revaluation reserve.

If land and buildings were carried at historical cost, the carrying amount would be £19.7m (2017/18: £20.8m).

As part of the ongoing funding agreement for the West Bromwich Building Society Staff Retirement Scheme (the SRS), the Trustees of the SRS have been granted a charge over the Society's Head Office, a specialised administration building. The charge may be exercised only in the event of the Society defaulting on its pension obligations and in such circumstances assigns the rights of ownership of the building to the SRS.

19. Deferred tax

Deferred tax is calculated on all temporary differences under the liability method using an effective tax rate of 17% to 19% (2017/18: 17% to 19%). The movement on the deferred tax account is as follows:

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
At beginning of year	**10.8**	11.4	**11.3**	10.7
Changes on initial application of IFRS 9	**5.8**	-	**0.2**	-
At beginning of year including impact of IFRS 9 adoption	**16.6**	11.4	**11.5**	10.7
Current year Income Statement (charge)/credit	**(4.0)**	(0.4)	**(2.9)**	0.7
Amount recognised directly in other comprehensive income	**0.2**	(0.3)	**0.2**	(0.1)
Adjustments in respect of prior years	**0.3**	0.1	**(0.1)**	-
At end of year	**13.1**	10.8	**8.7**	11.3

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

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
Deferred tax assets				
Accelerated tax depreciation	**4.5**	5.2	**4.5**	5.2
Carried forward tax losses	**6.9**	8.7	**3.5**	5.5
Pensions and other post retirement benefits	**0.8**	0.9	**0.8**	0.9
Other temporary differences	**6.7**	0.5	**1.5**	0.5
	18.9	15.3	**10.3**	12.1
Deferred tax liabilities				
Property valuations	**(4.5)**	(4.2)	**(0.6)**	(0.6)
Other temporary differences	**(1.3)**	(0.3)	**(1.0)**	(0.2)
	(5.8)	(4.5)	**(1.6)**	(0.8)

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

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
Accelerated tax depreciation	**(0.7)**	(0.6)	**(0.7)**	(0.6)
Other provisions	**(0.8)**	0.5	**(0.3)**	0.2
Carried forward tax losses	**(1.9)**	(0.2)	**(2.0)**	1.1
Property valuations	**(0.3)**	-	**-**	-
	(3.7)	(0.3)	**(3.0)**	0.7

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. Unused tax losses, which have not been recognised within deferred tax assets at 31 March 2019, amounted to Group: £39.9m and Society: £20.8m. These losses will be available to offset against future taxable profits, subject to certain loss restriction rules set by HMRC.

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

The UK corporation tax rate will reduce from 19% to 17% with effect from 1 April 2020. Deferred tax assets and liabilities have been recognised at rates between 17% and 19% (2017/18: rates between 17% and 19%), being the rates substantively enacted at the Statement of Financial Position date and expected to apply when the deferred tax balances are realised.

20. Trade and other receivables

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Prepayments and accrued income	**3.3**	6.2	**3.3**	6.2
Other	**0.4**	0.2	**0.3**	0.2
	3.7	6.4	**3.6**	6.4

21. Shares

Group and Society	2019 £m	2018 £m
Held by individuals	**3,990.2**	4,050.0
Other shares	**1.0**	1.1
Fair value adjustment for hedged risk	**-**	0.3
	3,991.2	4,051.4

22. Amounts due to other customers

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Deemed loans	**-**	-	**337.1**	492.4
Other customers	**77.7**	133.1	**78.5**	133.4
	77.7	133.1	**415.6**	625.8

23. Debt securities in issue

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Certificates of deposit	**1.0**	-	**1.0**	-
Non-recourse finance on securitised advances	**343.1**	493.3	**-**	-
	344.1	493.3	**1.0**	-

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.

For the purposes of the Statements of Cash Flows, debt securities in issue are classified as liabilities arising from financing activities. The following table analyses movements in debt securities in issue.

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
At beginning of year	**493.3**	263.2	**-**	-
Financing cash flows				
Proceeds from issue of debt securities	**1.0**	350.0	**1.0**	-
Costs on issue of debt securities	**-**	(1.5)	**-**	-
Repayments of debt securities in issue	**(149.2)**	(113.4)	**-**	-
Non-cash flows:				
Accrued interest	**1.0**	1.3	**-**	-
Amortisation	**0.4**	0.4	**-**	-
Other movements	**(2.4)**	(6.7)	**-**	-
At end of year	**344.1**	493.3	**1.0**	-

24. Trade and other payables

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
Accruals	**7.6**	8.4	**7.1**	7.9
Other creditors	**4.5**	3.6	**3.4**	3.0
	12.1	12.0	**10.5**	10.9

25. Provisions for liabilities

Group	**FSCS 2019 £m**	**Other 2019 £m**	**Total 2019 £m**
At beginning of year	**0.2**	**1.9**	**2.1**
Utilised in the year	**(0.2)**	**(0.8)**	**(1.0)**
Charge for the year	**-**	**0.3**	**0.3**
At end of year	**-**	**1.4**	**1.4**

Group	FSCS 2018 £m	Other 2018 £m	Total 2018 £m
At beginning of year	0.8	2.3	3.1
Utilised in the year	(0.9)	(1.0)	(1.9)
Charge for the year	0.3	0.6	0.9
At end of year	0.2	1.9	2.1

Society	**FSCS 2019 £m**	**Other 2019 £m**	**Total 2019 £m**
At beginning of year	**0.2**	**1.8**	**2.0**
Utilised in the year	**(0.2)**	**(0.9)**	**(1.1)**
Charge for the year	**-**	**-**	**-**
At end of year	**-**	**0.9**	**0.9**

Society	FSCS 2018 £m	Other 2018 £m	Total 2018 £m
At beginning of year	0.8	2.2	3.0
Utilised in the year	(0.9)	(1.0)	(1.9)
Charge for the year	0.3	0.6	0.9
At end of year	0.2	1.8	2.0

Financial Services Compensation Scheme (FSCS)

In common with all regulated UK deposit takers, the Society pays levies to the FSCS. During the period, the FSCS repaid the remaining loan owed to HM Treasury, in respect of certain Bradford and Bingley assets, and confirmed that no further loan interest would be levied.

The provision at 31 March 2018 related to the Society's share of interest costs for the 2017/18 scheme year and was fully settled in the year. A supplementary levy for 2018/19, raised following a large credit union failure, was also paid during the year.

Other provisions

Other provisions primarily relate to Payment Protection Insurance (PPI) redress based on the amounts expected to be settled through to the Financial Conduct Authority (FCA) deadline of 29 August 2019.

26. Subscribed capital

Group and Society	Number of shares 2019	Number of shares 2018	Carrying value 2019 £m	Carrying value 2018 £m
Permanent interest bearing shares				
At beginning of year	**75,000**	75,000	**75.0**	75.0
Capital restructuring	**(66,109)**	-	**(66.1)**	-
At end of year	**8,891**	75,000	**8.9**	75.0

The 6.15% permanent interest bearing shares (PIBS) comprised 75,000 PIBS of £1,000 each issued at a price of 99.828% of their principal amount, with the issue premium amortised. £66,109,000 in aggregate nominal amount of the PIBS were exchanged or tendered and subsequently cancelled as part of the Liability Management Exercise described in note 42.

The PIBS are repayable at the option of the Society in whole on the 5 April 2021 or any scheduled interest payment thereafter, subject to PRA approval.

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 the claims of holders of core capital deferred shares (CCDS). The holders of PIBS are not entitled to any share in any final surplus upon winding up or dissolution of the Society.

Future interest payments are at the discretion of the Society, up to a maximum 6.15% prior to 5 April 2021 and, thereafter, a rate of interest reset periodically and equal to the applicable 5-year gilt rate plus a margin of 2.8%.

27. Profit participating deferred shares

Group and Society	2019 £m	2018 £m
Book value		
Nominal value	-	182.5
Cumulative fair value adjustments at date of transition	-	3.8
Capitalised issue costs	-	(2.2)
	-	184.1
Cumulative reserve deficit	-	(9.1)
Net value at end of year	-	175.0

The profit participating deferred shares (PPDS), which consisted of 3,650 shares each with a value of £50,000, were exchanged and subsequently cancelled as part of the Liability Management Exercise described in note 42. Prior to cancellation, the PPDS were entitled to receive a distribution, at the discretion of the Society, of up to 25% of the Group's post-tax profits (calculated prior to payment of the PPDS dividend). No such distribution could be made if the PPDS cumulative reserves were in deficit.

28. Core capital deferred shares

Group and Society	Number of shares	CCDS nominal amount £m	Share premium £m	Total £m
At 1 April 2018	-	-	-	**-**
Issuance	1,288,813	1.3	127.6	**128.9**
Issue costs	-	-	(1.9)	**(1.9)**
At 31 March 2019	**1,288,813**	**1.3**	**125.7**	**127.0**

In April 2018, the Society issued 1,288,813 core capital deferred shares (CCDS) of £1 each at an issue price of £100 per share as part of the Liability Management Exercise described in note 42.

CCDS are perpetual instruments and a form of Common Equity Tier 1 (CET 1) capital.

CCDS are the most junior-ranking capital instrument of the Society, ranking behind the claims of all depositors, payables and investing members.

Each holder of CCDS has one vote, regardless of the number of CCDS held.

The CCDS holders are entitled to receive a distribution at the discretion of the Society. The total distribution paid on each CCDS in respect of any given financial year of the Society is subject to a cap provided for in the Rules of the Society and adjusted annually for inflation. The Directors have not declared a distribution in respect of the year ended 31 March 2019.

In the event of a winding up or dissolution of the Society, the share of surplus assets (if any) a CCDS holder would be eligible to receive is determined by the calculation of a core capital contribution proportion, limited to a maximum of the average principal amount, currently £100 per CCDS.

29. Subordinated liabilities

Group and Society	2019 £m	2018 £m
Subordinated notes due 2038 – 11.0%	22.8	-

The Society issued subordinated notes in April 2018 as part of the Liability Management Exercise described in note 42. The Society's subordinated notes rank behind all other creditors of the Society, with the exception of holders of CCDS and PIBS.

For the purposes of the Statements of Cash Flows, subordinated liabilities are classified as liabilities arising from financing activities. The following table analyses movements in subordinated liabilities.

Group and Society	2019 £m
At beginning of year	-
Financing cash flows	
Interest paid on subordinated liabilities	(1.2)
Costs on issue of subordinated liabilities	(0.9)
Non-cash flows:	
Issuance in exchange for PPDS (note 42)	22.5
Accrued interest (settled during the year)	1.2
Accrued interest (carried forward at 31 March 2019)	1.2
At end of year	22.8

30. Financial assets and liabilities at fair value through profit or loss (FVTPL)

i) Financial assets mandatorily measured at FVTPL

As explained in note 43, the Society's closed portfolio of equity release mortgages is held at FVTPL under IFRS 9. The movements on the portfolio during the year are analysed in the table below.

	Group and Society 2019 £m
At 1 April 2018 (IFRS 9 basis)	18.4
Interest added	1.0
Redemptions	(2.9)
Changes in fair value	(1.7)
At 31 March 2019	14.8

ii) Financial assets designated as measured at FVTPL on initial recognition

As explained in note 43, none of the Group or Society's financial assets have been designated as measured at FVTPL on IFRS 9 adoption and comparatives have not been restated.

	Group 2018 £m
Financial assets designated as measured at FVTPL	
Loans fully secured on land	
Carrying value at 31 March	8.4
Net losses in the year	(0.6)
Financial liabilities designated as measured at FVTPL	
Non-recourse finance on securitised advances	
Carrying value at 31 March	12.5
Net losses in the year	(0.8)
Derivative financial instruments economically hedging the financial assets and liabilities designated at FVTPL	
Carrying value at 31 March	(1.3)
Net gains in the year	1.4

As explained in note 43, the financial assets and liabilities in the previous table are held at amortised cost under IFRS 9. The fair values of the financial assets and financial liabilities, previously designated as measured at FVTPL, at 31 March 2019 are equal to their carrying values and are shown in the table which follows, together with the fair value gains and losses that would have been recognised in profit or loss if the financial instruments had not been reclassified on transition to IFRS 9.

	Group 2019 £m
Financial assets previously designated as measured at FVTPL	
Loans fully secured on land	
Fair value at 31 March	**3.5**
Net fair value gains in the year	**0.2**
Financial liabilities previously designated as measured at FVTPL	
Non-recourse finance on securitised advances	
Fair value at 31 March	**6.5**
Net fair value losses in the year	**(0.2)**

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

Group	**Before tax amount 2019 £m**	**Taxation 2019 £m**	**Net of tax amount 2019 £m**
Fair value through other comprehensive income investments	**(1.1)**	**0.2**	**(0.9)**
Retirement benefit obligations	**(2.5)**	**0.5**	**(2.0)**
Other comprehensive income	**(3.6)**	**0.7**	**(2.9)**

Group	Before tax amount 2018 £m	Taxation 2018 £m	Net of tax amount 2018 £m
Available for sale financial assets	(1.1)	0.2	(0.9)
Retirement benefit obligations	(1.6)	0.4	(1.2)
Cash flow hedges	0.8	(0.1)	0.7
Other comprehensive income	(1.9)	0.5	(1.4)

Society	**Before tax amount 2019 £m**	**Taxation 2019 £m**	**Net of tax amount 2019 £m**
Fair value through other comprehensive income investments	**(1.1)**	**0.2**	**(0.9)**
Retirement benefit obligations	**(2.5)**	**0.5**	**(2.0)**
Other comprehensive income	**(3.6)**	**0.7**	**(2.9)**

Society	Before tax amount 2018 £m	Taxation 2018 £m	Net of tax amount 2018 £m
Available for sale financial assets	(1.1)	0.2	(0.9)
Retirement benefit obligations	(1.6)	0.4	(1.2)
Other comprehensive income	(2.7)	0.6	(2.1)

32. Retirement benefit obligations

Group and Society	2019 £m	2018 £m	2017 £m	2016 £m	2015 £m
Defined benefit pension scheme obligation/(asset)	**4.9**	5.1	6.5	(0.8)	7.5

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 2016 carried out by the appointed actuary to the Scheme have been rolled forward to the accounting date by an independent qualified actuary and updated in accordance with IAS 19, 'Employee Benefits'. Pension obligations are valued differently for accounting and funding purposes. In accordance with IAS 19, best estimate assumptions are used to determine the retirement benefit obligation shown in the Statement of Financial Position whereas the funding valuations use more prudent assumptions and also include allowance for future administration costs, which are not included in the IAS 19 valuation.

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.

As part of the ongoing funding agreement for the SRS, the Trustees of the SRS have been granted a charge over the Society's Head Office, which may be exercised only in the event of the Society defaulting on its pension obligations and in such circumstances assigns the rights of ownership of the building to the SRS. In addition to this, the estimated amount of total employer deficit contributions expected to be paid to the Scheme during 2019/20, based on the required amounts under the schedule of contributions is £3.3m.

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 weighted average duration of the expected benefit payments from the Scheme is around 19 years.

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

Group and Society	2019	2018	2017	2016	2015
Pension increases in payment (RPI capped at 5%)	**3.0%**	3.0%	3.1%	2.8%	2.8%
Pension increases in payment (CPI capped at 2.5%)	**1.8%**	1.7%	1.7%	1.6%	1.6%
Discount rate	**2.4%**	2.8%	2.8%	3.7%	3.5%
Life expectancy of male aged 65 at year end date	**22.4**	22.9	23.2	23.0	22.9
Life expectancy of female aged 65 at year end date	**23.4**	23.8	24.2	24.4	24.3
Life expectancy of male aged 65 at year end date plus 20 years	**23.7**	24.3	25.0	24.4	24.3
Life expectancy of female aged 65 at year end date plus 20 years	**24.9**	25.3	26.1	25.9	25.8

The sensitivity of the defined benefit obligation to changes in the significant actuarial assumptions is shown in the table below (on a gross basis, prior to the application of hedging arrangements which are described in the 'Scheme assets' section of this note):

Group and Society	2019 Increase/ (Decrease) £m	2018 Increase/ (Decrease) £m
Discount rate		
Effect on defined benefit obligation of a 1% increase	**(19.0)**	(18.5)
Inflation		
Effect on defined benefit obligation of a 1% increase	**15.3**	15.0
Life expectancy		
Effect on defined benefit obligation of a 1 year increase	**4.0**	3.6

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

Group and Society	2019 £m	2018 £m	2017 £m	2016 £m	2015 £m
Present value of funded obligations	**113.1**	108.5	113.2	93.6	97.8
Present value of unfunded obligations	**0.8**	0.7	0.8	0.6	1.0
	113.9	109.2	114.0	94.2	98.8
Fair value of scheme assets	**(109.0)**	(104.1)	(107.5)	(95.0)	(91.3)
Net liability/(asset) in the Statement of Financial Position	**4.9**	5.1	6.5	(0.8)	7.5

The amounts recognised in the Income Statement are as follows:

Group and Society	2019 £m	2018 £m	2017 £m
Interest cost	**3.0**	3.1	3.4
Interest receivable on plan assets	**(2.9)**	(3.0)	(3.4)
Running costs	**0.2**	0.3	0.3
Past service cost	**0.4**	-	-
Total pension fund cost	**0.7**	0.4	0.3

Past service cost and 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.

The 2018/19 past service cost of £0.4m represents the estimated costs of Guaranteed Minimum Pension (GMP) equalisation, in response to the High Court ruling in the Lloyds Bank GMP Inequalities case on 26 October 2018.

Change in benefit obligations

Group and Society	2019 £m	2018 £m	2017 £m
Benefit obligations at beginning of year	**109.2**	114.0	94.2
Interest cost	**3.0**	3.1	3.4
Actuarial losses/(gains)	**5.1**	(2.5)	21.0
Running costs (release of reserve)	**(0.1)**	(0.1)	(0.1)
Benefits paid	**(3.7)**	(5.3)	(4.5)
Past service cost	**0.4**	-	-
Benefit obligations at end of year	**113.9**	109.2	114.0

32. Retirement benefit obligations (continued)

Change in scheme assets

Group and Society	2019 £m	2018 £m	2017 £m
Fair value of scheme assets at beginning of year	**104.1**	107.5	95.0
Interest receivable on plan assets	**2.9**	3.0	3.4
Actuarial gains/(losses)	**2.6**	(4.1)	10.6
Contribution by employer	**3.4**	3.4	3.4
Running costs	**(0.3)**	(0.4)	(0.4)
Benefits paid	**(3.7)**	(5.3)	(4.5)
Fair value of scheme assets at end of year	**109.0**	104.1	107.5

The amount recognised outside profit and loss in the Statement of Comprehensive Income for 2018/19 is an actuarial loss of £2.5m (2017/18: £1.6m). The cumulative amount recognised outside profit and loss at 31 March 2019 is an actuarial loss of £57.7m.

History of experience gains and losses

Group and Society	2019	2018	2017	2016	2015
Experience gains/(losses) on scheme assets:					
Amount (£m)	**2.6**	(4.1)	10.6	(6.1)	1.5
Percentage of scheme assets	**2%**	(4%)	10%	(6%)	2%
Experience losses/(gains) on scheme liabilities:					
Amount (£m)	**-**	0.7	(0.9)	(1.7)	(1.3)
Percentage of scheme liabilities	**0%**	1%	(1%)	(2%)	(1%)

Scheme assets

The value of the invested assets at 31 March 2019 was £109.0m, analysed as follows:

Group and Society	2019 £m	2018 £m	2017 £m
Diversified growth fund*	**55.8**	54.4	54.2
Liability driven investment	**27.2**	28.3	28.6
Insurance asset	**18.7**	18.5	19.4
Cash and other assets	**7.3**	2.9	5.3
	109.0	104.1	107.5

*The diversified growth fund includes circa £25.7m of assets in transit at 31 March 2019 which were invested in early April.

As part of its asset and liability matching investment strategy, designed to mitigate inflation and interest rate risk exposure, the Scheme has invested in four 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. The Scheme is targeted to be 80-90% hedged on movements in interest rates and 90-100% hedged on movements in inflation rates based on the Technical Provisions funding target.

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 £1.3m (2017/18: £1.1m).

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 to 31 March 2018 staff were able to contribute between 2% and 10% with the Society providing matched funding. From 1 April 2018 staff within the stakeholder scheme were required to contribute between 3% and 10%, with the Society providing matched funding plus 0.6%. From 1 April 2019 staff within the stakeholder scheme are required to contribute between 4% and 10%, with the Society providing matched funding plus 0.6%.

33. 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 risk). These risks are described in notes 34 to 36.

The use of derivative financial instruments for risk management purposes is described in note 12.

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 2019 (IFRS 9 basis)

Group	Amortised cost £m	Fair value through other comprehensive income £m	Fair value through profit or loss £m	Total £m
Assets				
Cash and balances with the Bank of England	182.5	-	-	**182.5**
Loans and advances to credit institutions	106.7	-	-	**106.7**
Investment securities	-	309.3	-	**309.3**
Derivative financial instruments	-	-	6.5	**6.5**
Loans and advances to customers	4,731.9	-	14.8	**4,746.7**
Total financial assets	**5,021.1**	**309.3**	**21.3**	**5,351.7**
Non-financial assets				**202.2**
Total assets				**5,553.9**
		Other financial liabilities £m	**Fair value through profit or loss £m**	**Total £m**
Liabilities				
Shares		3,991.2	-	**3,991.2**
Amounts due to credit institutions		667.3	-	**667.3**
Amounts due to other customers		77.7	-	**77.7**
Derivative financial instruments		-	39.3	**39.3**
Debt securities in issue		344.1	-	**344.1**
Total financial liabilities		**5,080.3**	**39.3**	**5,119.6**
Non-financial liabilities				**48.1**
Total liabilities				**5,167.7**

33. Financial instruments (continued)

At 31 March 2018 (IAS 39 basis)

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	324.7	-	-	324.7
Loans and advances to credit institutions	120.6	-	-	120.6
Investment securities	-	311.9	-	311.9
Derivative financial instruments	-	-	19.5	19.5
Loans and advances to customers	4,797.0	-	8.4	4,805.4
Total financial assets	5,242.3	311.9	27.9	5,582.1
Non-financial assets				199.4
Total assets				5,781.5

	Other financial liabilities £m	Fair value through profit or loss £m	Total £m
Liabilities			
Shares	4,051.4	-	4,051.4
Amounts due to credit institutions	571.3	-	571.3
Amounts due to other customers	133.1	-	133.1
Derivative financial instruments	-	38.7	38.7
Debt securities in issue	480.8	12.5	493.3
Total financial liabilities	5,236.6	51.2	5,287.8
Non-financial liabilities			23.7
Total liabilities			5,311.5

At 31 March 2019 (IFRS 9 basis)

Society	Amortised cost £m	Fair value through other comprehensive income £m	Fair value through profit or loss £m	Total £m
Assets				
Cash and balances with the Bank of England	182.5	-	-	**182.5**
Loans and advances to credit institutions	59.0	-	-	**59.0**
Investment securities	623.7	309.3	1.2	**934.2**
Derivative financial instruments	-	-	5.9	**5.9**
Loans and advances to customers	3,081.9	-	14.8	**3,096.7**
Investments	1,215.8	-	-	**1,215.8**
Total financial assets	**5,162.9**	**309.3**	**21.9**	**5,494.1**
Non-financial assets				**58.2**
Total assets				**5,552.3**

	Other financial liabilities £m	Fair value through profit or loss £m	Total £m
Liabilities			
Shares	3,991.2	-	**3,991.2**
Amounts due to credit institutions	667.3	-	**667.3**
Amounts due to other customers	415.6	-	**415.6**
Derivative financial instruments	-	35.5	**35.5**
Total financial liabilities	**5,074.1**	**35.5**	**5,109.6**
Non-financial liabilities			**42.8**
Total liabilities			**5,152.4**

33. Financial instruments (continued)

At 31 March 2018 (IAS 39 basis)

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	324.7	-	-	324.7
Loans and advances to credit institutions	49.2	-	-	49.2
Investment securities	717.5	311.9	-	1,029.4
Derivative financial instruments	-	-	19.5	19.5
Loans and advances to customers	2,956.8	-	-	2,956.8
Investments	1,350.6	-	-	1,350.6
Total financial assets	5,398.8	311.9	19.5	5,730.2
Non-financial assets				63.4
Total assets				5,793.6

	Other financial liabilities £m	Fair value through profit or loss £m	Total £m
Liabilities			
Shares	4,051.4	-	4,051.4
Amounts due to credit institutions	571.3	-	571.3
Amounts due to other customers	625.8	-	625.8
Derivative financial instruments	-	31.5	31.5
Total financial liabilities	5,248.5	31.5	5,280.0
Non-financial liabilities			18.8
Total liabilities			5,298.8

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 2019 (IFRS 9 basis)

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	**182.5**	182.5	-	-	**182.5**
Loans and advances to credit institutions	**106.7**	-	106.7	-	**106.7**
Loans and advances to customers	**4,731.9**	-	-	4,669.9	**4,669.9**
	5,021.1	**182.5**	**106.7**	**4,669.9**	**4,959.1**
Financial liabilities					
Shares	**3,991.2**	-	-	3,955.5	**3,955.5**
Amounts due to credit institutions	**667.3**	-	667.3	-	**667.3**
Amounts due to other customers	**77.7**	-	77.7	-	**77.7**
Debt securities in issue	**344.1**	327.2	15.8	-	**343.0**
	5,080.3	**327.2**	**760.8**	**3,955.5**	**5,043.5**

At 31 March 2018 (IAS 39 basis)

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	324.7	324.7	-	-	324.7
Loans and advances to credit institutions	120.6	-	120.6	-	120.6
Loans and advances to customers	4,797.0	-	-	4,781.7	4,781.7
	5,242.3	324.7	120.6	4,781.7	5,227.0
Financial liabilities					
Shares	4,051.4	-	-	4,033.5	4,033.5
Amounts due to credit institutions	571.3	-	571.3	-	571.3
Amounts due to other customers	133.1	-	133.1	-	133.1
Debt securities in issue	480.8	471.3	7.9	-	479.2
	5,236.6	471.3	712.3	4,033.5	5,217.1

33. Financial instruments (continued)

At 31 March 2019 (IFRS 9 basis)

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	**182.5**	182.5	-	-	**182.5**
Loans and advances to credit institutions	**59.0**	-	59.0	-	**59.0**
Investment securities	**623.7**	-	623.4	-	**623.4**
Loans and advances to customers	**3,081.9**	-	-	3,102.5	**3,102.5**
	3,947.1	**182.5**	**682.4**	**3,102.5**	**3,967.4**
Financial liabilities					
Shares	**3,991.2**	-	-	3,955.5	**3,955.5**
Amounts due to credit institutions	**667.3**	-	667.3	-	**667.3**
Amounts due to other customers	**415.6**	-	415.6	-	**415.6**
Debt securities in issue	**1.0**	-	1.0	-	**1.0**
	5,075.1	**-**	**1,083.9**	**3,955.5**	**5,039.4**

At 31 March 2018 (IAS 39 basis)

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	324.7	324.7	-	-	324.7
Loans and advances to credit institutions	49.2	-	49.2	-	49.2
Investment securities	717.5	1.9	714.8	-	716.7
Loans and advances to customers	2,956.8	-	-	3,014.3	3,014.3
	4,048.2	326.6	764.0	3,014.3	4,104.9
Financial liabilities					
Shares	4,051.4	-	-	4,033.5	4,033.5
Amounts due to credit institutions	571.3	-	571.3	-	571.3
Amounts due to other customers	625.8	-	625.8	-	625.8
	5,248.5	-	1,197.1	4,033.5	5,230.6

The Group adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018. Balances in the tables above are presented in accordance with their IFRS 9 classification at 31 March 2019 and on an IAS 39 basis at 31 March 2018.

a) Loans and advances to customers
The fair value of loans and advances to customers has been determined 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 2019.

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 2019.

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

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 (IFRS 9 basis)	**Level 1 2019 £m**	**Level 2 2019 £m**	**Level 3 2019 £m**	**Total 2019 £m**
Financial assets				
Investment securities				
At fair value through other comprehensive income	309.3	-	-	**309.3**
Derivative financial instruments	-	6.5	-	**6.5**
Loans and advances to customers	-	-	14.8	**14.8**
	309.3	**6.5**	**14.8**	**330.6**
Financial liabilities				
Derivative financial instruments	-	39.3	-	**39.3**
	-	**39.3**	**-**	**39.3**

Group (IAS 39 basis)	Level 1 2018 £m	Level 2 2018 £m	Level 3 2018 £m	Total 2018 £m
Financial assets				
Investment securities	311.9	-	-	311.9
Derivative financial instruments	-	19.5	-	19.5
Loans and advances to customers	-	8.4	-	8.4
	311.9	27.9	-	339.8
Financial liabilities				
Derivative financial instruments	-	38.7	-	38.7
Debt securities in issue	-	12.5	-	12.5
	-	51.2	-	51.2

33. Financial instruments (continued)

Society (IFRS 9 basis)	Level 1 2019 £m	Level 2 2019 £m	Level 3 2019 £m	Total 2019 £m
Financial assets				
Investment securities				
At fair value through other comprehensive income	309.3	-	-	**309.3**
At fair value through profit or loss	1.2	-	-	**1.2**
Derivative financial instruments	-	5.9	-	**5.9**
Loans and advances to customers	-	-	14.8	**14.8**
	310.5	**5.9**	**14.8**	**331.2**
Financial liabilities				
Derivative financial instruments	-	35.5	-	**35.5**
	-	**35.5**	**-**	**35.5**

Society (IAS 39 basis)	Level 1 2018 £m	Level 2 2018 £m	Level 3 2018 £m	Total 2018 £m
Financial assets				
Investment securities	311.9	-	-	311.9
Derivative financial instruments	-	19.5	-	19.5
	311.9	19.5	-	331.4
Financial liabilities				
Derivative financial instruments	-	31.5	-	31.5
	-	31.5	-	31.5

The Group adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018. Balances in the tables above are presented in accordance with their IFRS 9 classification at 31 March 2019 and on an IAS 39 basis at 31 March 2018. IFRS 9 adoption resulted in the reclassification of the Society's equity release portfolio from an amortised cost to fair value measurement basis. The mortgages are fair valued using a discounted cash flow model for which key inputs are not based on observable market data. The calculation therefore meets the definition of a level 3 valuation technique. Details of the key model assumptions and the fair value impact of changes in those assumptions are given in note 1.

The table below analyses movements in the level 3 portfolio during the period.

Group and Society	Equity release portfolio £m
At 1 April 2018	**18.4**
Items recognised in the Income Statement	
Interest receivable and similar income	**1.0**
Fair value losses on financial instruments	**(1.7)**
Redemptions	**(2.9)**
At 31 March 2019	**14.8**

There have been no transfers of financial assets or liabilities between levels of the valuation hierarchy in the period.

34. Credit risk

(a) Credit risk definition and management

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); and
- wholesale counterparties (including other financial institutions). Specifically within the treasury portfolio, 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. An economic downturn and future falls in property values (either residential or commercial) could affect the level of impairment losses 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 four Executive sub-committees; the Executive Risk Committee, the Residential Credit Committee, the Commercial Loans Risk Committee and the Model Risk Committee. Their role in the credit risk framework is outlined below:

- The Executive Risk Committee (ERC) is responsible for providing 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. In the context of credit risk the ERC proposes to Risk Committee any recommendations for Board approval regarding the Residential Lending Statement and Credit Risk Appetite Statement. The ERC approves material changes to the Lending and Security Policies, and reviews these policies every third year as a minimum.
- 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 ERC.
- 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 Model Risk Committee supports the Society's development and maintenance of models, including those related to the management of credit risk. The Committee oversees the initiation, development, approval, implementation, performance, monitoring and validation of the Society's models in the context of compliance with both Regulation and the Society's own governance requirements. A summary of the minutes of this committee are presented to the ERC.

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 107 to 110.

The Group's most significant exposures to credit risk are loans secured on UK residential properties and loans secured on UK land.

(b) Residential assets held at amortised cost

Concentration by loan type	**Group 2019* £m**	Group 2018 £m	**Society 2019* £m**	Society 2018 £m
Prime owner occupied	**2,797.3**	2,677.5	**2,672.2**	2,530.8
Buy to let	**1,503.2**	1,637.1	**374.9**	411.3
Other	**63.3**	71.4	**1.2**	1.4
Gross balances	**4,363.8**	4,386.0	**3,048.3**	2,943.5
Expected credit loss provisions	**(6.0)**	(13.2)	**(1.2)**	(8.4)
Fair value macro hedge adjustments	**0.5**	(13.3)	**0.5**	(13.3)
	4,358.3	4,359.5	**3,047.6**	2,921.8

* The equity release portfolio was reclassified from an amortised cost to fair value through profit or loss (FVTPL) basis of measurement on IFRS 9 adoption and is therefore excluded from the Group and Society figures in the table above for the year ended 31 March 2019. As permitted by IFRS 9, comparatives have not been restated.

34. Credit risk (continued)

(i) Credit quality

The Group assesses credit risk on owner occupied and buy to let residential mortgages using behavioural scorecard and other analysis to determine probabilities of default across a number of rating grades. The IFRS 9 impairment models make use of this data, incorporating forecasts of future economic conditions and account-specific factors to produce forward-looking probabilities of default by account and allocating loans to one of three stages (as explained in note 1).

The table below analyses gross exposures to residential assets by 12-month probability of default and IFRS 9 stage at the reporting date, with the exception of the closed second charge lending portfolio for which probability of possession is used as a credit risk measure, rather than probability of default.

At 31 March 2019

	Group				Society			
Probability of default range	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
0.00 to < 0.25	3,070.7	109.0	-	**3,179.7**	2,362.7	86.0	-	**2,448.7**
0.25 to < 0.50	495.0	39.2	-	**534.2**	325.5	17.7	-	**343.2**
0.50 to < 0.75	182.7	44.7	-	**227.4**	27.0	6.8	-	**33.8**
0.75 to < 1.00	15.3	3.8	-	**19.1**	0.3	0.1	-	**0.4**
1.00 to < 5.00	90.5	186.4	-	**276.9**	73.9	95.3	-	**169.2**
5.00 to < 10.00	4.4	0.2	-	**4.6**	3.2	0.2	-	**3.4**
10.00 to < 100.00	20.5	28.7	-	**49.2**	9.6	16.0	-	**25.6**
100.00 (default)	-	-	60.3	**60.3**	-	-	24.0	**24.0**
Second charge	8.1	2.9	1.4	**12.4**	-	-	-	**-**
	3,887.2	414.9	61.7	**4,363.8**	2,802.2	222.1	24.0	**3,048.3**

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

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
Not past due	**4,319.8**	4,336.4	**3,032.7**	2,923.7
Past due 1 to 3 months	**27.2**	23.3	**9.2**	9.3
Past due 3 to 6 months	**7.3**	8.6	**4.0**	3.6
Past due 6 to 12 months	**1.7**	3.7	**0.9**	2.9
Past due over 12 months	**1.2**	1.1	**0.5**	0.3
Possessions	**6.6**	12.9	**1.0**	3.7
	4,363.8	4,386.0	**3,048.3**	2,943.5

(ii) Expected credit losses

The table below illustrates the IFRS 9 staging distribution of residential loans and advances to customers held at amortised cost, loan commitments and related expected credit loss provisions at the year end. Stage 2 loans have been further analysed to show those which are more than 30 days past due, the IFRS 9 backstop for identifying a significant increase in credit risk (SICR), and those which meet other SICR criteria as detailed in note 1 to the accounts.

At 31 March 2019

	Group			Society		
	Gross exposure £m	Expected credit loss provision £m	Provision coverage %	Gross exposure £m	Expected credit loss provision £m	Provision coverage %
Residential loans at amortised cost						
Stage 1	**3,887.2**	**0.6**	**0.02%**	**2,802.2**	**0.1**	**0.00%**
Stage 2						
> 30 days past due	**15.1**	**0.2**	**1.42%**	**5.6**	**-**	**0.59%**
Other SICR indicators	**399.8**	**0.9**	**0.21%**	**216.5**	**0.2**	**0.09%**
Stage 3	**61.7**	**4.3**	**6.97%**	**24.0**	**0.9**	**3.72%**
	4,363.8	**6.0**	**0.14%**	**3,048.3**	**1.2**	**0.04%**

Loan commitments						
Stage 1	**75.7**	**-**	**0.00%**	**66.3**	**-**	**0.00%**

For the purposes of the disclosure above, gross exposures and expected credit loss provisions are rounded to the nearest £0.1m whereas the provision coverage percentages are based on the underlying data prior to rounding.

The tables below analyse the movement in gross residential exposures and the related expected credit loss allowances for the year ended 31 March 2019:

	Group				Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross exposure (IFRS 9 basis)								
At 1 April 2018	3,907.7	379.5	72.9	**4,360.1**	2,729.2	164.8	23.6	**2,917.6**
Transfers due to increased credit risk:								
From stage 1 to stage 2	(231.0)	231.0	-	**-**	(146.9)	146.9	-	**-**
From stage 1 to stage 3	(12.8)	-	12.8	**-**	(6.7)	-	6.7	**-**
From stage 2 to stage 3	-	(19.2)	19.2	**-**	-	(7.0)	7.0	**-**
Transfers due to decreased credit risk:								
From stage 2 to stage 1	151.6	(151.6)	-	**-**	65.4	(65.4)	-	**-**
From stage 3 to stage 1	6.7	-	(6.7)	**-**	1.9	-	(1.9)	**-**
From stage 3 to stage 2	-	15.2	(15.2)	**-**	-	4.7	(4.7)	**-**
Mortgage advances	691.3	-	-	**691.3**	684.7	-	-	**684.7**
Net redemptions and repayments	(626.7)	(40.0)	(17.5)	**(684.2)**	(525.9)	(21.9)	(5.8)	**(553.6)**
Amounts written off	(0.1)	-	(3.7)	**(3.8)**	-	-	(0.9)	**(0.9)**
Other movements	0.5	-	(0.1)	**0.4**	0.5	-	-	**0.5**
At 31 March 2019	**3,887.2**	**414.9**	**61.7**	**4,363.8**	**2,802.2**	**222.1**	**24.0**	**3,048.3**

34. Credit risk (continued)

	Group				Society			
	Stage 1 £m	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Expected credit loss provision (IFRS 9 basis)								
At 1 April 2018	0.6	2.5	4.7	**7.8**	-	0.5	1.0	**1.5**
Transfers due to increased credit risk:								
From stage 1 to stage 2	-	0.4	-	**0.4**	-	0.1	-	**0.1**
From stage 1 to stage 3	(0.1)	-	0.5	**0.4**	-	-	0.2	**0.2**
From stage 2 to stage 3	-	(0.3)	1.0	**0.7**	-	(0.1)	0.2	**0.1**
Transfers due to decreased credit risk:								
From stage 2 to stage 1	0.1	(0.7)	-	**(0.6)**	-	(0.1)	-	**(0.1)**
From stage 3 to stage 2	-	0.1	(0.5)	**(0.4)**	-	-	-	**-**
Remeasurement of expected credit losses with no stage transfer	0.2	(0.6)	2.6	**2.2**	0.1	(0.1)	0.5	**0.5**
Redemptions	(0.1)	(0.3)	(0.2)	**(0.6)**	-	(0.1)	(0.1)	**(0.2)**
Amounts written off	(0.1)	-	(3.7)	**(3.8)**	-	-	(0.9)	**(0.9)**
Other movements	-	-	(0.1)	**(0.1)**	-	-	-	**-**
At 31 March 2019	**0.6**	**1.1**	**4.3**	**6.0**	**0.1**	**0.2**	**0.9**	**1.2**

(iii) Geographical analysis
The table below shows the geographic spread of the residential loan portfolio at the year end date:

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
East Anglia	**125.9**	130.2	**86.2**	86.4
East Midlands	**457.4**	450.9	**339.4**	320.0
Greater London	**498.0**	520.3	**239.7**	239.3
Northern Ireland	**4.1**	4.5	**0.6**	0.8
North	**190.5**	187.8	**138.9**	132.6
North West	**536.9**	546.6	**384.8**	380.0
Scotland	**96.5**	105.3	**26.8**	30.5
South East	**714.1**	725.4	**481.9**	468.5
South West	**361.6**	366.1	**260.8**	255.6
Wales	**216.4**	218.0	**155.8**	150.4
West Midlands	**730.2**	718.6	**608.9**	585.2
Yorkshire	**432.2**	412.3	**324.5**	294.2
	4,363.8	4,386.0	**3,048.3**	2,943.5

(iv) Collateral

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

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
>95%	**57.9**	48.1	**48.9**	27.4
91% - 95%	**169.9**	97.5	**160.5**	86.6
86% - 90%	**344.3**	224.0	**304.0**	196.5
76% - 85%	**713.0**	673.4	**480.1**	429.1
51% - 75%	**2,003.6**	2,258.6	**1,292.8**	1,403.7
<51%	**1,075.1**	1,084.4	**762.0**	800.2
	4,363.8	4,386.0	**3,048.3**	2,943.5

The Group's average indexed loan to value at the year end date is 56.4% (2017/18: 55.0%), calculated as a simple average across all residential loans.

The following table indicates collateral held against residential loans and advances to customers by IFRS 9 stage at 31 March 2019 and impairment status under IAS 39 at 31 March 2018:

Fair value of collateral held	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Stage 1	**7,510.3**	-	**4,860.3**	-
Stage 2	**822.1**	-	**442.2**	-
Stage 3	**128.2**	-	**59.4**	-
Not impaired	**-**	8,546.5	**-**	5,888.7
Impaired	**-**	70.0	**-**	35.1
Possessions	**-**	13.5	**-**	3.5
	8,460.6	8,630.0	**5,361.9**	5,927.3

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.

(v) Forbearance

A range of forbearance strategies is employed in order to work with borrowers to control arrears and, wherever possible, avoid repossession. These are set out in the relevant Group policies. The agreed strategy will reflect the customer's individual circumstances, appropriately taking any disclosed vunerabilities into consideration, 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.

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

Group	Arrangements 2019 £m	Concessions 2019 £m	Capitalisation 2019 £m	Term extensions 2019 £m	Total 2019 £m
Not past due	1.2	0.8	0.9	20.7	**23.6**
Past due 1 to 3 months	1.9	0.5	-	0.2	**2.6**
Past due 3 to 6 months	2.9	0.3	-	0.1	**3.3**
Past due 6 to 12 months	0.5	-	-	-	**0.5**
Past due over 12 months	0.7	0.1	-	-	**0.8**
	7.2	**1.7**	**0.9**	**21.0**	**30.8**

34. Credit risk (continued)

Group	Arrangements 2018 £m	Concessions 2018 £m	Capitalisation 2018 £m	Term extensions 2018 £m	Total 2018 £m
Not past due	0.7	0.6	1.6	7.4	10.3
Past due 1 to 3 months	2.1	0.7	0.3	0.2	3.3
Past due 3 to 6 months	2.5	0.3	0.1	0.1	3.0
Past due 6 to 12 months	2.1	0.1	-	-	2.2
Past due over 12 months	0.8	-	-	0.1	0.9
	8.2	1.7	2.0	7.8	19.7

(c) Commercial assets

Commercial assets comprise a closed portfolio of non-core commercial loans which is analysed in the table below.

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
Concentration by loan type				
Loans secured on commercial property	**394.9**	436.8	**12.2**	13.8
Loans secured on residential property	**19.4**	17.9	**18.2**	16.6
Gross balances	**414.3**	454.7	**30.4**	30.4
Fair value adjustments	**30.0**	33.3	**3.9**	4.6
Gross exposures	**444.3**	488.0	**34.3**	35.0
Impairment provisions	**(70.7)**	(42.1)	**-**	-
	373.6	445.9	**34.3**	35.0

Of the Group fair value adjustments, £27.6m (2017/18: £30.8m) relate to loans secured on commercial property and £2.4m (2017/18: £2.5m) relate to loans secured on residential property. Of the Society fair value adjustments, £1.5m (2017/18: £2.1m) relates to loans secured on commercial property and £2.4m (2017/18: £2.5m) relates to loans secured on residential property.

(i) Credit quality

The internal credit risk grading approach for the closed commercial loan book does not use scorecards or probability of default calculations. Instead loans are individually assessed against a series of prescriptive and judgmental criteria, by subject matter experts following a clearly defined methodology, to arrive at a risk grade. The distribution of the portfolio by grade and IFRS 9 stage at 31 March 2019 is set out in the table below.

At 31 March 2019

	Group				**Society**
	Stage 1 £m	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Stage 1 £m**
Strong	45.3	-	-	**45.3**	34.3
Good	28.6	-	-	**28.6**	-
Satisfactory	0.2	133.1	-	**133.3**	-
Default:					
In LPA receivership	-	-	236.0	**236.0**	-
Other default	-	-	1.1	**1.1**	-
	74.1	133.1	237.1	**444.3**	34.3

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

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Not past due	328.3	361.3	34.3	35.0
Past due up to 3 months	11.5	-	-	-
Past due 3 to 6 months	-	6.8	-	-
Past due 6 to 12 months	32.9	46.7	-	-
Past due over 12 months	71.6	73.2	-	-
	444.3	488.0	34.3	35.0

(ii) Expected credit losses

The table below illustrates the IFRS 9 staging distribution of commercial loans and advances to customers and related expected credit loss provisions at the year end. Stage 2 loans have been further analysed to show those which are more than 30 days past due, the IFRS 9 backstop for identifying a significant increase in credit risk (SICR), and those which meet other SICR criteria as detailed in note 1 to the accounts.

	Group			Society		
	Gross exposure £m	Expected credit loss provision £m	Provision coverage %	Gross exposure £m	Expected credit loss provision £m	Provision coverage %
Commercial loans						
Stage 1	74.1	0.3	0.42%	34.3	-	0.00%
Stage 2						
> 30 days past due	11.5	0.3	2.74%	-	-	-
Other SICR indicators	121.6	8.5	6.94%	-	-	-
Stage 3	237.1	61.6	25.99%	-	-	-
	444.3	70.7	15.91%	34.3	-	0.00%

For the purposes of the disclosure above, gross exposures and expected credit loss provisions are rounded to the nearest £0.1m whereas the provision coverage percentages are based on the underlying data prior to rounding.

34. Credit risk (continued)

The tables below analyse the movement in gross commercial exposures and the related expected credit loss allowances for the year ended 31 March 2019:

Gross exposure (IFRS 9 basis)	Group Stage 1 £m	Group Stage 2 £m	Group Stage 3 £m	Group Total £m	Society Stage 1 £m
At 1 April 2018	76.6	118.0	293.4	**488.0**	35.0
Transfers due to increased credit risk:					
From stage 1 to stage 2	(2.0)	2.0	-	**-**	-
Transfers due to decreased credit risk:					
From stage 2 to stage 1	9.1	(9.1)	-	**-**	-
From stage 3 to stage 2	-	26.1	(26.1)	**-**	-
Net redemptions, repayments and fair value adjustments for hedged risk	(9.6)	(3.4)	(22.3)	**(35.3)**	(0.7)
Amounts written off	-	(0.5)	(6.8)	**(7.3)**	-
Other movements	-	-	(1.1)	**(1.1)**	-
At 31 March 2019	74.1	133.1	237.1	**444.3**	34.3

Expected credit loss allowance (IFRS 9 basis)	Group Stage 1 £m	Group Stage 2 £m	Group Stage 3 £m	Group Total £m	Society Stage 1 £m
At 1 April 2018	0.1	11.8	62.5	**74.4**	-
Transfers due to increased credit risk:					
From stage 1 to stage 2	(0.1)	0.1	-	**-**	-
Transfers due to decreased credit risk:					
From stage 2 to stage 1	0.3	(0.2)	-	**0.1**	-
From stage 3 to stage 2	-	2.3	(2.6)	**(0.3)**	-
Remeasurement of expected credit losses with no stage transfer	-	(4.7)	8.7	**4.0**	-
Redemptions	-	-	(0.2)	**(0.2)**	-
Amounts written off	-	(0.5)	(6.8)	**(7.3)**	-
At 31 March 2019	0.3	8.8	61.6	**70.7**	-

(iii) Industry analysis of commercial loans
The analysis of commercial loans by industry type is as follows:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Healthcare and leisure	125.9	136.9	-	-
Industrial and warehouse	13.8	18.9	3.7	4.1
Office	24.8	27.3	3.3	4.6
Retail	257.8	284.4	6.7	7.2
Residential	21.8	20.3	20.6	19.1
Other	0.2	0.2	-	-
	444.3	488.0	34.3	35.0

(iv) Geographical analysis
The table below shows the geographic spread of the commercial loan portfolio at the year end date:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
East Anglia	17.0	16.9	0.4	0.1
East Midlands	28.4	31.4	1.3	2.3
Greater London	41.6	44.4	22.9	22.0
North	40.5	41.0	-	-
North West	146.7	152.3	3.4	3.9
Scotland	1.1	2.8	0.5	1.0
South East	62.3	78.9	1.1	1.7
South West	16.9	17.6	0.2	0.1
Wales	4.5	12.5	0.8	0.6
West Midlands	42.2	45.9	-	-
Yorkshire	43.1	44.3	3.7	3.3
	444.3	488.0	34.3	35.0

34. Credit risk (continued)

(v) Collateral

The Group's average indexed loan to value at the year end date is 81.5% (2017/18: 79.6%), calculated as a simple average across all commercial loans.

The following table indicates collateral held against commercial loans and advances to customers by IFRS 9 stage at 31 March 2019 and IAS 39 impairment status at 31 March 2018:

Group **Value of collateral held**	**Indexed 2019 £m**	**Unindexed 2019 £m**	Indexed 2018 £m	Unindexed 2018 £m
Stage 1	**190.4**	**176.5**	-	-
Stage 2	**111.5**	**100.4**	-	-
Stage 3	**153.2**	**150.6**	-	-
Not impaired	**-**	**-**	374.4	325.3
Impaired	**-**	**-**	115.2	102.7
	455.1	**427.5**	489.6	428.0

Society **Value of collateral held**	**Indexed 2019 £m**	**Unindexed 2019 £m**	Indexed 2018 £m	Unindexed 2018 £m
Stage 1	**106.3**	**104.7**	-	-
Not impaired	**-**	**-**	87.9	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.

(vi) Forbearance

Certain 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.

The analysis below sets out the commercial mortgage gross exposures with evidence of forbearance and renegotiated terms at the year end date.

Group	**Arrangements 2019 £m**	**Capitalisation 2019 £m**	**Term extensions 2019 £m**	**Total 2019 £m**
Not past due	4.6	11.4	2.8	**18.8**
Past due up to 3 months	11.5	-	-	**11.5**
Past due 6 to 12 months	5.0	-	-	**5.0**
Past due over 12 months	3.9	-	-	**3.9**
	25.0	11.4	2.8	**39.2**

Group	Arrangements 2018 £m	Capitalisation 2018 £m	Term extensions 2018 £m	Total 2018 £m
Not past due	4.7	11.6	6.9	23.2
Past due 6 to 12 months	16.7	-	-	16.7
Past due over 12 months	3.8	-	-	3.8
	25.2	11.6	6.9	43.7

(d) 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.

From 1 April 2018, expected credit losses (ECLs) on treasury assets held at amortised cost or fair value through other comprehensive income (FVOCI) are recognised in accordance with IFRS 9 as described in note 1. At 31 March 2019, the Group and Society's loans and advances to credit institutions and investment securities held at amortised cost or FVOCI were all categorised as stage 1 and the associated ECLs were negligible. At the reporting date, 100% (2017/18: 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 tables below show the relative concentrations of the Group's treasury investment portfolio, all of which are denominated in sterling:

	Group 2019 £m	Group 2018 £m	**Society 2019 £m**	Society 2018 £m
Concentration by credit grading				
AAA	**306.1**	294.7	**306.1**	294.7
AA+ to AA-	**254.7**	385.7	**228.6**	356.9
A+ to A-	**34.2**	59.4	**12.6**	16.8
BBB+	**3.5**	17.4	**3.5**	17.4
Other	**-**	-	**624.9**	717.5
	598.5	757.2	**1,175.7**	1,403.3
Concentration by sector				
Financial institutions	**109.8**	137.8	**62.1**	66.3
Asset backed securities	**215.0**	229.4	**839.9**	947.0
Supranational institutions	**71.2**	65.3	**71.2**	65.3
Sovereign	**202.5**	324.7	**202.5**	324.7
	598.5	757.2	**1,175.7**	1,403.3
Concentration by region				
UK	**488.8**	629.2	**1,103.8**	1,335.0
Europe (excluding UK)	**24.5**	47.9	**0.6**	0.6
North America	**14.0**	14.8	**0.1**	2.4
Supranational	**71.2**	65.3	**71.2**	65.3
	598.5	757.2	**1,175.7**	1,403.3

35. 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 Risk 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 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.

The Group's use of derivative financial instruments to manage interest rate risk is explained in note 12 to the accounts.

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 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 future time periods. In conducting this analysis, general reserves, CCDS 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 2019 £m	Average 2019 £m	High 2019 £m	Low 2019 £m
Market value	**(2.6)**	(4.3)	(6.1)	(2.0)
Net interest income	**(2.9)**	(2.4)	(3.5)	(1.6)

36. 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 30 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 Risk Management Policy.

The Liquidity and Funding limits are 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 Treasury and Financial Risk Management Policy. ALCo meets monthly;
- Operational management of liquidity risk is further delegated to the Liquidity Management Committee (LMC). LMC meets regularly (typically 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 Group maintains sufficient liquidity to meet its cash flow needs under any 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 Prudential Regulation Authority's liquidity regime, the Group holds sufficient high quality liquid assets, such as government securities, supranational bonds, covered bonds and cash deposited with the Bank of England, to ensure that it can meet its liabilities over a 30 day period under stressed conditions. This is known as its Liquidity Coverage Ratio (LCR). The Group holds high quality liquidity above that required by the LCR in accordance with its own day-to-day assessment of liquidity adequacy.

The Overall Liquidity Adequacy Rule (OLAR) states that a regulated firm must at all times maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. There are three measures that the Group considers key to meeting the OLAR:

- Liquidity ratios - the amount of liquidity necessary to meet its LCR, Net Stable Funding Ratio (NSFR) and to maintain overall liquidity adequacy is assessed daily;
- Liquidity stress tests - adequacy of Group liquidity under a number of different stress scenarios is modelled and maintained within the Board's liquidity risk tolerance; and
- Refinancing gaps - the level of wholesale and combined retail/wholesale funding permitted to mature over given time periods is subject to Board approved limits.

Further details of liquidity management are contained within the Risk Management Report on pages 25 to 31.

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 Group's liquidity management processes consider the actual repayment profiles of financial assets and liabilities which are likely to be significantly different to that shown in the analysis.

At 31 March 2019

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	172.0	-	-	-	-	10.5	**182.5**
Loans and advances to credit institutions	58.6	48.1	-	-	-	-	**106.7**
Investment securities	-	43.8	41.3	153.1	71.1	-	**309.3**
Derivative financial instruments	-	-	0.4	5.9	0.2	-	**6.5**
Loans and advances to customers	-	176.1	60.2	316.0	4,194.4	-	**4,746.7**
Deferred tax assets	-	-	-	-	-	18.9	**18.9**
Trade and other receivables	-	-	-	-	-	3.7	**3.7**
Intangible assets	-	-	-	-	-	16.5	**16.5**
Investment properties	-	-	-	-	-	134.7	**134.7**
Property, plant and equipment	-	-	-	-	-	28.4	**28.4**
	230.6	**268.0**	**101.9**	**475.0**	**4,265.7**	**212.7**	**5,553.9**
Liabilities and equity							
Shares	3,313.8	121.3	300.3	253.1	2.7	-	**3,991.2**
Amounts due to credit institutions	-	112.9	93.2	461.2	-	-	**667.3**
Amounts due to other customers	4.5	45.4	27.8	-	-	-	**77.7**
Derivative financial instruments	-	0.2	0.1	12.7	26.3	-	**39.3**
Debt securities in issue	-	-	1.0	-	343.1	-	**344.1**
Current tax liabilities	-	-	-	-	-	1.1	**1.1**
Deferred tax liabilities	-	-	-	-	-	5.8	**5.8**
Trade and other payables	-	-	-	-	-	12.1	**12.1**
Provisions for liabilities	-	-	-	-	-	1.4	**1.4**
Retirement benefit obligations	-	-	-	-	-	4.9	**4.9**
Subordinated liabilities	-	-	-	-	-	22.8	**22.8**
Core capital deferred shares	-	-	-	-	-	127.0	**127.0**
Subscribed capital	-	-	-	-	-	8.9	**8.9**
General reserves	-	-	-	-	-	247.1	**247.1**
Revaluation reserve	-	-	-	-	-	3.3	**3.3**
Fair value reserve	-	-	-	-	-	(0.1)	**(0.1)**
	3,318.3	**279.8**	**422.4**	**727.0**	**372.1**	**434.3**	**5,553.9**

36. Liquidity risk (continued)

At 31 March 2018

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	318.1	-	-	-	-	6.6	324.7
Loans and advances to credit institutions	53.3	67.3	-	-	-	-	120.6
Investment securities	-	53.8	44.0	124.5	89.6	-	311.9
Derivative financial instruments	-	-	0.4	16.8	2.3	-	19.5
Loans and advances to customers	-	219.7	25.5	368.4	4,191.8	-	4,805.4
Deferred tax assets	-	-	-	-	-	15.3	15.3
Trade and other receivables	-	-	-	-	-	6.4	6.4
Intangible assets	-	-	-	-	-	15.3	15.3
Investment properties	-	-	-	-	-	132.2	132.2
Property, plant and equipment	-	-	-	-	-	30.2	30.2
	371.4	340.8	69.9	509.7	4,283.7	206.0	5,781.5
Liabilities and equity							
Shares	3,299.8	127.0	214.5	410.1	-	-	4,051.4
Amounts due to credit institutions	-	37.7	72.5	461.1	-	-	571.3
Amounts due to other customers	6.0	73.5	52.6	1.0	-	-	133.1
Derivative financial instruments	-	-	0.5	9.3	28.9	-	38.7
Debt securities in issue	-	-	-	-	493.3	-	493.3
Deferred tax liabilities	-	-	-	-	-	4.5	4.5
Trade and other payables	-	-	-	-	-	12.0	12.0
Provisions for liabilities	-	-	-	-	-	2.1	2.1
Retirement benefit obligations	-	-	-	-	-	5.1	5.1
Profit participating deferred shares	-	-	-	-	-	175.0	175.0
Subscribed capital	-	-	-	-	-	75.0	75.0
General reserves	-	-	-	-	-	215.8	215.8
Revaluation reserve	-	-	-	-	-	3.4	3.4
Available for sale reserve	-	-	-	-	-	0.8	0.8
	3,305.8	238.2	340.1	881.5	522.2	493.7	5,781.5

At 31 March 2019

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	172.0	-	-	-	-	10.5	**182.5**
Loans and advances to credit institutions	10.9	48.1	-	-	-	-	**59.0**
Investment securities	-	43.8	41.3	153.1	696.0	-	**934.2**
Derivative financial instruments	-	-	0.4	5.3	0.2	-	**5.9**
Loans and advances to customers	-	7.9	7.9	118.8	2,962.1	-	**3,096.7**
Deferred tax assets	-	-	-	-	-	10.3	**10.3**
Trade and other receivables	-	-	-	-	-	3.6	**3.6**
Investments	-	-	-	-	-	1,215.8	**1,215.8**
Intangible assets	-	-	-	-	-	15.9	**15.9**
Property, plant and equipment	-	-	-	-	-	28.4	**28.4**
	182.9	**99.8**	**49.6**	**277.2**	**3,658.3**	**1,284.5**	**5,552.3**
Liabilities and equity							
Shares	3,313.8	121.3	300.3	253.1	2.7	-	**3,991.2**
Amounts due to credit institutions	-	112.9	93.2	461.2	-	-	**667.3**
Amounts due to other customers	4.5	45.4	27.8	1.0	336.9	-	**415.6**
Derivative financial instruments	-	0.2	0.1	12.7	22.5	-	**35.5**
Debt securities in issue	-	-	1.0	-	-	-	**1.0**
Current tax liabilities	-	-	-	-	-	1.1	**1.1**
Deferred tax liabilities	-	-	-	-	-	1.6	**1.6**
Trade and other payables	-	-	-	-	-	10.5	**10.5**
Provisions for liabilities	-	-	-	-	-	0.9	**0.9**
Retirement benefit obligations	-	-	-	-	-	4.9	**4.9**
Subordinated liabilities	-	-	-	-	-	22.8	**22.8**
Core capital deferred shares	-	-	-	-	-	127.0	**127.0**
Subscribed capital	-	-	-	-	-	8.9	**8.9**
General reserves	-	-	-	-	-	260.8	**260.8**
Revaluation reserve	-	-	-	-	-	3.3	**3.3**
Fair value reserve	-	-	-	-	-	(0.1)	**(0.1)**
	3,318.3	**279.8**	**422.4**	**728.0**	**362.1**	**441.7**	**5,552.3**

36. Liquidity risk (continued)

At 31 March 2018

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	318.1	-	-	-	-	6.6	324.7
Loans and advances to credit institutions	8.2	41.0	-	-	-	-	49.2
Investment securities	-	53.8	44.0	124.5	807.1	-	1,029.4
Derivative financial instruments	-	-	0.4	16.8	2.3	-	19.5
Loans and advances to customers	-	8.4	12.4	115.4	2,820.6	-	2,956.8
Deferred tax assets	-	-	-	-	-	12.1	12.1
Trade and other receivables	-	-	-	-	-	6.4	6.4
Investments	-	-	-	-	-	1,350.6	1,350.6
Intangible assets	-	-	-	-	-	14.7	14.7
Property, plant and equipment	-	-	-	-	-	30.2	30.2
	326.3	103.2	56.8	256.7	3,630.0	1,420.6	5,793.6
Liabilities and equity							
Shares	3,299.8	127.0	214.5	410.1	-	-	4,051.4
Amounts due to credit institutions	-	37.7	72.5	461.1	-	-	571.3
Amounts due to other customers	6.7	74.7	56.5	23.8	464.1	-	625.8
Derivative financial instruments	-	-	0.5	7.9	23.1	-	31.5
Deferred tax liabilities	-	-	-	-	-	0.8	0.8
Trade and other payables	-	-	-	-	-	10.9	10.9
Provisions for liabilities	-	-	-	-	-	2.0	2.0
Retirement benefit obligations	-	-	-	-	-	5.1	5.1
Profit participating deferred shares	-	-	-	-	-	175.0	175.0
Subscribed capital	-	-	-	-	-	75.0	75.0
General reserves	-	-	-	-	-	240.6	240.6
Revaluation reserve	-	-	-	-	-	3.4	3.4
Available for sale reserve	-	-	-	-	-	0.8	0.8
	3,306.5	239.4	344.0	902.9	487.2	513.6	5,793.6

The significant development of liquidity stress testing and forecast models has continued throughout 2018/19 due to economic and market conditions. A wide range of scenarios is considered including mild and severe stresses, credit downgrades and a total closure of the wholesale market. An analysis of the liquidity portfolio is set out in the table below:

Group	**2019 £m**	**2019 %**	2018 £m	2018 %
Cash in hand and balances with the Bank of England	**182.5**	**30.5**	324.7	42.9
Cash with banks and building societies	**106.7**	**17.8**	120.6	15.9
Fixed rate bonds	**23.1**	**3.9**	27.3	3.6
Floating rate notes	**71.2**	**11.9**	55.2	7.3
Covered bonds	**143.9**	**24.0**	139.8	18.5
Residential mortgage backed securities	**71.1**	**11.9**	89.6	11.8
Total	**598.5**	**100.0**	757.2	100.0

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

At 31 March 2019

Group	**Less than 3 months £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**Total £m**
Liabilities					
Shares	3,418.4	304.0	278.1	2.1	**4,002.6**
Amounts due to credit institutions and other customers	152.9	121.4	499.7	-	**774.0**
Derivative financial instruments	4.9	15.4	56.6	12.5	**89.4**
Debt securities in issue	1.3	4.8	333.3	68.6	**408.0**
Subordinated liabilities	-	2.5	10.0	60.2	**72.7**
	3,577.5	**448.1**	**1,177.7**	**143.4**	**5,346.7**

At 31 March 2018

Group	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	3,553.2	218.9	291.3	-	4,063.4
Amounts due to credit institutions and other customers	103.6	126.2	470.7	-	700.5
Debt securities in issue	1.9	108.2	377.2	91.1	578.4
Derivative financial instruments	6.7	19.5	75.8	20.2	122.2
	3,665.4	472.8	1,215.0	111.3	5,464.5

36. Liquidity risk (continued)

At 31 March 2019

Society	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	3,418.4	304.0	278.1	2.1	**4,002.6**
Amounts due to credit institutions and other customers	152.9	121.4	499.7	-	**774.0**
Derivative financial instruments	3.8	12.0	43.5	11.2	**70.5**
Debt securities in issue	-	1.0	-	-	**1.0**
Subordinated liabilities	-	2.5	10.0	60.2	**72.7**
	3,575.1	**440.9**	**831.3**	**73.5**	**4,920.8**

At 31 March 2018

Society	Less than 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	3,553.2	218.9	291.3	-	4,063.4
Amounts due to credit institutions and other customers	103.6	126.2	470.7	-	700.5
Derivative financial instruments	5.4	15.5	55.6	17.7	94.2
	3,662.2	360.6	817.6	17.7	4,858.1

For each material class of financial liability a maturity analysis is provided on pages 123 to 126.

37. Financial commitments

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
a) Leasing commitments				
Total commitments under non-cancellable leases				
Rental commitments arising:				
Within one year	**0.6**	0.5	**0.6**	0.5
Later than one year and not later than five years	**1.3**	1.2	**1.3**	1.2
After five years	**-**	0.1	**-**	0.1
	1.9	1.8	**1.9**	1.8
b) Loan commitments				
Undrawn loan facilities	**75.7**	124.1	**66.3**	124.1

38. Related party transactions

i) Subsidiary, parent and ultimate controlling party

The Group is controlled by West Bromwich Building Society which is considered to be the ultimate parent undertaking. The subsidiaries of the Society are detailed in note 15. The Group's registered office and principal place of business is 2 Providence Place, West Bromwich, B70 8AF.

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 2019	Amount in respect of key management personnel and their close family members 2019 £000	No. of key management personnel 2018	Amount in respect of key management personnel and their close family members 2018 £000
Savings balances at 31 March	10	144	10	132
Interest payable on savings balances	10	1	10	1

Mortgage loans and savings are available to key management personnel and members of their close family at normal commercial terms. At 31 March 2019, there were no mortgage loans (2017/18: nil) outstanding to Directors and their connected persons.

A register is maintained by the Society containing details of loans, 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 £3.4m (2017/18: £3.4m) to defined benefit pension schemes, which are classified as related parties.

As part of the ongoing funding agreement for the West Bromwich Building Society Staff Retirement Scheme (the SRS), the Trustees of the SRS have been granted a charge over the Society's Head Office, which may be exercised only in the event of the Society defaulting on its pension obligations and in such circumstances assigns the rights of ownership of the building to the SRS.

v) Transactions with subsidiary companies

	Interest paid to Society 2019 £m	Interest paid to Society 2018 £m
Insignia Finance Limited	0.3	0.1
West Bromwich Commercial Limited	11.7	12.2
West Bromwich Homes Limited	2.9	2.9
West Bromwich Mortgage Company Limited	17.2	15.8
	32.1	31.0

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

	Loans owed by subsidiaries 2019 £m	Loans owed by subsidiaries 2018 £m
Insignia Finance Limited	10.1	13.1
West Bromwich Commercial Limited	364.1	411.0
West Bromwich Homes Limited	118.9	120.2
West Bromwich Mortgage Company Limited	722.1	805.7
	1,215.2	1,350.0

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 £128.5m (2017/18: £92.4m).

39. 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 real estate - 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, finance, treasury services, human resources and computer services, none of which constitute a separately reportable segment.

During 2018/19, the Group commenced responsible buy to let lending to limited companies which is reported within the Retail segment. The segment previously termed 'Commercial' is now reported as 'Commercial real estate'. There were no other 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 2019

	Retail £m	Commercial real estate £m	Property £m	Consolidation adjustments £m	Total Group £m
Interest receivable and similar income					
Calculated using the effective interest method	119.6	15.3	-	(16.4)	**118.5**
On instruments measured at fair value through profit or loss	(7.1)	0.2	-	-	**(6.9)**
Total interest receivable and similar income	112.5	15.5	-	(16.4)	**111.6**
Interest expense and similar charges	(52.0)	(14.6)	(2.9)	16.4	**(53.1)**
Net interest receivable/(expense)	**60.5**	**0.9**	**(2.9)**	**-**	**58.5**
Fees and commissions receivable	2.6	-	-	-	**2.6**
Other operating income	(0.1)	-	4.1	-	**4.0**
Fair value (losses)/gains on financial instruments	(1.7)	(2.4)	-	(0.3)	**(4.4)**
Total income	**61.3**	**(1.5)**	**1.2**	**(0.3)**	**60.7**
Administrative expenses	(41.2)	(1.3)	(0.1)	-	**(42.6)**
Depreciation and amortisation	(6.9)	-	-	-	**(6.9)**
Operating profit/(loss) before revaluation gains, impairment and provisions	**13.2**	**(2.8)**	**1.1**	**(0.3)**	**11.2**
Gains on investment properties	-	-	2.6	-	**2.6**
Impairment on loans and advances	(1.2)	(1.8)	-	-	**(3.0)**
Provisions for liabilities	-	(0.3)	-	-	**(0.3)**
Profit/(Loss) before tax	**12.0**	**(4.9)**	**3.7**	**(0.3)**	**10.5**

Statements of Financial Position at 31 March 2019

	Retail £m	Commercial real estate £m	Property £m	Consolidation adjustments £m	Total Group £m
Total assets	**5,497.3**	**381.6**	**137.0**	**(462.0)**	**5,553.9**
Total liabilities	**5,139.9**	**472.5**	**123.1**	**(567.8)**	**5,167.7**
Capital expenditure	**6.3**	**-**	**-**	**-**	**6.3**

Income Statements for the year ended 31 March 2018

	Retail £m	Commercial real estate £m	Property £m	Consolidation adjustments £m	Total Group £m
Interest receivable and similar income					
Calculated using the effective interest method	113.0	13.7	-	(13.4)	113.3
On instruments measured at fair value through profit or loss	(15.6)	(0.4)	-	-	(16.0)
Total interest receivable and similar income	97.4	13.3	-	(13.4)	97.3
Interest expense and similar charges	(40.8)	(11.5)	(2.9)	13.4	(41.8)
Net interest receivable/(expense)	56.6	1.8	(2.9)	-	55.5
Fees and commissions receivable	2.7	-	-	-	2.7
Other operating income	(0.2)	-	4.0	-	3.8
Fair value (losses)/gains on financial instruments	(0.5)	3.0	-	-	2.5
Total income	58.6	4.8	1.1	-	64.5
Administrative expenses	(41.8)	(1.6)	(0.1)	-	(43.5)
Depreciation and amortisation	(7.2)	-	-	-	(7.2)
Operating profit before revaluation gains, impairment and provisions	9.6	3.2	1.0	-	13.8
Gains on investment properties	-	-	3.8	-	3.8
Impairment on loans and advances	0.1	(8.0)	-	-	(7.9)
Provisions for liabilities	(0.9)	-	-	-	(0.9)
Profit/(Loss) before tax	8.8	(4.8)	4.8	-	8.8

Statements of Financial Position at 31 March 2018

	Retail £m	Commercial real estate £m	Property £m	Consolidation adjustments £m	Total Group £m
Total assets	5,709.0	449.5	134.8	(511.8)	5,781.5
Total liabilities	5,259.8	507.9	124.0	(580.2)	5,311.5
Capital expenditure	7.3	-	-	-	7.3

40. Asset encumbrance

Certain financial assets have been utilised as collateral to support the wholesale funding initiatives of the Group. As the Group has retained substantially all of the risks and rewards of ownership, the assets remain on the Statement of Financial Position but are encumbered and cannot be utilised for other purposes.

As described in note 13, the Group has established a number of securitisation structures funded by the issue of mortgage backed securities (MBSs). Retained MBSs and designated mortgage loan pools may be pledged as collateral for participation in Bank of England funding schemes.

For liquidity management purposes, the Society also enters into sale and repurchase agreements whereby it sells investment securities to third parties with a commitment to repurchase them at a future date. The proceeds of the sale and repurchase agreements are included within amounts due to credit institutions.

An analysis of Group assets pledged at 31 March is set out below.

	Encumbered 2019 £m	**Unencumbered 2019 £m**	Encumbered 2018 £m	Unencumbered 2018 £m
Cash and balances at the Bank of England	**29.9**	**152.6**	53.0	271.7
Loans and advances to credit institutions	**-**	**106.7**	-	120.6
Investment securities	**-**	**309.3**	-	311.9
Derivative financial instruments	**-**	**6.5**	-	19.5
Loans and advances to customers	**1,439.1**	**3,307.6**	1,585.1	3,220.3
Other assets	**-**	**202.2**	-	199.4
	1,469.0	**4,084.9**	1,638.1	4,143.4

In addition to the above, at 31 March 2019, Group loans and advances to credit institutions included £48.1m (2017/18: £41.0m) of collateral pledged against derivative financial instruments.

41. Country-by-country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 introduced 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.

These 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 are 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.
- 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 receipts/payments represent the amount of tax received/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.

	2019	2018
Average number of Group employees, all of which employed in the UK	**720**	753
Arising in the UK:	**£m**	£m
Group total income	**60.7**	64.5
Group profit before tax	**10.5**	8.8
Group corporation tax receipts	**-**	0.1
Public subsidies received by the Group	**-**	-

Hawthorn Finance Limited did not transact with entities outside the Group and had no employees (2017/18: nil)

42. Capital restructuring

The Liability Management Exercise (LME) was undertaken to modernise the Society's capital structure and secure its capital position via the issue of qualifying Common Equity Tier 1 capital instruments, namely core capital deferred shares (CCDS). This negotiated arm's length transaction completed in April 2018 and involved:

- The exchange of 100% the Society's Profit Participating Deferred Shares (PPDS) for a combination of new CCDS, new 11% Tier 2 subordinated notes (Tier 2 Notes) and cash. The exchanged PPDS were cancelled on the settlement date.
- The exchange of 77% of the Society's Permanent Interest Bearing Shares (PIBS) for CCDS and cash. The exchanged PIBS were cancelled on the settlement date.
- The buyback of 11% of the Society's PIBS from retail investors in exchange for cash. The settled PIBS were cancelled immediately.

In accordance with IAS 32 'Financial Instruments: Presentation' the cancellation of the exchanged PPDS and PIBS, the consideration paid and the issue of CCDS have been recognised directly in equity. The Tier 2 Notes are presented as subordinated liabilities in the Statement of Financial Position. They have been initially recognised at fair value, assessed as being the nominal value of the Tier 2 Notes (£22.5m) net of directly attributable issue costs (of £0.9m), and subsequently measured at amortised cost using the effective interest method.

The impact of the LME on Group and Society equity is disclosed as 'capital restructuring' in the Statements of Changes in Members' Interests and Equity. The transaction had the effect of reducing overall equity by £62.2m and increasing members' general reserves by £51.9m. These figures are net of £4.1m tax recognised directly in equity.

Although overall equity reduces, regulatory capital following completion of the LME was £4.4m higher owing to:

1) The regulatory capital value assigned to the £75.0m of PIBS reduces under CRD IV transitional rules and, at the point of the transaction, only contributed £30.0m to regulatory capital – the exchange and cancellation of PIBS therefore only reduced regulatory capital by £21.1m, £45.0m less than the reduction in equity shown in the Statement of Changes in Members' Interests and Equity; and

2) Tier 2 Notes of £21.6m (excluding accrued interest) are shown as subordinated liabilities in the Statement of Financial Position but are included within regulatory capital.

The value that PIBS contribute to the Society's total regulatory capital is set to amortise to £nil by 5 April 2021. At this point the Society's total regulatory capital will be better off by £25.5m (before future distributions) as a consequence of the LME.

For the purposes of the Statements of Cash Flows, the cash elements of the LME are disclosed as 'capital restructuring' within cash flows from financing activities.

43. Impact of adopting IFRS 9 'Financial Instruments'

a) Introduction

IFRS 9 'Financial Instruments' has been adopted by the Group with effect from 1 April 2018. The standard replaces IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 introduces new rules for classification and measurement, impairment and hedge accounting for financial instruments and also establishes new disclosure requirements under IFRS 7 'Financial Instruments: Disclosures'. As permitted by the new standard, comparative figures have not been restated.

The Group has made the accounting policy choice, allowed under IFRS 9, to continue applying IAS 39 for all hedge relationships until such time as the new macro hedging rules (carved out as a separate IASB project) are finalised.

The Group and Society's accounting policies for financial instruments for the years ended 31 March 2019 (under IFRS 9) and 31 March 2018 (under IAS 39) are set out in note 1.

b) Impact of IFRS 9 adoption on equity and regulatory capital

The table below summarises the impact on Group and Society equity as a result of IFRS 9 adoption at 1 April 2018:

	Notes	Group Increase/(Decrease) in general reserves £m	Society Increase/(Decrease) in general reserves £m
Impairment losses on residential mortgage loans		**(1.6)**	**(0.2)**
Impairment losses on non-securitised commercial mortgage loans	(i)	**(31.4)**	**-**
Impairment losses on investments in subsidiary undertakings		**-**	**(30.6)**
Reclassification of financial instruments designated at FVTPL under IAS 39		**(0.1)**	**-**
Reclassification of equity release portfolio	(ii)	**(0.5)**	**(0.5)**
Reclassification of investment securities		**-**	**(0.8)**
Deferred tax		**5.8**	**0.2**
Total	(iii)	**(27.8)**	**(31.9)**

Notes

(i) As the first loss exposure to commercial structured entities has been exceeded, increases in provision requirements for securitised commercial loans, arising on IFRS 9 adoption, are borne by the external loan note holders; hence the reserves movement in the table relates solely to the non-securitised balances.

(ii) On IFRS 9 adoption, the equity release portfolio was reclassified from an amortised cost to fair value through profit or loss (FVTPL) basis of measurement. The decrease to general reserves shown in the table is the net movement between releasing the IAS 39 impairment provisions previously held on the equity release mortgages and recognising the IFRS 9 cumulative fair value losses to the date of IFRS 9 transition.

(iii) As permitted by IFRS 9, comparatives have not been restated and the impact of adopting IFRS 9 has been recognised as an adjustment to general reserves on 1 April 2018. The initial estimate of the reduction to Group reserves, as reported in the Annual Report and Accounts for the year ended 31 March 2018, was circa £15m mainly due to an increase in commercial provision requirements as a result of moving from an incurred to expected loss basis of calculation. The cash flow projections used in the commercial provision assessment cover an extended period of time and, after further consideration of the potential future outcomes, taking account of all available data on the economic and market position and outlook as at 31 March 2018 and, in particular, the outlook for the retail sector, the calculated provision requirement is higher than initially estimated.

43. Impact of adopting IFRS 9 'Financial Instruments' (continued)

Regulatory capital

Transitional relief applies to IFRS 9 adjustments at 95% for the first year post implementation. Net of this relief the impact on Common Equity Tier 1 capital is a reduction of £2.1m; which is equivalent to a 0.09% reduction to the Group's Common Equity Tier 1 ratio.

c) Changes to classification and measurement of financial instruments

The table below shows the changes to the measurement categories and carrying amounts of financial assets and liabilities on initial adoption of IFRS 9.

Group	Notes	Measurement category IAS 39	Measurement category IFRS 9	Carrying amount IAS 39 31 March 2018 £m	Carrying amount IFRS 9 1 April 2018 £m
Financial assets					
Cash and balances with the Bank of England	(i)	Loans and receivables	Amortised cost	324.7	**324.7**
Loans and advances to credit institutions	(i)	Loans and receivables	Amortised cost	120.6	**120.6**
Investment securities	(ii)	Available for sale	FVOCI	311.9	**311.9**
Derivative financial instruments		FVTPL	FVTPL	19.5	**19.5**
Loans and advances to customers					
Loans fully secured on residential property (excluding equity release portfolio)	(i)	Loans and receivables	Amortised cost	4,361.1	**4,359.5**
Equity release portfolio	(iii)	Loans and receivables	FVTPL	18.9	**18.4**
Loans fully secured on land designated as FVTPL under IAS 39	(iv)	FVTPL	Amortised cost	8.4	**8.4**
Other loans fully secured on land		Loans and receivables	Amortised cost	417.0	**384.8**
				5,582.1	**5,547.8**
Financial liabilities					
Shares		Amortised cost	Amortised cost	4,051.4	**4,051.4**
Amounts due to credit institutions		Amortised cost	Amortised cost	571.3	**571.3**
Amounts due to other customers		Amortised cost	Amortised cost	133.1	**133.1**
Derivative financial instruments		FVTPL	FVTPL	38.7	**38.7**
Debt securities in issue designated as FVTPL under IAS 39	(iv)	FVTPL	Amortised cost	12.5	**12.6**
Other debt securities in issue		Amortised cost	Amortised cost	480.8	**480.0**
				5,287.8	**5,287.1**

Society	Notes	Measurement category IAS 39	Measurement category IFRS 9	Carrying amount IAS 39 31 March 2018 £m	Carrying amount IFRS 9 1 April 2018 £m
Financial assets					
Cash and balances with the Bank of England	(i)	Loans and receivables	Amortised cost	324.7	**324.7**
Loans and advances to credit institutions	(i)	Loans and receivables	Amortised cost	49.2	**49.2**
Investment securities					
Treasury investment portfolio	(ii)	Available for sale	FVOCI	311.9	**311.9**
Residential mortgage-backed securities issued by Group entities	(v)	Held to maturity	Amortised cost	714.8	**714.8**
Commercial mortgage-backed securities issued by Group entities	(vi)	Held to maturity	FVTPL	2.7	**1.9**
Derivative financial instruments		FVTPL	FVTPL	19.5	**19.5**
Loans and advances to customers					
Loans fully secured on residential property (excluding equity release portfolio)	(i)	Loans and receivables	Amortised cost	2,922.0	**2,921.8**
Equity release portfolio	(iii)	Loans and receivables	FVTPL	18.9	**18.4**
Other loans fully secured on land		Loans and receivables	Amortised cost	15.9	**15.9**
Loans to subsidiary undertakings		Loans and receivables	Amortised cost	1,350.0	**1,319.4**
				5,729.6	**5,697.5**
Financial liabilities					
Shares		Amortised cost	Amortised cost	4,051.4	**4,051.4**
Amounts due to credit institutions		Amortised cost	Amortised cost	571.3	**571.3**
Amounts due to other customers		Amortised cost	Amortised cost	625.8	**625.8**
Derivative financial instruments		FVTPL	FVTPL	31.5	**31.5**
				5,280.0	**5,280.0**

Notes

(i) The 'loans and receivables' category does not exist under IFRS 9. With the exception of the closed equity release mortgage portfolio, the financial assets previously classified as loans and receivables meet the criteria to be measured at amortised cost under IFRS 9.

(ii) The 'available for sale' category does not exist under IFRS 9. The financial assets previously classified as available for sale, being a portfolio of investment securities held for liquidity management purposes, meet the criteria to be measured at fair value through other comprehensive income (FVOCI) under IFRS 9.

(iii) The contractual terms of the closed equity release portfolio are not considered to give rise on specified dates to cash flows which are solely payments of principal and interest. The loans are therefore categorised at FVTPL under IFRS 9.

(iv) Under IAS 39, the Group designated certain debt securities in issue and an underlying portfolio of securitised loans and advances as FVTPL to eliminate accounting inconsistencies that would otherwise have arisen from measuring financial instruments (including derivatives) on different bases. This designation was irrevocable under IAS 39. As the circumstances giving rise to the measurement inconsistencies no longer exist, the Group has not elected to designate any financial assets or liabilities as FVTPL on IFRS 9 adoption.

(v) The 'held to maturity' category does not exist under IFRS 9. The Society holds residential mortgage-backed investment securities issued by the Group's structured entities. These loan notes are held in a business model to collect cash flows of principal and interest on set dates through to maturity, subject to sufficient receipts on the underlying mortgage pools. The underlying pools contain residential mortgages with contractual cash flows which are, themselves, solely payments of principal and interest (SPPI) and it has been assessed that the exposure to credit risk on the notes at the date of initial recognition was lower than that on the underlying mortgage pools. The investment securities therefore meet the SPPI criteria to be held at amortised cost under IFRS 9.

(vi) The 'held to maturity' category does not exist under IFRS 9. The Society holds commercial mortgage-backed investment securities issued by the Group's structured entities. These loan notes are in a business model to collect cash flows of principal and interest on set dates through to maturity, subject to sufficient receipts on the underlying mortgage pools. The underlying pools contain commercial mortgages with contractual cash flows which are, themselves, solely payments of principal and interest (SPPI). However, it cannot be confirmed that the exposure to credit risk on the notes, at the time of acquisition, was equal to or lower than that on the underlying mortgage pools. The investment securities therefore fail the SPPI criteria to be held at amortised cost under IFRS 9 and are carried at FVTPL.

43. Impact of adopting IFRS 9 'Financial Instruments' (continued)

d) Reconciliation of financial instrument balances from an IAS 39 to IFRS 9 basis

The tables below reconcile the Group and Society carrying values of financial assets and liabilities, as reported under IAS 39, to those applicable on initial adoption of IFRS 9 by measurement category.

Group	Carrying amount IAS39 31 March 2018 £m	Reclassification £m	Remeasurement £m	Carrying amount IFRS 9 1 April 2018 £m
Financial assets				
At amortised cost	5,242.3	(10.5)	(33.8)	**5,198.0**
Available for sale	311.9	(311.9)	-	**-**
At fair value through other comprehensive income	-	311.9	-	**311.9**
At fair value through profit or loss	27.9	10.5	(0.5)	**37.9**
Total financial assets	5,582.1	-	(34.3)	**5,547.8**
Financial liabilities				
At amortised cost	5,236.6	12.5	(0.7)	**5,248.4**
At fair value through profit or loss	51.2	(12.5)	-	**38.7**
Total financial liabilities	5,287.8	-	(0.7)	**5,287.1**

Society	Carrying amount IAS39 31 March 2018 £m	Reclassification £m	Remeasurement £m	Carrying amount IFRS 9 1 April 2018 £m
Financial assets				
At amortised cost	5,398.2	(21.6)	(30.8)	**5,345.8**
Available for sale	311.9	(311.9)	-	**-**
At fair value through other comprehensive income	-	311.9	-	**311.9**
At fair value through profit or loss	19.5	21.6	(1.3)	**39.8**
Total financial assets	5,729.6	-	(32.1)	**5,697.5**
Financial liabilities				
At amortised cost	5,248.5	-	-	**5,248.5**
At fair value through profit or loss	31.5	-	-	**31.5**
Total financial liabilities	5,280.0	-	-	**5,280.0**

e) Reconciliation of impairment provisions from an IAS 39 to IFRS 9 basis

The table below analyses the movements in impairment loss allowances arising on transition from the IAS 39 incurred loss methodology applied in 2017/18 to the expected credit loss approach prescribed by IFRS 9 and effective from 1 April 2018.

		Group			Society	
	Notes	Loans fully secured on residential property £m	Loans fully secured on land £m	Total loans and advances to customers £m	Loans fully secured on residential property £m	Loans to subsidiary undertakings £m
Impairment provisions on assets held at amortised cost						
At 31 March 2018 (IAS 39 basis)		13.2	42.1	55.3	8.4	92.4
Reclassification	(i)	(7.0)	-	(7.0)	(7.0)	-
IAS 39 collective provisions	(ii)	(2.5)	(11.4)	(13.9)	(0.5)	-
12-month ECL on assets not individually impaired under IAS 39	(iii)	0.6	0.1	0.7	-	-
Lifetime ECL on assets not individually impaired under IAS 39	(iv)	3.1	21.2	24.3	0.6	-
Changes to calculation methodology for assets individually impaired under IAS 39	(v)	(1.0)	22.4	21.4	(0.3)	30.6
Post model adjustments	(vi)	1.4	-	1.4	0.3	-
At 1 April 2018 (IFRS 9 basis)		**7.8**	**74.4**	**82.2**	**1.5**	**123.0**

Notes

(i) The Group's closed portfolio of equity release mortgages has been reclassified as FVTPL under IFRS 9. FVTPL assets are not subject to the impairment requirements of IFRS 9 and the equity release loss allowance previously recognised under IAS 39 is no longer required.

(ii) Assets not individually impaired under IAS 39 were grouped on the basis of similar credit risk characteristics and included in a collective impairment assessment. A collective provision was made where there was objective evidence that credit losses had been incurred but not observed at the reporting date. The expected loss methodology prescribed by IFRS 9 means that a provision requirement is calculated for all loans and advances to customers held at amortised cost.

(iii) Under IFRS 9, a provision is made for 12-month ECL on up to date loans allocated to stage 1. These loans were previously included in a collective impairment assessment under IAS 39.

(iv) Under IFRS 9, loans which have experienced a significant increase in credit risk since initial recognition or are in default are allocated to stages 2 or 3, thereby requiring a provision for lifetime ECL. This is a key driver for the increase in loss allowances on IFRS 9 adoption. The Group's closed commercial book is particularly sensitive to uncertainties in the economic outlook, for the retail sector and generally, which are now captured within the impairment calculation. In accordance with IAS 39, these loans were previously included in a collective impairment assessment with provisions made only where there was objective evidence of incurred credit losses. £0.2m of the increase in Group provision requirements relates to securitised commercial loans. As the first loss exposure of the Group has already been exceeded, the charge for these additional impairment losses is not borne by the Group but by the external loan note holders.

(v) The IFRS 9 provision for commercial loans which were individually impaired under IAS 39 includes an allowance for multiple economic scenarios, reflecting Brexit uncertainty and the weakened outlook for the retail sector, in some cases over long time periods. This increases the range of possible adverse outcomes which must be considered in the forward-looking calculation of ECLs resulting in significantly higher IFRS 9 loss allowances than those previously recognised under IAS 39. £0.7m of the increase in Group provision requirements relates to securitised commercial loans. As the first loss exposure of the Group has already been exceeded, the charge for these additional impairment losses is not borne by the Group but by the external loan note holders.

The conditions giving rise to the increased loss allowance against commercial mortgages impact the individual financial statements of the Society by increasing the level of expected credit losses recognised against the Society's investment in its subsidiary West Bromwich Commercial Limited. This investment comprises share capital and an intercompany loan which is a financial asset held at amortised cost and subject to the impairment requirements of IFRS 9.

(vi) Where the IFRS 9 models do not fully capture the credit risk associated with certain portfolios due to, for example, low volumes of historical defaults within the model development data set, the expected loss arising from those risks is estimated and an additional allowance recognised. The main element of the post model adjustment provision at 1 April 2018 was an allowance for the risk that a proportion of interest only mortgages will not redeem at contractual maturity due to the borrower being unable to repay the capital on the loan. During the year, the impairment models were enhanced to capture additional risks such that no post-model adjustments were required at 31 March 2019.

Annual Business Statement

1. Statutory percentages

	2019 %	Statutory limit %
Lending limit	**9.7**	25.0
Funding limit	**15.8**	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

	2019 %	2018 %
As a percentage of shares and borrowings:		
Gross capital	**8.05**	8.95
Free capital	**4.52**	5.88
Liquid assets	**11.78**	14.43
As a percentage of mean total assets:		
Profit for the financial year	**0.16**	0.14
Management expenses	**0.87**	0.87

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, in each case including accrued interest.
- 'Gross capital' represents the aggregate of general reserves, revaluation reserve, available for sale reserve, fair value reserve, profit participating deferred shares, core capital deferred shares, subscribed capital and subordinated liabilities.
- '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 2019

Name, qualification and age	Role	Date of appointment	Other directorships and interests
Julie Hopes MBA, ACIB Age 51	Non-Executive Director	1 April 2016	Police Mutual Assurance Society SAGA Services Limited SAGA Plc
Victoria Mitchell Age 54	Non-Executive Director	1 April 2018	
Mark Nicholls MA (Cantab), MBA Age 70	Chairman	1 January 2010	Rathbone Brothers Plc Rathbone Investment Management Ltd
Mark Preston BA (Hons), ACIB Age 59	Non-Executive Director	18 May 2011	The Northview Group Ltd Kensington Mortgage Company Limited Acenden Limited
Martin Ritchley FCA, FCIB, Hon DBA (Coventry) Age 72	Deputy Chairman and Senior Independent Director	1 September 2009	Royal Shakespeare Theatre Trust
Lynne Shamwana BA FCA Age 56	Non-Executive Director	1 February 2019	Virgin Tech Limited Virgin Care Corporate Services Limited Virgin Care Practices Limited Virgin Care Provider Services Limited Virgin Care Limited VH Doctors Limited Virgin Care Private Limited Virgin Care Services Limited Virgin Healthcare Holdings Limited
James Turner FCA, FCSI, BA (Hons) Age 49	Non-Executive Director	1 April 2017	Prudential Public Limited Company
Ashraf Piranie FCCA, MBA Age 55	Group Finance & Operations Director	13 March 2017	Elite Star Investments Limited Osborne House Property Management Limited DPC (2011) Limited West Bromwich Mortgage Company Limited CL Mortgages Limited
Jonathan Westhoff BA (Hons) Financial Services, FCMA, CGMA, ACIB Age 54	Chief Executive	5 May 2009	West Bromwich Commercial Limited West Bromwich Homes Limited West Bromwich Mortgage Company Limited CL Mortgages 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 Ashraf Piranie entered into his service contract on 13 March 2017, on this basis.

For further details of the Executive Directors' service contracts, see the Directors' Remuneration Report on pages 44 to 51.

Documents may be served on any of the above named Directors at the following address: Addleshaw Goddard, 3 Sovereign Square, Sovereign Street, Leeds, LS1 4ER.

Senior management	Role	Group directorships
Andrea Hackett	Divisional Director, Operations	
Manjit Hayre	Chief Risk Officer	
Greg Johnson ACIB	Divisional Director, IT Service and Solutions	
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 Insignia Finance Limited West Bromwich Mortgage Company Limited
John McErlean MIIA, FIIA	Divisional Director, Internal Audit	
Neil Noakes	Group Secretary	Insignia Finance Limited WBBS (SRS) Limited West Bromwich Homes Limited White Label Lending Limited
Carole Barlow BSc, FCIPD	Divisional Director, Human Resources	
James Wright BSc, ACIB, CIM Dip	Divisional Director, Sales & Marketing	Central Processing 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 III – The Basel Committee on Banking Supervision's framework for strengthened global regulatory standards on bank capital adequacy and liquidity. The requirements, embedded using CRD IV, became effective from 1 January 2014.

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 property assets which 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 (CET 1) capital – CET 1 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.

Core Capital Deferred Shares (CCDS) – A form of Common Equity Tier 1 (CET 1) capital issued by building societies.

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 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.

Encumbered assets – Assets held on the Statement of Financial Position which have been used as security for funding or otherwise pledged.

Expected credit loss (ECL) - A term used in the calculation of impairment provisions under accounting standard IFRS 9 'Financial Instruments'. The ECL is the present value of all cash shortfalls over the expected life of a financial instrument.

Exposure at default (EAD) – An estimate of the outstanding balance on a financial asset at the time of default.

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.

Fair value through other comprehensive income (FVOCI) assets – Financial assets held at fair value in the Statement of Financial Position with changes in fair value being recognised through other comprehensive income.

Fair value through profit or loss (FVTPL) assets – Financial assets held at fair value in the Statement of Financial Position with changes in fair value being recognised through the Income Statement.

Financial Conduct Authority (FCA) – The conduct regulator for financial services firms in the UK, with objectives to protect consumers and financial markets and to promote competition.

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 deposit-taking firm authorised by the FCA and PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.

Forbearance – Support offered to borrowers experiencing genuine financial hardship to enable them to remain in their homes, where this action is not expected to increase the level of debt in the long term.

Free capital – Gross capital less intangible assets, investment properties and property, plant and equipment. In 2017/18, free capital was adjusted for collective mortgage impairment provisions which are no longer applicable under IFRS 9.

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 reserves, subscribed capital, subordinated liabilities and core capital deferred shares. In the prior year, gross capital included profit participating deferred shares which were fully cancelled during the year as part of the Liability Management Exercise described in note 42.

Impaired loans – Under IFRS 9, impaired loans are those assessed as stage 3 (default). In previous years, under IAS 39, impaired loans were defined as loans where there was evidence to suggest that the Group would not receive all of the contractual cash flows or there was an expectation that the cash flows would be received at a later date than when they were contractually due.

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 – Prior to IFRS 9 adoption on 1 April 2018 the Group assessed, at each reporting date, whether or not there was objective evidence that individual financial assets were impaired. If no objective evidence of impairment existed for an individually assessed financial asset, it was included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. A collective provision was made against a group of financial assets where there was evidence that credit losses had 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.

Investment securities – Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings.

Law of Property Act (LPA) Receiver – a receiver appointed to manage a property, held as security for a mortgage, where the contractual terms of the mortgage have not been met.

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 balance 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.

Loss given default (LGD) – The difference between exposure at default (EAD) and the net amount expected to be recovered on a defaulted loan, expressed as a percentage of EAD.

Management expenses – Management expenses represent administrative expenses plus depreciation and amortisation. The management expenses ratio is calculated as management expenses expressed as a percentage of mean total assets.

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

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) – Securities 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) – Securities that represent an interest in an underlying pool of mortgage assets.

Net interest income – The difference between interest received on assets and interest paid on liabilities.

Net interest margin – Net interest income as a percentage of mean total assets.

Net Promoter Score (NPS) – A measure, ranging from -100 to +100, of the likelihood that a customer would recommend a product, service or brand. Net Promoter Score and NPS are trademarks of Satmetrix Systems, Inc., Bain & Company, Inc., and Fred Reichheld.

Net stable funding ratio (NSFR) – A ratio calculated as the amount of available stable funding against the amount of required stable funding.

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 can seize the collateral, but the lender's recovery is limited to the collateral alone.

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. It also includes rental income from investment property).

Permanent interest bearing shares (PIBS) – Unsecured, deferred shares that rank behind the claims of all depositors, payables and investing members of the West Brom with the exception of the claims of holders of core capital deferred shares and (in prior years) profit participating deferred shares.

Prime – Prime mortgages are those granted to the most credit worthy category of borrower.

Probability of default (PD) – The estimated probability that a borrower will default on their credit obligations.

Profit participating deferred shares (PPDS) – A form of unsecured Common Equity Tier 1 capital, fully cancelled following the Liability Management Exercise completed in April 2018 and described in note 42.

Prudential Regulation Authority (PRA) - The prudential regulator for UK banks, building societies and insurers, with a general objective to promote the safety and soundness of the firms it regulates.

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 – Mortgage lending secured against residential property.

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 Society is willing to accept (or not accept) in order to safeguard the interests of its 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. An entity 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.

Significant increase of credit risk (SICR) – A term used in IFRS 9 where quantitative and/or qualitative factors indicate that the credit risk associated with a non-defaulted loan has increased significantly since it was initially recognised in the Statement of Financial Position. Where a SICR has occurred, the loan is categorised as stage 2 requiring the recognition of lifetime expected credit losses.

Solely payments of principal and interest (SPPI) test – An assessment of whether the contractual terms of a financial asset give rise to cash flows which are solely payments of principal and interest on the principal amount outstanding. It is used to determine the appropriate measurement basis for the financial asset under IFRS 9.

Stage 1 – The IFRS 9 category to which financial assets held at amortised cost or FVOCI, which have not experienced a SICR since initial recognition, are assigned. 12-month ECLs are recognised for stage 1 assets and interest income is calculated by applying the effective interest rate to the gross carrying amount.

Stage 2 – The IFRS 9 category to which financial assets held at amortised cost or FVOCI, which have experienced a SICR since initial recognition, are assigned. Lifetime ECLs are recognised for stage 2 assets and interest income is calculated by applying the effective interest rate to the gross carrying amount.

Stage 3 – The IFRS 9 category to which defaulted financial assets held at amortised cost or FVOCI are assigned. Lifetime ECLs are recognised for stage 3 assets and interest income is calculated by applying the effective interest rate to the net (of impairment provision) carrying amount.

Subordinated liabilities – A form of unsecured Tier 2 capital. The Society's subordinated notes rank behind all other creditors of the Society, with the exception of holders of CCDS and PIBS.

Term Funding Scheme (TFS) – A scheme launched by the Bank of England, providing term funding to banks and building societies with the aim of promoting UK lending growth.

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 subordinated liabilities, eligible collective impairment allowances (in 2017/18) and certain regulatory deductions made for the purposes of assessing capital adequacy.

Total Capital Requirement (TCR) – The minimum amount of capital the Society is required to hold, set by the PRA and informed by the ICAAP.

Wholesale funding – The total of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Braille, audio and large print versions of this document are available upon request. Please contact us on 0345 241 3784.

Head Office: 2 Providence Place, West Bromwich B70 8AF.
www.westbrom.co.uk

1627-05/19-01