Condensed consolidated half-yearly financial information

30 September 2018

the West Brom

Chief Executive's Business Review

Against our mutual purpose, I am proud to announce that our simple strategy has yet again delivered a strong half-year performance with improved levels of profitability, supported by residential lending, delivered at a reduced cost.

Half-year results reflecting our mutual purpose

As a mutual organisation the West Brom exists for, and operates in, the interests of our membership; supporting our members' financial wellbeing by providing a safe and good return on their savings and enabling people to have somewhere they call home.

We continue to be focused on the delivery of our core strategic objectives; sustainable levels of residential lending funded primarily by retail savings, cost efficient services delivered to the standards members rightly expect and continuing the managed exit of non-core legacy positions.

Against our mutual purpose, I am proud to announce that our simple strategy has yet again delivered a strong half-year performance with an improved level of profit and a further strengthening of our Common Equity Tier 1 (CET 1) capital position, allowing us to complete a further £466m of residential lending. The level of profit achieved enables us to grow our core business sustainably whilst also allowing us to invest in products and services.

Profitability improved, a modernised capital base and better returns for savers

At £6.0m, the half-year statutory profit represents a year on year increase of 43%. This increase has been achieved due to an uplift in net interest margin to 1.02% (30 September 2017: 0.98%), a 3.5% reduction in management expenses and a 41% lower charge for impairment. These factors more than offset a £1.2m reduction in gains on investment properties to £1.8m, which reflects a cooling of house price valuation rises generally.

£6.0m

Profit before tax
(30 September 2017: £4.2m)

Managing the interests of members

As a mutual it is not our role to maximise the interest rate gap between savers and borrowers but to manage this at a level that covers the costs we incur in delivering our services to members and allowing room for investment in the future, whilst maintaining our strong capital position.

This is why, when the Bank of England decided in August to increase the Bank Rate by 0.25%, we took the opportunity to increase savings rates, where possible, to ensure our products continue to offer good value, particularly when compared with what is available through competitor branch networks. We have once again offered value to our savers, increasing the average we pay above the market average from 0.14% for the six months to 30 September 2017 to 0.27%[1].

At the West Brom we believe firmly that the value we offer extends beyond the competitive interest rates we pay our savers or charge our borrowers. We also pride ourselves on our service offering; the face-to-face service offered in our 37 heartland branches, our dedicated customer services support team and our WeBSave offering that allows members to manage their savings online.

Along with savings and mortgages we help support our members' broader financial wellbeing through a range of investment and protection products. Fees, commissions and other operating income increased to £3.6m compared with £3.1m in the first half of 2017/18. This comprised income earned on insurance and protection products, investment advice and rent receivable on our portfolio of investment properties.

Keeping control of costs

We strive to provide member services in the most cost efficient way possible and continue to invest in the technology to do so. In the first half of the year a number of areas where efficiency could be improved were identified and, as such, resulted in sustainable cost savings of 3.5%, supporting our ability to offer value to savers and borrowers and invest in the Society's future. Management expenses were £24.9m (30 September 2017: £25.8m) with the

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

Group management expenses ratio reduced from 0.89% to 0.88%, compared with the same period in 2017. A resolute focus on how we can deliver our services to members in the most efficient way possible will continue throughout the second half of the year.

3.5% reduction

in management expenses to £24.9m (30 September 2017: £25.8m) reflecting efficiency savings

A modernised capital base

The impact of the Liability Management Exercise which completed in April 2018 is detailed in the Group Statement of Changes in Members' Interests and Equity and in note 5 to the condensed consolidated half-yearly financial information. The transaction was a significant landmark for the Society, modernising its capital base and increasing members' general reserves by £52m. When combined with the unaudited profit for the half year and a further reduction in higher risk weighted legacy lending, this has resulted in our CET 1 capital ratio increasing to 15.2% (31 March 2018: 14.8%); a robust base from which we can grow and invest. The stable leverage ratio of 6.8% (31 March 2018: 6.9%) compares favourably with others in the sector and is significantly above the current regulatory minimum of 3%.

The following table illustrates the Group's capital position and ratios at 30 September 2018 and 31 March 2018, presented as currently calculated under CRD IV transitional rules, which apply to the Society until 5 April 2021, and also with the full impact of CRD IV implementation.

	Transitional CRD IV rules 30 Sep 18 £m	Full implementation of CRD IV 30 Sep 18 £m
Capital resources		
Equity attributable to members (excluding Additional Tier 1)	375.2	375.2
Other adjustments[1]	5.4	5.4
Common Equity Tier 1 (CET 1) capital	380.6	380.6
Additional Tier 1 capital	8.9	-
Total Tier 1 capital	389.5	380.6
Tier 2 capital[2]	21.7	21.7
Total regulatory capital resources	411.2	402.3
Risk weighted assets (RWA)	2,508.7	2,508.7
Leverage ratio exposure	5,706.7	5,706.7
Capital ratios	%	%
Common Equity Tier 1 ratio (as a percentage of RWA)	15.2	15.2
Tier 1 ratio (as a percentage of RWA)	15.5	15.2
Total capital ratio (as a percentage of RWA)	16.4	16.0
Leverage ratio	6.8	6.7

	Transitional CRD IV rules 31 Mar 18 £m	Full implementation of CRD IV 31 Mar 18 £m
Capital resources		
Equity attributable to members (excluding Additional Tier 1)	395.0	395.0
Other adjustments[1]	(20.8)	(20.8)
Common Equity Tier 1 (CET 1) capital	374.2	374.2
Additional Tier 1 capital	30.0	-
Total Tier 1 capital	404.2	374.2
Tier 2 capital[2]	16.3	16.3
Total regulatory capital resources	420.5	390.5
Risk weighted assets (RWA)	2,523.1	2,523.1
Leverage ratio exposure	5,885.2	5,885.2
Capital ratios	%	%
Common Equity Tier 1 ratio (as a percentage of RWA)	14.8	14.8
Tier 1 ratio (as a percentage of RWA)	16.0	14.8
Total capital ratio (as a percentage of RWA)	16.7	15.5
Leverage ratio	6.9	6.4

[1] Other adjustments mainly comprise deductions for intangible assets and deferred tax. For September 2018, the other adjustments line also includes IFRS 9 transitional relief.

[2] Tier 2 capital excludes accrued interest.

On 1 April 2018 a new accounting standard came into effect; IFRS 9 'Financial Instruments', which has changed the way impairment is calculated and has resulted in an increase in the level of provisioning. Transitional rules apply for the implementation of this new standard which enable banks and building societies to phase in the capital impact of IFRS 9 adoption over a period of five years. During this period, percentages of the additional impairment provision requirements, recognised in general reserves on IFRS 9 adoption, are added back to CET 1 capital. Had these transitional arrangements not been in place, the CET 1 ratio at 30 September 2018 would have been 14.3% and the leverage ratio would have been 6.2%.

15.2%

Common Equity Tier 1 capital ratio (31 March 2018: 14.8%)

Commitment to our core purpose

Our lending

Throughout the first half of the year the Society has continued to cement its position as a well-recognised residential mortgage lender with gross lending totalling £466m (30 September 2017: £478m) and owner occupied net lending of £173m (30 September 2017: £243m).

Over the last few years we have continued to see increasing challenges for first time buyers, owing to a lack of supply, constraints on their ability to borrow and increased house prices relative to incomes. As a result, the expectations of people in how they occupy the place they call home have also begun to shift, with an increased proportion of younger generations renting as well as seeking support to buy. With this in mind, and aligned to our purpose of promoting home ownership, we have continued to develop our product proposition to support first time buyers. We have introduced Help to Buy remortgage products, an assisted mortgage range for those looking to buy with the support of a sponsor and self-build products. We have also introduced products for portfolio buy to let landlords who continue to support the private rented sector. I am pleased to report that the Society has supported over 2,000 first time buyers to own their own home in the six months to 30 September 2018, with first time buyer advances making up 38% of total lending in the period (30 September 2017: 28%).

38%

of new mortgages helping first time buyers (30 September 2017: 28%)

Our funding

Aligned to mutual principles, mortgage lending remains primarily funded by retail savings balances, with 87% of our residential lending balances provided by members' savings (31 March 2018: 93%). Of these savings balances 69% are held in branch based accounts, a higher proportion than at the year end (31 March 2018: 66%).

In addition to our members' savings, wholesale markets provide an important source of supplementary funding primarily as the majority is longer-term in nature, with 68% placed with the Society for periods exceeding two years. In the first half of the year the Society's wholesale funding ratio increased modestly from 22.8% to 24.1%. Wholesale funding includes mortgage backed securitisations, which provides term funding.

Holding high quality liquid assets is important in ensuring the Society is comfortably able to meet its financial obligations as they fall due under both normal and plausible stressed scenarios. The key regulatory measure of liquidity is the Liquidity Coverage Ratio (LCR) which, at 144% was at a strong level (31 March 2018: 194%), considerably above the current minimum regulatory requirement. The liquidity figure at 31 March 2018 year end was higher than normal, as the Society had raised £350m of 5 year term funding through a residential mortgage backed securitisation, in January 2018.

Asset quality improved

Since 2009 a key strategic objective for the Society has been to improve the risk profile of the balance sheet by taking opportunities to remove legacy positions, primarily commercial assets, where economically viable. In the first half of the year non-core commercial lending balances reduced by 5%; at 30 September 2018 total remaining gross balance sheet exposures stood at £464m (31 March 2018: £488m), of which £41m is securitised (31 March 2018: £53m) with no residual risk exposure for the Group. Following adoption of IFRS 9 on 1 April 2018, provisions are now recognised on an expected loss basis, as explained in note 4 to the condensed consolidated half-yearly financial information. This has increased the level of provision coverage from 8.6% at 31 March 2018 on an IAS 39 basis to 16.7% at 30 September 2018 on an IFRS 9 basis. The strategy of reducing non-core exposures and lending only into traditional residential lending segments has resulted in a material change to the Society's balance sheet. Prime owner occupied residential loan balances have more than doubled, from £1.38bn to £2.84bn, since the Society re-entered the mortgage market in 2012/13, over which same time period non-core commercial balances reduced by nearly 60% from £1.10bn to £0.46bn.

With significant growth in our prime owner occupied lending over the past five years or so, it is also encouraging to see that the number of residential customers experiencing difficulty with their payments remains significantly below the market average. At half year core residential 3 months or longer arrears stood at 0.29%, compared with the market average of 0.78%[2] which is a testament to the responsible approach we have taken to ensure our borrowers can afford their mortgage payments.

Under the new IFRS 9 accounting standard, impairment must be measured on an expected loss basis, rather than the incurred loss approach prescribed by its predecessor, IAS 39. Since our year-end disclosures, we have continued to improve the methodologies that underpin our provisioning approach, particularly around the market sensitivities inherent within our commercial book. To this end, as detailed in note 4, IFRS 9 implementation has resulted in a reduction in general reserves of £27.9m almost entirely due to additional commercial provisioning requirements under this new standard.

Member value delivered

The Society delivers member value through the competitive products we offer, the service we provide through our branches, customer services team, online and our community relationships.

Products

For savers, in what continues to be a historically low interest rate environment, our average rates were some 42% higher than the market average, demonstrating our determination to support our savers through this period of unprecedented low interest rates. Along with this competitive rate of interest we seek to ensure our products cater for a breadth of member needs from children's accounts supporting the next generation to save, our Help to Buy ISA supporting a new generation of home owners to our range of easy access and fixed rate bonds supporting our members to save either an emergency buffer or for longer-term goals.

For our borrowers we continue to offer a wide range of products that satisfy both the simple needs of those looking to buy and remortgage but also those with more complex requirements, those looking to build, operate as a landlord through a limited company, or remortgage but retain their Help to Buy Equity Loan. Across all of our mortgage products we seek to offer competitive rates to borrowers (within the Society's risk appetite), with a range of initial fee options and incentives such as free valuations.

Service

Our products offer competitive rates, but we know that our product offering must be enhanced by our service offering. To this end, we strive to offer the very best service to all Society members both current and future. For the period to 30 September 2018, the Society's Net Promoter Score was an impressive +71 (31 March 2018: +65) and customer satisfaction was also up from 94% to 95%. This really is important to a society seeking to achieve the highest service standards possible in the most efficient way. These service standards were independently recognised in this year's Financial Adviser Service Awards in the category for mortgage lenders and packagers, where the Society received the coveted five star rating for its quality of service.

[2] UK Finance table AP1

Engagement

In my statement at full year I announced two exciting new initiatives, the Member and Employee Councils that seek to galvanise how actively our key stakeholders are engaged in our decision making. To this end, I am pleased to update that, following a significant number of applications, both councils are now appointed and will start in the second half to contribute to the decisions of both the Executive Committee and the Board. While you'll be hearing much more information about the roles of the Councils as we move forward, I wanted to take this opportunity to thank all the members and employees who applied, a testament to what an engaged, motivated and passionate member base the West Brom has.

Community

As both a regional member-owned organisation and a local employer we recognise the importance of giving back to the local community. This year the Society has partnered with Black Country Women's Aid as our charity of the year to support the much needed work they do in supporting the victims of domestic abuse, violence and exploitation. A significant number of both fundraising and volunteering events have already taken place in the first six months of the year with much more to follow.

Principal risks and uncertainties

The Society continues to recognise that effective risk management is essential to achieving the Society's objectives in an operating environment where the nature of the threats which prevail is continually evolving.

A description of the principal risks and uncertainties is provided in this report to the extent that they differ from those at 31 March 2018 as reported on pages 24 and 25 of the 2017/18 Annual Report and Accounts.

Principal risks

During the period, the Society added Model Risk to its principal risk categories, recognising the importance of models in critical decision making processes. Model Risk is defined as the risk of adverse consequences resulting from decisions based on models that are inaccurate, sub-optimal, incorrectly implemented, or misused. The Society has established its Model Risk Management Framework to describe its approach to assessing, measuring, monitoring, managing and controlling Model Risk. The Model Risk Committee, a sub-committee of the Executive Risk Committee, assists the Society in its management of Model Risk as part of a comprehensive risk governance structure.

Business conditions and the economic environment

Brexit related uncertainty has grown and the impact of this on the economy is closely monitored. Whilst the regulatory authorities have commented that the UK Banking system could support the real economy should the UK leave the EU without a transitional deal in place, the potential range of outcomes for Brexit has widened. The Society's UK focus should allow it to be protected from the potential adverse implications of a problematic Brexit, but it could be impacted by wider economic changes, affecting house prices, Bank Rate and employment. Business plans continue to model the impact of a range of scenarios and stress tests to provide comfort that the Society can tolerate the consequences. In particular, financial projections are reviewed regularly to identify mitigation actions.

Margin compression

The 2017/18 Annual Report and Accounts included details of the factors leading to margin compression as a consequence of reducing mortgage pricing for traditional borrowers and increasing saving rates following the first Bank Rate increase in 10 years. This position has further exacerbated following the subsequent Bank Rate increase seen in August as the benefits passed to our savers by the Society have not been matched by an equivalent increase in borrowers' rates. Whilst the margin for the first half of the year did show a small improvement, the current pressures may impact the Society's growth opportunities within the traditional mortgage market, as the Society will only lend at rates which enable us to achieve our risk-adjusted return on capital thresholds, which is a key measure in quantifying the best interests of our membership as a whole.

Technology investment and operational resilience

The Society is committed to a programme of strategic investment in its core technology platforms that support both mortgage origination and savings to allow greater digital capability. The programme is underway and will retain significant management involvement for the remainder of 2018/19 and through to 2021.

This investment will continue to ensure the Society's focus on operational availability and resiliency. As described in the 2017/18 Annual Report and Accounts, 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. During 2017/18, the Society invested significantly in cyber security infrastructure and training and has continued to do so in 2018/19, 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.

Strengthening risk management capabilities

Our existing capability to assess, manage and control risks continues to be illustrated by the strong progress we have made to de-risk the balance sheet along with the impressive performance of new residential lending. As indicated earlier in the Business Review, opportunities within the traditional mortgage markets may be constrained in future periods. Notwithstanding market pressures, we are continuing to build 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.

A Society positioned well for the future

Outlook

These results illustrate the continued success of our strategy; increased levels of profitability, a reduction in balance sheet risk and a modernised capital base to withstand better potential market risks, including those associated with Brexit. As we look to the future we recognise the importance of maintaining the momentum of our strategy and continuing to improve the level of returns we are able to offer members.

In order to do this we recognise the equal importance of investment in the Society's future, particularly the core systems required to deliver the digital services members expect of a modern building society and a concentrated focus on how we control our costs. Both investment and cost control will be essential to ensure the Society is well positioned moving forward.

Jonathan Westhoff
Chief Executive

Forward-looking statements

Certain statements in this half-yearly report are forward-looking. Although the West Brom believes that the expectations reflected in these forward-looking statements are reasonable, we can give no assurance that these expectations will prove to be an accurate reflection of actual results. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the West Brom. As a result, the West Brom's actual future financial condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward-looking statements. Due to such risks and uncertainties the West Brom cautions readers not to place undue reliance on such forward-looking statements.
We undertake no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Condensed consolidated half-yearly Income Statement

for the six months ended 30 September 2018

	Notes	6 months ended 30 Sep 18 unaudited £m	6 months ended 30 Sep 17* unaudited £m	Year ended 31 Mar 18* audited £m
Interest receivable and similar income		**54.3**	48.7	97.3
Interest expense and similar charges		**(25.3)**	(20.3)	(41.8)
Net interest receivable		**29.0**	28.4	55.5
Fees and commissions receivable		**1.6**	1.2	2.7
Other operating income		**2.0**	1.9	3.8
Fair value gains on financial instruments		**0.2**	2.3	2.5
Total income		**32.8**	33.8	64.5
Administrative expenses		**(21.6)**	(22.1)	(43.5)
Depreciation and amortisation	11	**(3.3)**	(3.7)	(7.2)
Operating profit before revaluation gains, impairment and provisions		**7.9**	8.0	13.8
Gains on investment properties	12	**1.8**	3.0	3.8
Impairment on loans and advances	7	**(3.7)**	(6.3)	(7.9)
Provisions for liabilities and charges	8	**-**	(0.5)	(0.9)
Profit before tax		**6.0**	4.2	8.8
Taxation		**(1.1)**	(0.8)	(0.9)
Profit for the period		**4.9**	3.4	7.9

*As explained in note 4 to the condensed consolidated half-yearly financial information, the Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The condensed consolidated Income Statement is therefore presented on an IFRS 9 basis for the six months ended 30 September 2018 and an IAS 39 basis for the six months ended 30 September 2017 and year ended 31 March 2018.

Condensed consolidated half-yearly Statement of Comprehensive Income

for the six months ended 30 September 2018

	6 months ended 30 Sep 18 unaudited £m	6 months ended 30 Sep 17* unaudited £m	Year ended 31 Mar 18* audited £m
Profit for the period	**4.9**	3.4	7.9
Other comprehensive income			
Items that may subsequently be reclassified to profit or loss			
Available for sale investments			
Valuation losses taken to equity	**-**	(0.2)	(1.1)
Fair value through other comprehensive income investments			
Valuation losses taken to equity	**(0.9)**	-	-
Cash flow hedge gains taken to equity	**-**	2.5	0.8
Taxation	**0.2**	(0.4)	0.1
Items that will not subsequently be reclassified to profit or loss			
Actuarial losses on defined benefit obligations	**-**	-	(1.6)
Taxation	**-**	-	0.4
Other comprehensive income for the period, net of tax	**(0.7)**	1.9	(1.4)
Total comprehensive income for the period	**4.2**	5.3	6.5
As a percentage of mean total assets	**%**	**%**	**%**
Profit for the period	**0.09**	0.06	0.14
Management expenses (annualised)	**0.88**	0.89	0.87

*As explained in note 4 to the condensed consolidated half-yearly financial information, the Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The condensed consolidated Statement of Comprehensive Income is therefore presented on an IFRS 9 basis for the six months ended 30 September 2018 and an IAS 39 basis for the six months ended 30 September 2017 and year ended 31 March 2018.

Condensed consolidated half-yearly Statement of Financial Position

at 30 September 2018

	Notes	30 Sep 18 unaudited £m	30 Sep 17* unaudited £m	31 Mar 18* audited £m
Assets				
Cash and balances with the Bank of England		**130.1**	212.4	324.7
Loans and advances to credit institutions		**106.0**	143.8	120.6
Investment securities		**259.4**	316.0	311.9
Derivative financial instruments		**17.9**	11.2	19.5
Loans and advances to customers	9	**4,843.6**	4,866.3	4,805.4
Deferred tax assets		**19.7**	15.0	15.3
Trade and other receivables		**3.6**	3.3	6.4
Intangible assets	11	**15.1**	13.7	15.3
Investment properties	12	**134.0**	131.6	132.2
Property, plant and equipment	11	**29.6**	31.1	30.2
Total assets		**5,559.0**	5,744.4	5,781.5
Liabilities				
Shares	10	**3,869.2**	4,160.0	4,051.4
Amounts due to credit institutions		**760.1**	683.9	571.3
Amounts due to other customers		**96.7**	189.2	133.1
Derivative financial instruments		**33.0**	53.0	38.7
Debt securities in issue	13	**369.7**	169.3	493.3
Current tax liabilities		**4.0**	-	-
Deferred tax liabilities		**4.2**	4.9	4.5
Trade and other payables		**9.7**	7.7	12.0
Provisions for liabilities and charges	8	**1.5**	2.5	2.1
Retirement benefit obligations		**4.0**	5.1	5.1
Subordinated liabilities	18	**22.8**	-	-
Total liabilities		**5,174.9**	5,275.6	5,311.5
Equity				
Profit participating deferred shares	14	**-**	173.8	175.0
Core capital deferred shares	15	**127.0**	-	-
Subscribed capital	17	**8.9**	75.0	75.0
General reserves		**244.7**	213.7	215.8
Revaluation reserve		**3.4**	3.4	3.4
Available for sale reserve		**-**	1.5	0.8
Fair value reserve		**0.1**	-	-
Cash flow hedging reserve		**-**	1.4	-
Total members' interests and equity		**384.1**	468.8	470.0
Total members' interests, equity and liabilities		**5,559.0**	5,744.4	5,781.5

*As explained in note 4 to the condensed consolidated half-yearly financial information, the Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The condensed consolidated Statement of Financial Position is therefore presented on an IFRS 9 basis at 30 September 2018 and an IAS 39 basis at 30 September 2017 and 31 March 2018.

Condensed consolidated Statement of Changes in Members' Interests and Equity

for the six months ended 30 September 2018

6 months ended 30 September 2018 (unaudited)

	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 (note 4)	-	-	-	(27.9)	-	(0.8)	0.8	**(27.9)**
Restated balance at 1 April 2018	175.0	-	75.0	187.9	3.4	-	0.8	**442.1**
Profit for the period	-	-	-	4.9	-	-	-	**4.9**
Other comprehensive income for the period (net of tax)								
Fair value through other comprehensive income investments	-	-	-	-	-	-	(0.7)	**(0.7)**
Total other comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**(0.7)**	**(0.7)**
Total comprehensive income for the period	**-**	**-**	**-**	**4.9**	**-**	**-**	**(0.7)**	**4.2**
Capital restructuring (note 5)	**(175.0)**	**127.0**	**(66.1)**	**51.9**	**-**	**-**	**-**	**(62.2)**
At 30 September 2018	**-**	**127.0**	**8.9**	**244.7**	**3.4**	**-**	**0.1**	**384.1**

6 months ended 30 September 2017 (unaudited)*

	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 period	0.8	-	2.6	-	-	-	3.4
Other comprehensive income for the period (net of tax)							
Realisation of previous revaluation gains	-	-	0.1	(0.1)	-	-	-
Available for sale investments	-	-	-	-	(0.2)	-	(0.2)
Cash flow hedge gains	-	-	-	-	-	2.1	2.1
Total other comprehensive income	-	-	0.1	(0.1)	(0.2)	2.1	1.9
Total comprehensive income for the period	0.8	-	2.7	(0.1)	(0.2)	2.1	5.3
At 30 September 2017	173.8	75.0	213.7	3.4	1.5	1.4	468.8

Condensed consolidated Statement of Changes in Members' Interests and Equity (continued)

Year ended 31 March 2018 (audited)*

	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 period	2.0	-	5.9	-	-	-	7.9
Other comprehensive income for the period (net of tax)							
Available for sale investments	-	-	-	-	(0.9)	-	(0.9)
Actuarial losses on defined 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 period	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 4 to the condensed consolidated half-yearly financial information, the Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The condensed consolidated Statement of Changes in Members' Interests and Equity is therefore presented on an IFRS 9 basis for the six months ended 30 September 2018 and an IAS 39 basis for the six months ended 30 September 2017 and the year ended 31 March 2018.

Condensed consolidated half-yearly Statement of Cash Flows

for the six months ended 30 September 2018

	6 months ended 30 Sep 18 unaudited £m	6 months ended 30 Sep 17 unaudited £m	Year ended 31 Mar 18 audited £m
Net cash outflow from operating activities (below)	**(103.2)**	(91.9)	(323.4)
Cash flows from investing activities			
Purchase of investment securities	**(62.5)**	(37.8)	(155.6)
Proceeds from disposal of investment securities	**65.3**	124.8	267.7
Proceeds from disposal of investment properties	**-**	0.3	0.5
Purchase of property, plant and equipment and intangible assets	**(2.5)**	(2.9)	(7.1)
Net cash flows from investing activities	**0.3**	84.4	105.5
Cash flows from financing activities			
Issue of debt securities	**1.0**	-	348.5
Repayment of debt securities	**(124.0)**	(86.9)	(113.4)
Capital restructuring (note 5)	**(36.2)**	-	-
Net cash flows from financing activities	**(159.2)**	(86.9)	235.1
Net (decrease)/increase in cash and cash equivalents	**(262.1)**	(94.4)	17.2
Cash and cash equivalents at beginning of period	**492.5**	475.3	475.3
Cash and cash equivalents at end of period	**230.4**	380.9	492.5

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

	30 Sep 18 unaudited £m	30 Sep 17 unaudited £m	31 Mar 18 audited £m
Cash and cash equivalents			
Cash in hand (including Bank of England Reserve account)	**119.4**	205.4	318.1
Loans and advances to credit institutions	**106.0**	143.8	120.6
Investment securities	**5.0**	31.7	53.8
	230.4	380.9	492.5

The Group is required to maintain certain mandatory balances with the Bank of England which, at 30 September 2018, amounted to £10.7m (30 September 2017: £7.0m and 31 March 2018: £6.6m). The movement in these balances is included within cash flows from operating activities.

Condensed consolidated half-yearly Statement of Cash Flows (continued)

for the six months ended 30 September 2018

	6 months ended 30 Sep 18 unaudited £m	6 months ended 30 Sep 17* unaudited £m	Year ended 31 Mar 18* audited £m
Cash flows from operating activities			
Profit before tax	**6.0**	4.2	8.8
Adjustments for non-cash items included in profit before tax			
Impairment on loans and advances	**3.7**	6.3	7.9
Depreciation and amortisation	**3.3**	3.7	7.2
Revaluation of investment properties	**(1.8)**	(3.0)	(3.8)
Provisions for liabilities and charges	**(0.6)**	(0.6)	(1.0)
Interest on subordinated liabilities	**1.2**	-	-
Fair value losses on equity release portfolio	**0.9**	-	-
Other non-cash movements	**1.3**	8.0	24.1
	14.0	18.6	43.2
Changes in operating assets and liabilities			
Loans and advances to customers	**(79.0)**	(111.2)	(69.5)
Loans and advances to credit institutions	**(4.1)**	0.2	0.6
Derivative financial instruments	**(4.1)**	(20.9)	(43.5)
Shares	**(182.1)**	(264.8)	(373.2)
Deposits and other borrowings	**153.0**	290.1	123.1
Trade and other receivables	**2.5**	0.2	(2.9)
Trade and other payables	**(2.3)**	(2.7)	1.7
Retirement benefit obligations	**(1.1)**	(1.4)	(3.0)
Tax received	**-**	-	0.1
Net cash outflow from operating activities	**(103.2)**	(91.9)	(323.4)

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

Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2018

1. General information

These half-yearly financial results do not constitute statutory accounts as defined in section 81A of the Building Societies Act 1986. A copy of the statutory accounts for the year to 31 March 2018 has been delivered to the Financial Conduct Authority and the relevant information in this report has been extracted from these statutory accounts. These accounts have been reported on by the Group's auditor and the report of the auditor was (i) unqualified, and (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report.

The consolidated half-yearly financial information for the six months to 30 September 2018 and 30 September 2017 is unaudited and has not been reviewed by the Group's auditor.

2. Basis of preparation

This condensed consolidated half-yearly financial report for the six months ended 30 September 2018 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with IAS 34, 'Interim Financial Reporting' as adopted by the European Union. The half-yearly condensed consolidated financial report should be read in conjunction with the Annual Report and Accounts for the year ended 31 March 2018, which have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

3. Going concern and business viability statement

Details of the Group's objectives, policies and processes for managing its exposure to risk are contained in the Risk Management Report of the 2017/18 Annual Report and Accounts. The Directors also include statements in the Directors' Report in respect of going concern and longer-term business viability on page 30 of the 2017/18 Annual Report and Accounts.

The Directors have reviewed the latest plans and forecasts for the Group giving consideration to liquidity and capital adequacy. They are satisfied that the Group has adequate resources to meet both the normal demands of the business and the requirements which might arise in stressed circumstances for the foreseeable future and that the longer-term business viability statement in the 2017/18 Annual Report and Accounts remains appropriate. Accordingly they continue to adopt the going concern basis in preparing these half-yearly financial results.

4. Accounting policies

The accounting policies adopted by the Group in the preparation of its 2018 Interim Financial Report are consistent with those disclosed in the Annual Report and Accounts for the year ended 31 March 2018 with the exception of the adoption of IFRS 15 'Revenue from Contracts with Customers' and IFRS 9 'Financial Instruments', the impacts of which are set out below.

IFRS 15 'Revenue from Contracts with Customers'

IFRS 15 'Revenue from Contracts with Customers' has been adopted by the Group with effect from 1 April 2018. The standard specifies how and when an entity should recognise revenue providing a simple, principles based five-step model applicable to all contracts with customers. The majority of the Group's revenue is in the form of net interest income from financial instruments which falls outside the scope of IFRS 15. The Group has assessed, and continues to monitor, all revenue generating activities in the scope of IFRS 15 and has concluded that no changes in revenue recognition practices arise as a result of adopting the new standard.

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'.

The first audited financial statements prepared on an IFRS 9 basis will be published in the Annual Report and Accounts for the year ended 31 March 2019. As permitted by the new standard, comparative figures will not be 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.

b) Changes to accounting policies
Where the Group's accounting policies have changed as a result of IFRS 9 implementation, the details are set out below.

(i) Classification and measurement

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.

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 Group's 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.

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, 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 Society's 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. The book is therefore measured at FVTPL.

The fair values of derivatives are based on level 2 valuation techniques, as described in the Annual Report and Accounts for the year ended 31 March 2018. 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. The Group's hedge accounting policies have not changed in the period, remaining as described in the Group Annual Report and Accounts for the year ended 31 March 2018. 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 has not designated any financial assets as FVTPL on transition to IFRS 9 or subsequently.

Financial liabilities
In accordance with IFRS 9, all of the Group's financial liabilities are classified and 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.

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. The Group's hedge accounting policies have not changed in the period, remaining as described in the Group Annual Report and Accounts for the year ended 31 March 2018. Interest arising on derivative financial instruments is recognised within net interest on an accruals basis.

The fair values of derivative liabilities are categorised as level 2, in accordance with the three tier valuation hierarchy defined by IFRS 13 'Fair Value Measurement' and Amendments to IFRS 7 'Financial Instruments: Disclosures' and described in the Group Annual Report and Accounts for the year ended 31 March 2018.

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 has not designated any financial liabilities as FVTPL on transition to IFRS 9 or subsequently.

(ii) 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 as 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 other liabilities and charges.

For each of the Group'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. The calculations involve a number of assumptions over a period no longer than the maximum contractual period that the Group is exposed to credit risk.

In accordance with IFRS 9, forecasts of future economic conditions are integral to the ECL calculations for each portfolio. The Group currently models three forward-looking macroeconomic scenarios: a central forecast with economic assumptions aligned to the Society's Medium Term Plan (and therefore assigned the highest probability), an upside scenario and a downside forecast.

ECL calculation – core residential mortgages

For the core residential mortgage books, the impairment models employ 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) and internal credit risk rating grade. Residual origination PD curves and (relative and absolute) threshold levels were established via an iterative process involving statistical analysis of the Group's default data. In addition, a range of internally monitored potential impairment indicators have been selected as qualitative criteria for classifying an individual loan as stage 2. Examples of qualitative indicators include cancelled direct debit instructions and evidence of impaired credit history obtained from external agencies.

Residential loans are considered to be in default or credit-impaired if they are in arrears by three or more months or in bankruptcy, litigation, possession or LPA receivership.

Within the core residential models ECL is calculated by multiplying forward-looking probability of default (PD), exposure at default (EAD) and loss given default (LGD). The models output 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.

Macroeconomic variable inputs to the model are reviewed quarterly and include house price index (HPI), interest rates, unemployment, household income 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 30 September 2018 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 and downside 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 with the borrower. 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 and downside macroeconomic scenarios has the effect of stressing the key model assumptions to create 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 or if 90 days past due. 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 upside and downside macroeconomic scenarios translate 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 30 September 2018 were negligible.

(iii) 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.

c) Impact of IFRS 9 adoption on equity and regulatory capital

Equity

The table below summarises the impact on Group equity as a result of IFRS 9 adoption.

Impact of IFRS 9 adoption on equity

	Notes	Increase/(Decrease) in general reserves 1 Apr 18 unaudited £m
Impairment losses on residential mortgage loans		(1.6)
Impairment losses on non-securitised commercial mortgage loans	(i)	(31.4)
Reclassification of financial instruments designated at FVTPL under IAS 39		(0.1)
Reclassification of equity release portfolio	(ii)	(0.5)
Deferred tax		5.7
Total	(iii)	**(27.9)**

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 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 this reduction to reserves, as reported in the Group 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.

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 0.04% reduction to the Common Equity Tier 1 ratio.

d) Changes to classification and measurement of financial instruments

The table below shows the changes to the measurement categories and carrying amounts of the Group's financial assets and liabilities on initial adoption of IFRS 9.

Changes to classification and measurement of financial instruments

	Notes	Measurement category IAS 39	Measurement category IFRS 9	Carrying amount IAS 39 31 Mar 18 audited £m	Carrying amount IFRS 9 1 Apr 18 unaudited £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**

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 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.

e) Reconciliation of financial instrument balances from an IAS 39 to IFRS 9 basis

The table below reconciles the carrying values of financial assets and liabilities, as reported under IAS 39, to those applicable on initial adoption of IFRS 9.

Reconciliation of financial instrument balances from an IAS 39 to IFRS 9 basis

	Carrying amount IAS 39 31 Mar 18 audited £m	Reclassification unaudited £m	Remeasurement unaudited £m	Carrying amount IFRS 9 1 Apr 18 unaudited £m
Financial assets				
Amortised cost				
Cash and balances with the Bank of England	324.7	-	-	324.7
Loans and advances to credit institutions	120.6	-	-	120.6
Loans and advances to customers				
Loans fully secured on residential property (excluding equity release portfolio)	4,361.1	-	(1.6)	4,359.5
Equity release portfolio	18.9	(18.9)	-	-
Loans fully secured on land	417.0	8.4	(32.2)	393.2
Total amortised cost	5,242.3	(10.5)	(33.8)	5,198.0
Available for sale				
Investment securities	311.9	(311.9)	-	-
Total available for sale	311.9	(311.9)	-	-
FVOCI				
Investment securities	-	311.9	-	311.9
Total FVOCI	-	311.9	-	311.9
FVTPL				
Derivative financial instruments	19.5	-	-	19.5
Loans and advances to customers				
Equity release portfolio	-	18.9	(0.5)	18.4
Loans fully secured on land	8.4	(8.4)	-	-
Total FVTPL	27.9	10.5	(0.5)	37.9
Total financial assets	**5,582.1**	**-**	**(34.3)**	**5,547.8**
Financial liabilities				
Amortised cost				
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
Debt securities in issue	480.8	12.5	(0.7)	492.6
Total amortised cost	5,236.6	12.5	(0.7)	5,248.4
FVTPL				
Derivative financial instruments	38.7	-	-	38.7
Debt securities in issue	12.5	(12.5)	-	-
Total FVTPL	51.2	(12.5)	-	38.7
Total financial liabilities	**5,287.8**	**-**	**(0.7)**	**5,287.1**

f) 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.

Reconciliation of impairment provisions from an IAS 39 to IFRS 9 basis

	Notes	Loans fully secured on residential property £m	Loans fully secured on land £m	Total £m
Impairment provision (unaudited)				
At 31 March 2018 (IAS 39 basis)		13.2	42.1	55.3
Reclassification	(i)	(7.0)	-	(7.0)
IAS 39 collective provisions	(ii)	(2.5)	(11.4)	(13.9)
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
Changes to calculation methodology for assets individually impaired under IAS 39	(v)	(1.0)	22.4	21.4
Post model adjustments	(vi)	1.4	-	1.4
At 1 April 2018 (IFRS 9 basis)		**7.8**	**74.4**	**82.2**

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 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 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.

(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 is 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.

g) Analysis of loans and advances to customers and impairment provisions by IFRS 9 stage

The table below illustrates the staging distribution of loans and advances to customers held at amortised cost and related provisions on initial adoption of IFRS 9. 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 section (b)(ii).

Analysis of loans and advances to customers and impairment provisions by IFRS 9 stage

		Stage 2			
	Stage 1	Other SICR indicators	> 30 days past due	Stage 3	Total
	£m	£m	£m	£m	£m
At 1 April 2018 (unaudited)					
Gross exposures					
Loans fully secured on residential property	3,914.9	362.6	16.9	72.9	4,367.3
Loans fully secured on land	56.2	118.0	-	293.4	467.6
Total	**3,971.1**	**480.6**	**16.9**	**366.3**	**4,834.9**
Provisions					
Loans fully secured on residential property	0.6	2.3	0.2	4.7	7.8
Loans fully secured on land	0.1	11.8	-	62.5	74.4
Total	**0.7**	**14.1**	**0.2**	**67.2**	**82.2**
Provision coverage	%	%	%	%	%
Loans fully secured on residential property	0.02	0.63	1.18	6.45	0.18
Loans fully secured on land	0.18	10.00	-	21.30	15.91

h) Critical accounting estimates and judgements in applying accounting policies

In the process of implementing IFRS 9, the Group made various judgements, estimates and assumptions which affected the amounts recognised in the financial statements. Sources of estimation uncertainty arising on IFRS 9 adoption are described in section (ii) below.

(i) Significant judgements in applying IFRS 9 accounting policies

Classification and measurement
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 in section (b)(ii). Model monitoring and model validation procedures will be used to continually evaluate the appropriateness of the staging criteria and macroeconomic variable inputs.

(ii) 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.

As described in section (b), the Group's impairment models incorporate three macroeconomic forecasts (central, upside and downside), each comprising a number of economic variables considered to be credit risk drivers.

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 30 September 2018 and the associated probability weightings.

IFRS 9 economic scenarios

		Scenario	
	Central	**Upside**	**Downside**
	%	**%**	**%**
Scenario probability weighting	**60**	**10**	**30**
Economic variables (5 year average)			
HPI growth	2.6	4.8	0.2
Unemployment rate	4.1	3.9	4.8
Household income growth	3.3	3.6	2.8
GDP growth	1.7	2.1	1.3
Bank Rate	1.0	2.0	0.5

A key assumption for the residential portfolios is the probability weighting of the macroeconomic forecasts which each incorporate a different outlook for the economic variables shown in the table above. The sensitivity of the residential provision calculations to the scenario probability weightings is as follows:

Residential mortgages

	30 Sep 18 unaudited £m
Probability-weighted ECL	6.3
Increase/(Decrease) to ECL on 100% weighting of scenario:	
Central	(0.8)
Upside	(2.0)
Downside	2.7

Impairment on loans and advances - commercial mortgages
Consistent with residential mortgages, the IFRS 9 ECL calculation for the commercial portfolio incorporates central, upside and downside economic scenarios with probability weightings of 60%, 10% and 30% 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 1.5% in the downside scenario 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 30 Sep 18 unaudited £m**
Central scenario weighting	Increase weighting from 60% to 100%	(13.6)
Exit yield requirement	Increase of 0.5% across all scenarios	5.3

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 losses 30 Sep 18 unaudited £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	0.3

Taxation
HMRC legislation states that tax on the IFRS 9 transitional impact is realised over the 10 years following adoption of the accounting standard. Deferred tax on IFRS 9 adoption has been recognised at rates substantively enacted at the reporting date and expected to apply when the deferred tax assets are realised. For this purpose, deferred tax on IFRS 9 transition has been recognised at 17%, rather than the current UK standard rate of 19% charged on the statutory profit before tax in the period.

A full review of the tax position of the Society and its subsidiaries will be carried out at the year-end date.

5. Liability Management Exercise

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 exchanged/tendered PIBS, consideration paid and 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, and subsequently measured at amortised cost using the effective interest method.

The impact of the LME on Group equity is disclosed as 'capital restructuring' in the condensed consolidated Statement of Changes in Members' Interests and Equity. The transaction had the effect of reducing overall equity by £62m and increasing members' general reserves by £52m. These figures are quoted net of tax. Tax has been recognised based on the Group's best estimate of the LME's tax effect which is yet to be confirmed.

For the purposes of the condensed consolidated half-yearly Statement of Cash Flows, the cash elements of the LME are disclosed as 'capital restructuring' within cash flows from financing activities.

The impact of the LME on regulatory capital was to increase Common Equity Tier 1 capital by £3.9m; which is equivalent to a 0.16% increase to the Common Equity Tier 1 ratio.

6. Business segments

Operating segments are reported in accordance with the internal reporting provided to the Group Board (the chief operating decision maker), which is responsible for allocating resources to the reportable segments and assessing their performance.

The Group has three main business segments:

- Retail - incorporating residential lending, savings, investments and protection;
- Commercial - primarily representing loans for commercial property investment; and
- Property - a portfolio of residential properties for rent.

Central Group operations have been included in Retail and comprise risk management, finance, treasury services, human resources and computer services, none of which constitute a separately reportable segment.

There were no changes to reportable segments during the period.

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.

6 months ended 30 September 2018 (unaudited)

	Retail £m	Commercial £m	Property £m	Consolidation adjustments £m	Total Group £m
Interest receivable and similar income	54.2	8.4	-	(8.3)	**54.3**
Interest expense and similar charges	(24.7)	(7.4)	(1.5)	8.3	**(25.3)**
Net interest receivable/(expense)	**29.5**	**1.0**	**(1.5)**	**-**	**29.0**
Fees and commissions receivable	1.6	-	-	-	**1.6**
Other operating (expense)/income	(0.1)	-	2.1	-	**2.0**
Fair value (losses)/gains on financial instruments	(0.6)	0.8	-	-	**0.2**
Total income	**30.4**	**1.8**	**0.6**	**-**	**32.8**
Administrative expenses	(20.9)	(0.6)	(0.1)	-	**(21.6)**
Depreciation and amortisation	(3.3)	-	-	-	**(3.3)**
Operating profit before revaluation gains, impairment and provisions	**6.2**	**1.2**	**0.5**	**-**	**7.9**
Gains on investment properties	-	-	1.8	-	**1.8**
Impairment on loans and advances	(0.3)	(3.4)	-	-	**(3.7)**
Profit/(Loss) before tax	**5.9**	**(2.2)**	**2.3**	**-**	**6.0**
Total assets	**5,525.2**	**399.6**	**136.5**	**(502.3)**	**5,559.0**
Total liabilities	**5,133.7**	**490.7**	**123.2**	**(572.7)**	**5,174.9**
Capital expenditure	**2.5**	**-**	**-**	**-**	**2.5**

6. Business segments (continued)

6 months ended 30 September 2017 (unaudited)	Retail £m	Commercial £m	Property £m	Consolidation adjustments £m	Total Group £m
Interest receivable and similar income	50.6	5.3	-	(7.2)	48.7
Interest expense and similar charges	(19.7)	(6.3)	(1.5)	7.2	(20.3)
Net interest receivable/(expense)	30.9	(1.0)	(1.5)	-	28.4
Fees and commissions receivable	1.2	-	-	-	1.2
Other operating (expense)/income	(0.1)	-	2.0	-	1.9
Fair value (losses)/gains on financial instruments	(0.4)	2.7	-	-	2.3
Total income	31.6	1.7	0.5	-	33.8
Administrative expenses	(21.3)	(0.7)	(0.1)	-	(22.1)
Depreciation and amortisation	(3.7)	-	-	-	(3.7)
Operating profit before revaluation gains, impairment and provisions	6.6	1.0	0.4	-	8.0
Gains on investment properties	-	-	3.0	-	3.0
Impairment on loans and advances	(0.7)	(5.6)	-	-	(6.3)
Provisions for liabilities and charges	(0.5)	-	-	-	(0.5)
Profit/(Loss) before tax	5.4	(4.6)	3.4	-	4.2
Total assets	5,677.3	491.9	134.2	(559.0)	5,744.4
Total liabilities	5,217.4	544.6	124.4	(610.8)	5,275.6
Capital expenditure	3.1	-	-	-	3.1

6. Business segments (continued)

Year ended 31 March 2018 (audited)	Retail £m	Commercial £m	Property £m	Consolidation adjustments £m	Total Group £m
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 and charges	(0.9)	-	-	-	(0.9)
Profit/(Loss) before tax	8.8	(4.8)	4.8	-	8.8
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

7. Allowance for losses on loans and advances to customers

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 30 September 2017 and 31 March 2018 and under IFRS 9 at 30 September 2018.

	6 months ended 30 Sep 18 unaudited £m	6 months ended 30 Sep 17 unaudited £m	Year ended 31 Mar 18 audited £m
Impairment charge for the period	**3.7**	6.3	7.9
Impairment provision at end of period			
Loans fully secured on residential property	**6.3**	16.4	13.2
Loans fully secured on land	**77.4**	50.6	42.1
Total	**83.7**	67.0	55.3

7. Allowance for losses on loans and advances to customers (continued)

The table below analyses the movement in IFRS 9 impairment provisions for the six months to 30 September 2018 by IFRS 9 stage.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
IFRS 9 impairment provisions (unaudited)				
At 1 April 2018	0.7	14.3	67.2	82.2
Amounts written off net of recoveries	-	-	(2.7)	(2.7)
Charge for the period comprising:				
Decreases due to derecognition	-	-	(0.3)	(0.3)
Changes in credit risk (including stage transfers)	-	(0.9)	5.8	4.9
Change in carrying value of debt securities in issue	-	-	(0.5)	(0.5)
Recoveries of amounts previously written off	-	-	(0.4)	(0.4)
(Credit)/Charge for the period	**-**	**(0.9)**	**4.6**	**3.7**
Non-recourse finance on securitised advances	-	-	0.5	0.5
At 30 September 2018	**0.7**	**13.4**	**69.6**	**83.7**

8. Provisions for liabilities and charges

6 months ended 30 September 2018 (unaudited)

	FSCS £m	Other £m	Total £m
At beginning of period	0.2	1.9	**2.1**
Utilised in the period	(0.2)	(0.4)	**(0.6)**
Charge for the period	-	-	**-**
At end of period	**-**	**1.5**	**1.5**

6 months ended 30 September 2017 (unaudited)

	FSCS £m	Other £m	Total £m
At beginning of period	0.8	2.3	3.1
Utilised in the period	(0.9)	(0.2)	(1.1)
Charge for the period	0.5	-	0.5
At end of period	0.4	2.1	2.5

Year ended 31 March 2018 (audited)

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

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 period.
Since the end of the reporting period, the FSCS has communicated its intention to raise a supplementary levy for 2018/19 following a large credit union failure. The Society's estimated share of this levy is not material.

Other provisions

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

9. Loans and advances to customers

	30 Sep 18 unaudited £m	30 Sep 17 unaudited £m	31 Mar 18 audited £m
Amortised cost			
Loans fully secured on residential property	**4,476.4**	4,410.8	4,403.9
Loans fully secured on land	**417.5**	474.3	428.3
	4,893.9	4,885.1	4,832.2
Fair value through profit or loss			
Loans fully secured on residential property	**16.4**	-	-
Loans fully secured on land	**-**	12.2	8.5
	4,910.3	4,897.3	4,840.7
Fair value adjustment for hedged risk	**17.0**	36.0	20.0
Less: impairment provisions	**(83.7)**	(67.0)	(55.3)
	4,843.6	4,866.3	4,805.4

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 30 September 2018 and an IAS 39 basis at 30 September 2017 and 31 March 2018.

Included within loans and advances to customers are £464.4m (31 March 2018: £488.0m) of commercial lending balances of which £40.5m (31 March 2018: £53.2m) have been sold by the Group to bankruptcy remote structured entities. A further £971.7m (31 March 2018: £1,172.1m) of residential mortgage balances, included with 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) of which £650.5m (31 March 2018: £717.5m) are held by the Society.

10. Shares

	30 Sep 18 unaudited £m	30 Sep 17 unaudited £m	31 Mar 18 audited £m
Held by individuals	**3,867.9**	4,158.3	4,050.0
Other shares	**1.1**	1.1	1.1
Fair value adjustment for hedged risk	**0.2**	0.6	0.3
	3,869.2	4,160.0	4,051.4

11. Property, plant, equipment and intangible assets

6 months ended 30 September 2018 (unaudited)		
	Intangible assets £m	**Tangible assets £m**
Net book value at 1 April 2018	**15.3**	**30.2**
Additions	**1.4**	**1.1**
Depreciation, amortisation, impairment and other movements	**(1.6)**	**(1.7)**
Net book value at 30 September 2018	**15.1**	**29.6**

6 months ended 30 September 2017 (unaudited)		
	Intangible assets £m	Tangible assets £m
Net book value at 1 April 2017	13.3	32.1
Additions	1.8	1.3
Depreciation, amortisation, impairment and other movements	(1.4)	(2.3)
Net book value at 30 September 2017	13.7	31.1

Year ended 31 March 2018 (audited)		
	Intangible assets £m	Tangible assets £m
Net book value at 1 April 2017	13.3	32.1
Additions	6.3	1.0
Depreciation, amortisation, impairment and other movements	(4.3)	(2.9)
Net book value at 31 March 2018	15.3	30.2

Capital commitments

The Group has placed contracts amounting to a total of £nil (31 March 2018: £nil) for future expenditure that was not provided in the financial statements.

12. Investment properties

	6 months ended 30 Sep 18 unaudited £m	6 months ended 30 Sep 17 unaudited £m	Year ended 31 Mar 18 audited £m
Valuation			
At beginning of period	**132.2**	128.9	128.9
Disposals	**-**	(0.3)	(0.5)
Revaluation gains	**1.8**	3.0	3.8
At end of period	**134.0**	131.6	132.2

13. Debt securities in issue

	30 Sep 18 unaudited £m	30 Sep 17 unaudited £m	31 Mar 18 audited £m
Certificates of deposit	1.0	-	-
Non-recourse finance on securitised advances	368.7	169.3	493.3
	369.7	169.3	493.3

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. Prior to redemption of the Notes on the final interest payment date, the Notes will be subject to mandatory and/or optional redemption, in certain circumstances, on each interest payment date.

14. Profit participating deferred shares

	30 Sep 18 unaudited £m	30 Sep 17 unaudited £m	31 Mar 18 audited £m
Book value			
Nominal value	-	182.5	182.5
Cumulative fair value adjustments at date of transition	-	3.8	3.8
Capitalised issue costs	-	(2.2)	(2.2)
	-	184.1	184.1
Cumulative reserve deficit	-	(10.3)	(9.1)
Net value at end of period	-	173.8	175.0

The profit participating deferred shares (PPDS) were exchanged and subsequently cancelled as part of the Liability Management Exercise described in note 5. 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.

15. Core capital deferred shares

	Number of shares	CCDS nominal amount unaudited £m	Share premium unaudited £m	Total unaudited £m
At 1 April 2018	-	-	-	-
Issuance	1,288,813	1.3	127.6	128.9
Issue costs	-	-	(1.9)	(1.9)
At 30 September 2018	**1,288,813**	**1.3**	**125.7**	**127.0**

In April 2018, the Society issued 1,288,813 core capital deferred shares (CCDS).

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 period to 30 September 2018.

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.

16. Related party transactions

Related party transactions for the six months to 30 September 2018 are within the normal course of business and of a similar nature to those for the last financial year, full details of which are disclosed in the Annual Report and Accounts for the year ended 31 March 2018.

17. Subscribed capital

	30 Sep 18 unaudited £m	30 Sep 17 unaudited £m	31 Mar 18 audited £m
Permanent interest bearing shares	**8.9**	75.0	75.0

In a winding up or dissolution of the Society the claims of the holders of permanent interest bearing shares (PIBS) would rank behind all other creditors of the Society, with the exception of holders of 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.

18. Subordinated liabilities

	30 Sep 18 unaudited £m	30 Sep 17 unaudited £m	31 Mar 18 audited £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 5. The Society's subordinated notes rank behind all other creditors of the Society, with the exception of holders of CCDS and PIBS.

19. Financial instruments

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.

19. Financial instruments (continued)

Financial assets and financial liabilities held at amortised cost

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

6 months ended 30 September 2018 (unaudited)

	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	**130.1**	130.1	-	-	**130.1**
Loans and advances to credit institutions	**106.0**	-	106.0	-	**106.0**
Loans and advances to customers	**4,827.2**	-	-	4,837.7	**4,837.7**
	5,063.3	**130.1**	**106.0**	**4,837.7**	**5,073.8**
Financial liabilities					
Shares	**3,869.2**	-	-	3,849.4	**3,849.4**
Amounts due to credit institutions	**760.1**	-	760.1	-	**760.1**
Amounts due to other customers	**96.7**	-	96.7	-	**96.7**
Debt securities in issue	**369.7**	347.2	16.0	-	**363.2**
	5,095.7	**347.2**	**872.8**	**3,849.4**	**5,069.4**

6 months ended 30 September 2017 (unaudited)

	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	212.4	212.4	-	-	212.4
Loans and advances to credit institutions	143.8	-	143.8	-	143.8
Loans and advances to customers	4,854.1	-	-	4,940.1	4,940.1
	5,210.3	212.4	143.8	4,940.1	5,296.3
Financial liabilities					
Shares	4,160.0	-	-	4,140.0	4,140.0
Amounts due to credit institutions	683.9	-	683.9	-	683.9
Amounts due to other customers	189.2	-	189.2	-	189.2
Debt securities in issue	152.7	143.5	7.2	-	150.7
	5,185.8	143.5	880.3	4,140.0	5,163.8

19. Financial instruments (continued)

Year ended 31 March 2018 (audited)

	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

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 30 September 2018 and on an IAS 39 basis at 30 September 2017 and 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 30 September 2018.

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 30 September 2018.

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 financial assets and liabilities held at fair value in the Statement of Financial Position, analysed according to the fair value hierarchy described previously.

6 months ended 30 September 2018 (unaudited)

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Investment securities	259.4	-	-	**259.4**
Derivative financial instruments	-	17.9	-	**17.9**
Loans and advances to customers	-	-	16.4	**16.4**
	259.4	**17.9**	**16.4**	**293.7**
Financial liabilities				
Derivative financial instruments	**-**	**33.0**	**-**	**33.0**

19. Financial instruments (continued)

6 months ended 30 September 2017 (unaudited)	Level 1 £m	Level 2 £m	Total £m
Financial assets			
Investment securities	316.0	-	316.0
Derivative financial instruments	-	11.2	11.2
Loans and advances to customers	-	12.2	12.2
	316.0	23.4	339.4
Financial liabilities			
Derivative financial instruments	-	53.0	53.0
Debt securities in issue	-	16.6	16.6
	-	69.6	69.6

Year ended 31 March 2018 (audited)	Level 1 £m	Level 2 £m	Total £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

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 30 September 2018 and on an IAS 39 basis at 30 September 2017 and 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 4.

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

	Equity release portfolio £m
At 1 April 2018 (unaudited)	**18.4**
Items recognised in the Income Statement	
Interest receivable and similar income	**0.5**
Fair value losses on financial instruments	**(0.9)**
Redemption payments	**(1.6)**
At 30 September 2018 (unaudited)	**16.4**

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

20. Post balance sheet event (non-adjusting)

On 26 October 2018, the High Court ruled that defined benefit pension schemes must equalise for the effect of Guaranteed Minimum Pensions (GMPs) providing different benefits for men and women. The Society is liaising with its scheme actuary to quantify the impact of this decision on its Staff Retirement Scheme. There are a number of matters to clarify to quantify the impact of this ruling. Based on the information currently available the estimated present value of the Society's defined benefit obligation could increase by up to £2m.

As the change in defined benefit liability arises as a result of a plan amendment occurring after the reporting date, it represents a non-adjusting post balance sheet event. In accordance with IAS 19, 'Employee Benefits', the increase in obligation is expected to be recognised as a past service cost (within administrative expenses) in the second half of the financial year ended 31 March 2019.

21. Statement of Directors' responsibilities

The Directors confirm that this condensed set of financial statements has been prepared in accordance with IAS 34 'Interim Financial Reporting' as adopted by the European Union, and that the interim management report herein includes a fair review of the information required by DTR 4.2.7R and DTR 4.2.8R.

The Directors of West Bromwich Building Society are listed in the West Bromwich Building Society Annual Report for the year ended 31 March 2018.

Signed on behalf of the Board of Directors:

Jonathan Westhoff
Chief Executive

Ashraf Piranie
Group Finance & Operations Director

6 December 2018

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the West Brom

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