Annual Report & Accounts

2019

SKIPTON
BUILDING SOCIETY
Since 1853

Contents

1 Performance and Strategy

2019 Group Highlights

Key performance highlights

1,046,294
Society Membership
Society membership increased by 35,868 (3.5%) to 1,046,294 (2018: by 91,366 (9.9%) to 1,010,426)

£17.4bn
Savings Balances
Savings balances grew by £1.2bn to £17.4bn, an annual growth rate of 7.6% (2018: 7.7%)

86%
Customer Satisfaction
Society net customer satisfaction was 86% (2018: 94%)

(For details of the new approach taken to measuring this score in 2019 please see page 23)

89%
Employee Engagement
Society employee engagement was 89% (2018: 89%)

£153.2m
Group Profit
Total Group profit before tax (PBT) was £153.2m (2018: £188.7m)

£1.9bn
Mortgage Book Growth
The mortgage book grew by £1.9bn to £20.0bn, an annual growth rate of 10.3% (2018: 10.0%)

£155.2m
Underlying Group PBT
Underlying Group PBT (as defined on page 25) was £155.2m (2018: £186.6m)

39.1%
Group Common Equity Tier 1 Ratio
The Group Common Equity Tier 1 ratio remained strong at 39.1% (2018: 32.8%)

Awards won

The Sunday Times 25 Best Big Companies to Work For 2020

Financial Adviser Service Awards 2019 Five star mortgage lender

Winner of What Mortgage Awards 2019 for 'Best National Building Society'

Winner of 'Best Remortgage Provider' and Highly commended as 'Best Building Society Mortgage Provider'

> “All of the people who work for Skipton are focused on doing their very best for you and I am grateful to them for their hard work and to you for the trust that you continued to place in us during 2019.”

Chairman’s Statement

Your Society has had another year of good progress in 2019. Since 1853, our purpose has been to help more people into homes, save for their life ahead and support their long term financial well-being. We have continued to deliver on this purpose in 2019 thanks to the trust you have placed in us and the continued hard work of all those who work for the Society.

Our good progress has been achieved despite a challenging external environment which has led to reduced interest margins in the Society’s Mortgage and Savings business and subdued activity in the housing market, impacting transaction levels at our estate agency business, Connells. In my report last year, I highlighted how defining an exact vision of the future was particularly challenging in the context of the complex Brexit negotiations and global political issues and economic trends. I outlined that we were well prepared for all eventualities. This preparation paid off given the political deadlock over the Brexit negotiations during the year, which was resolved at the General Election held in December, but with uncertainty likely to remain with us in 2020 as the future trading arrangements with the EU are negotiated. Our strong capital position and diversified business enabled us to continue to deliver to our members and invest in the future.

The global economy entered a period of more subdued growth and trade tensions increased in 2019. It has not been possible for central banks to raise interest rates meaningfully above historically low levels. Latterly, we have also seen what is known as the inverted yield curve. Typically, it should cost less to borrow for the short term than it should for the long term and savings rates for the short term should be less than they are for the long term. The opposite was seen in some financial markets in 2019 as global concerns over growth and low inflation increased.

At the same time, the impact has been seen of the ring-fencing legislation, created following the global financial crisis, which required larger diversified banks to separate their core retail banking from their investment banking activities. The new ring-fenced retail banks are deploying some of their surplus liquidity into the mortgage market making it more competitive and reducing margins. Mortgage lending is the principal means by which we earn funds to pay savers and the impact of this increased competition, whilst good for mortgage customers, is another factor reducing rates paid to savers.

As a mutual owned by members, without the presence of shareholders with their greater focus on maximising profit, we can, and do, make different judgements in the way we seek to balance the interests of all of our stakeholders and how we invest for the long term. These judgements include paying savers rates above average market rates whilst ensuring we generate profits to enable future investment in our products and services. We are acutely aware of the impact that lower rates have on savings members. Since the Society was founded in 1853, it has been the responsibility of your Board to ensure that your Society remains well positioned for the future and at the same time deliver value to its current members. Just like our predecessors, your current Board takes this responsibility very seriously. We judge progress against a range of measures which are focused on our purpose outlined above.

David Cutter covers the detail of what we have delivered during 2019 in his Group Chief Executive’s Report. In summary, membership grew by 35,868 to 1,046,294, savings and mortgage balances grew faster than the market growth and, in line with our purpose, we provided 29,727 mortgages to first time buyers and those moving home or looking to remortgage, and paid savers on average rates of 0.54% above the industry average for which comparable data is available. This was coupled with continued high levels of customer satisfaction for our branch, telephony and online services, strong levels of employee engagement, as well as mutually beneficial relationships with our suppliers.

Being a building society means we do not have to pay dividends to shareholders, enabling us to invest for the long term benefit of members. In 2019, we released our mobile app which after six months was already being used by 100,000 members. We believe that the app and our continued investment in our online services, webchat, telephony and other digital technology make it easier for members to do business with us, as well as ensuring we further improve our productivity and efficiency and remain competitive in our core markets. Digital technology is changing the lives of us all, but we know that at times it is important to speak to someone or visit a branch, particularly for important life-shaping decisions. This is why we continue to invest in our telephony services and branch network and, as part of a continuing programme, we refurbished 11 branches during the year. We have also invested in new services enabled by a new IT platform for our financial advice business, a business where we aim to achieve growth in the long term. This platform will enable us to make our financial advice services available to more members as we help them save for their life ahead and support their long term financial well-being.

Your Society includes other businesses which have continued to perform well in 2019. Connells, our estate agency subsidiary, produced another good set of results despite a soft UK housing market. The reduced number of housing transactions in the market as a whole did have an impact on Connells’ underlying profits but its diversified business, which includes survey and valuation, mortgage advice, property lettings management and new homes service businesses, continued to perform well and deliver good returns. In addition, Skipton International, our business based in the Channel Islands, delivered a strong performance through its focus of providing competitive savings products, helping people to buy homes in the Channel Islands and also helping expatriates and foreign nationals to buy or remortgage residential investment property in the UK. Skipton Business Finance, our factoring and invoice discounting business, also performed well and delivered good growth in profits.

We talk much about how our purpose has not changed since 1853. This is true, but in many ways the environment in which we operate has changed beyond all recognition in the past 167 years to what our founders would have imagined. We are responding to these challenges particularly in how we support the communities in which we operate, the need for greater diversity and inclusion and in tackling climate change, which is likely to be one of the single most important factors over the next decade for individuals, businesses and governments to tackle. Climate change will require a collective will and some difficult choices which will need to be faced up to in the short term. We are responding to these issues, as you will see from the ambitious goals around eliminating single use plastic, halving our carbon footprint and reducing waste as outlined in our Sustainability Report.

Despite the progress in 2019, and investment we have made for the future, as we all know, the journey is never done. We expect the factors influencing interest margins in 2019 to continue in 2020 and, whilst we are responding to these in a number of ways, we expect to see reduced profitability. The economic environment remains uncertain and issues will emerge, but we are satisfied that the underlying strength of our businesses and our strong capital position will enable us to deal with these as they arise.

The heritage of Skipton Building Society, the fact that it has no shareholders and can invest for the long term, our values-based culture of trust, ownership and one team and the people it employs are what make it unique. This shapes how we serve you our members, the judgements we make and how you trust us to provide service to you and help you with some of the most important financial decisions you face. All of the people who work for Skipton are focused on doing their very best for you and I am grateful to them for their hard work and to you for the trust that you continued to place in us during 2019.

Robert East
Chair

25 February 2020

> "In a challenging operating environment, with intense competition and ultra-low interest rates, these results are solid and reflective of a balanced performance."

Group Chief Executive's Report

In the face of a challenging operating environment, Skipton has continued to deliver first class service and value to its members. We have continued to invest in our business for the benefit of our current and future members, we have launched an app for our customers, which saw 100,000 registrations during the year, and we have made some major changes to our financial advice offering, making it more personal, affordable and straightforward and hence accessible and relevant to more people.

Since 1853, our purpose has been to help more people into homes and save for their future. Our strong capital position and diversified business has enabled us to continue to successfully and sustainably deliver for our members today and we are well positioned to do so in the future.

The Society has delivered a solid and balanced performance in the year which has seen us increase our membership and increase our mortgage and savings balances at rates above our natural market share, despite a subdued housing market and highly competitive mortgage market.

Performance highlights in 2019 include:

- Continued membership growth, with member numbers increasing by 35,868 to 1,046,294 (31 December 2018: 1,010,426);
- Group gross mortgage lending was up 13.1% to £4.9bn (2018: £4.3bn), with mortgage balances growing by 10.3% since the end of 2018 (2018: 10.0%);
- Society savings balances grew by 7.6% (2018: 7.7%) to £17.4bn by the end of 2019;
- Group total assets increased by 9.9% during the year to £25.5bn (2018: £23.2bn);
- The Group net interest margin was 0.98% (2018: 1.09%); the expected decrease is a reflection of the previously signalled intense competition in the mortgage market;
- Total profit before tax (PBT) was £153.2m (2018 restated: £188.7m). The decrease in total Group profits was due to the reduction in underlying profits (see below) but also includes fair value losses of £3.4m (2018: fair value gains of £1.0m) relating to the Society's legacy equity release portfolio which was acquired on merger with Scarborough Building Society in 2009 and has a balance at the end of 2019 of £410.0m (2018: £410.9m). These fair value losses are driven by changes in market expectations of long term interest rates, inflation and house price growth;
- Despite the challenging environment, the Group recorded underlying profits before tax (as defined on page 25) of £155.2m (2018 restated: £186.6m). The Mortgages and Savings division reported an underlying PBT of £103.9m (2018 restated: £113.2m). Although the Group has seen a £3.1m fall in its net interest income due to the pressures outlined above, it is important that we continue to invest in our proposition and service to our members and customers – this resulted in costs in the Mortgages and Savings division increasing by £7.9m. The Group also incurred a charge of £1.8m (2018: £4.2m credit), which is held centrally, in relation to the long term management incentive scheme in place for senior managers within the Group's Estate Agency division. The Estate Agency division recorded underlying profits of £50.1m, being £9.6m below the prior year primarily due to the subdued UK property market;
- Group administrative expenses increased by £17.5m (or 3.3%) to £554.0m, with the investments referred to above made by the Mortgages and Savings division and the charge for the management incentive scheme being a key driver of this increase. Connells' administrative expenses decreased by 0.4% from £374.8m to £373.4m;
- The Group loan impairment charge on residential and commercial mortgages was £0.3m (2018: £2.3m);
- The Society's capital base remained strong with its Common Equity Tier 1 (CET 1) ratio at 31 December 2019 at 39.1% (2018: 32.8%) and the leverage ratio at 6.0% (2018: 6.1%). Following changes in the Society's IRB approach in 2019, risk weighted assets (RWAs) have decreased, resulting in the increase seen in the CET 1 ratio. The key driver for the decrease in RWAs is a refinement to the Society's IRB Loss Given Default Model, resulting in an improved estimation technique for predicting house price deflation in an economic downturn; and
- The Liquidity Coverage Ratio was 207% (2018: 203%) and the liquidity ratio (as a percentage of shares and deposit liabilities) was 19.5% (2018: 19.9%).

Unwavering focus on our members

We are continually working to ensure our customers have the best experience during any interaction with the Society. Our people are committed to putting the customer first and providing excellent service. As a result we have continued to invest in our member offering, with the mobile app launched in the year, webchat, telephony and other digital technology making it easier for our members to do business with us. We have also invested in new services enabled by a new IT platform for our financial advice business, enabling us to make financial advice services available to more members as we help them save for their life ahead and support their long term financial well-being.

For savers, the Society paid an average savings rate of 1.29% during the year (2018: 1.29%), which was on average 0.54% higher than the rest of market average for banks and building societies during 2019 (2018: 0.59% higher) (source: CACI Current Account & Savings Database Stock for the 12 months to 31 December 2019).

We have continued to refurbish our branch network to meet the changing needs of our customers and invest in developing the skills of our people so they can deliver the best possible service and value. In 2019, having changed our approach to capturing customer responses, the Society achieved a net customer satisfaction rating of 86% (2018: 94%).

Delivering through our people

A fundamental part of the Society's solid and balanced performance seen during the period, and the ongoing high satisfaction of our customers, is our people. The Society is focused on ensuring its people are highly engaged and motivated to deliver a great experience for our customers both now and in the future. In June 2019, the Society achieved an employee engagement score of 89% (2018: 89%), well above financial services industry norms.

We have been an Investors in People accredited organisation for over 25 years and in 2019 the Society retained its Investors in People Platinum standard for the second year running, the highest accolade that can be achieved against this standard.

I am proud that for the sixth year running we have been named as one of *The Sunday Times* Best Companies to Work For and were placed 8th in *The Sunday Times* 25 Best Big Companies list.

Enabling our members to achieve home ownership and save for their life ahead aspirations

In 2019 we continued to enable more people to save for their future and finance their own home. We are proud of our award-winning achievements in 2019 that demonstrate our commitment to this; we were named 'Best Remortgage Provider' and highly commended in the category of 'Best Building Society Mortgage Provider' by Moneyfacts and we were named 'Best National Building Society' by What Mortgage? for the sixth year running, an incredible achievement.

The Society helped 29,727 homeowners (2018: 26,734) to purchase or remortgage their properties, including 5,923 first time buyers (2018: 5,516) and 7,878 (2018: 7,350) buy-to-let borrowers. The Group's net residential UK mortgage lending accounted for 4.0% of the growth in the UK residential mortgage market (2018: 4.0%), compared to our 1.3% share of UK residential mortgage balances (source: Bank of England statistics, December 2019).

We have seen continued success in 2019 in attracting LISA customers to the Society, bringing the total number of LISA customers to 158,850 (2018: 129,707) and total balances to £876.5m (2018: £602.4m). Our LISA customers benefited from Government bonuses of £89.0m paid during the year. LISA fits perfectly with our purpose as a building society, helping customers aged 18 to 39 to save to own their own home or for their future needs in retirement. In order to further help first-time buyers the Society extended its participation in the shared ownership market in the year, to include 95% loan-to-value mortgages.

The growth in the Society's savings balances in the year accounted for 1.9% of the growth in the UK deposit savings market (2018: 2.5%), compared to our market share of savings balances of 1.1% (source: Bank of England statistics, December 2019).

Strong performance in the Mortgages and Savings division

The Mortgages and Savings division reported an underlying PBT of £103.9m, down from £113.2m in 2018 as the Society continued to invest in its strategic priorities and was impacted by intense competition in the mortgage market, placing increased pressures on the net interest margin. The division reported statutory PBT of £100.8m, compared to £114.8m in 2018, reflecting the reduction in underlying profits together with fair value losses of £3.4m (2018: fair value gains of £1.0m) in relation to the equity release portfolio.

As a result of the aforementioned margin pressures, when expressed as a percentage of mean assets, the Group net interest margin (which is almost entirely generated from the Mortgages and Savings division) was 0.98% (2018: 1.09%). In view of a declining net interest margin, careful management of costs is a key strategic priority, however investments continue to be made for the long term benefit of members, including developing online services, continuing to invest in branches, delivering a mobile app and a revised financial advice proposition. The cost income ratio of the division was 60.2% (2018: 56.2%), whilst the management expense ratio of the division was 0.65% (2018: 0.68%).

Further information on the performance of the Mortgages and Savings division can be found in the Strategic Report on page 29.

Good performance from estate agency in a difficult market

In a subdued UK property market, Connells, our Estate Agency division, continued to perform well, delivering reported and underlying profits before tax of £50.1m (2018: £56.9m reported; £59.7m underlying).

The volume of UK housing transactions fell again in 2019 and consequently the number of house sales (exchanges) arranged by Connells in the period fell by 7%. However, the Connells group maintained its focus on winning new instructions and produced a creditable performance during the year. The land and new homes, lettings, mortgage services, conveyancing and survey and valuations divisions within Connells all contributed well in the period, further demonstrating the benefits of Connells' diversified business model.

Further information on the performance of the Estate Agency division can be found in the Strategic Report on page 30.

Other subsidiaries

Skipton Business Finance, a provider of debt factoring and invoice discounting to small and medium-sized enterprises, recorded a PBT of £4.0m (2018: £3.8m); Jade Software Corporation, the provider of the Society's core database and software development language, and provider of digital business solutions to a number of other clients, broke even in the year (2018: £3.8m profit).

Further information on the performance of these subsidiaries can be found in the Strategic Report on page 30.

Conclusion and outlook

In a challenging operating environment, with intense competition and ultra-low interest rates, these results are solid and reflective of a balanced performance. I am proud that we have continued to increase our membership and increase our mortgage and savings balances at rates above our natural market share, whilst remaining relevant to new and existing customers and offering them great experiences with Skipton.

After stagnation and political impasses following the Brexit referendum, the UK left the EU on 31 January 2020, however negotiations over future arrangements will shortly commence and are likely to mean significant uncertainty for the foreseeable future. Whilst the economic environment remains uncertain we start in a good place to face the coming years, with high customer satisfaction levels, leading employee engagement scores and being well-capitalised.

As we continue to grow it is essential for us to become more efficient to counteract the impact of a declining net interest margin whilst remaining relevant, customer focused and people orientated. We remain passionate about the opportunity to 'Build a better Society' and I firmly believe that our long term focus of helping people to plan for their life ahead is resonating with our members.

The intense competition in the UK residential mortgage market is expected to continue. We recognise that this environment also makes it really tough for our savers and we will continue to support them as much as possible.

We anticipate the factors influencing interest margins to continue in 2020 and, whilst we are responding to these in a number of ways, we expect to see reduced profitability. The Society does however remain in a strong position, with strong capital and liquidity ratios, healthy and sustainable growth seen in mortgage and savings balances and strong underlying profitability, further strengthened by subsidiary earnings. We remain vigilant regarding potential economic headwinds and we are well placed to manage the risks that we may face and to capitalise upon any opportunities that may arise for the benefit of our members.

David Cutter
Group Chief Executive

25 February 2020

Strategic Report

Skipton Building Society is the UK's fourth largest building society, with over £25bn of assets and over one million members. As we continue to grow, we're still helping people into homes and towards their dreams of building better futures.

Our story started in 1853 and we have been helping generations for over 166 years; we're well placed to help even more in the future. We are a purpose-led organisation and as times change our purpose stays the same. We are here to help more people into homes, help people save for life ahead and support long term financial well-being.

*This in turn supports our core vision of **"Building a better Society"**, delivered through our core values of 'Trust', 'Ownership' and 'One Team'.*

The business model

As a mutual organisation, the Society is owned by its members and our mutual roots keep us grounded. They're what make us different to banks. We don't answer to shareholders and instead we're shaped by our members who vote for directors and hold the Board to account. The Society's business model centres on providing a secure place for our members' savings and the provision of loans to our borrowers to enable people to buy their own homes. We also source funding from the wholesale markets, which diversifies our funding base and improves our financial stability. In addition, we support the rented housing sector by providing buy-to-let mortgages to landlords. Our business model is strengthened by the provision of high quality financial advice, enabling us to offer guidance to our customers to support their long term financial well-being.

The difference between the interest received from our borrowers and on liquid assets and the interest payable to our savers and on wholesale funding forms our net interest income. This income, together with other income mainly from the provision of financial advice and dividends from subsidiaries, covers any impairment losses, provisions, tax expenses and operating costs including paying our people. Our mutual status means we do not pay dividends, since we do not have any external shareholders. Therefore, our remaining profits are reinvested into the Society for the long term benefit of our members; to support growth, help us to maintain a sustainable business model and preserve a strong capital position to protect members in the event of an economic downturn.

The Society's business model can be illustrated as follows:

Where the money comes from

- Members' deposits (80%)
- Wholesale markets (20%)
- Retained earnings from previous profits in the Society and dividends from our subsidiaries

What we do with it

Provide mortgages to help people into homes:
- Residential mortgages (78%)
- Buy-to-let mortgages (22%)

How we generate income

- Net interest income
  - the difference between the interest received from our borrowers and on our liquid assets, and the interest payable to our savers and on wholesale funding
- Other income
  - provision of financial advice and other financial products and services

What we incur costs on

- Paying our people
- Property and operating costs
- Mortgage and other impairment losses
- Paying taxes

What we use our profits for

- Enhancing the customer experience
- Investing in the future of the Society
- Maintaining capital strength

The Society is at the head of the Skipton Group, which comprises the following divisions:

Mortgages and Savings division

The Mortgages and Savings division is the core of the Group's business model, predominantly comprising the Society. The division also includes Skipton International Limited (SIL), which carries out mortgage lending in the Channel Islands and the UK and accepts deposits in Guernsey. Our specialist lending businesses, Amber Homeloans Limited (Amber) and North Yorkshire Mortgages Limited (NYM), which both ceased lending in 2008, are included in the division along with the Group's special purpose vehicles, formed to acquire funds from the wholesale markets, and the intermediate holding company Skipton Group Holdings Limited (SGHL).

Estate Agency division

The Society holds a significant presence in the estate agency sector through the Connells group (99.8% holding), which includes property sales, surveys and valuations, conveyancing, lettings, asset management and mortgage and insurance broking. The Society's capital position is reinforced by dividends from the Connells group, which are invested back into the Society for the benefit of our members.

Investment Portfolio

The Group holds interests in a small number of companies comprising the Investment Portfolio, including Skipton Business Finance (a provider of debt factoring and invoice discounting to small and medium-sized enterprises) and Jade Software Corporation (a software solutions provider based in New Zealand that specialises in delivering digital business solutions and assists in the development of the Society's core technology).

Promoting long term success

The Board's approach

Policies and practices

The business model set out on page 14 details how the Society generates long term value and preserves a strong capital position to protect our members. In order to achieve our purpose the Board sets defined medium term objectives built around four strategic pillars that help it focus on the right areas. The Board monitors progress against these strategic pillars using a number of key performance indicators that are reported to the Board and senior management on an ongoing basis and are key to the Board's management of the business and to its decision making process. For further details on our four strategic pillars and how we delivered against these in 2019 see pages 17 to 19.

The Board and senior management work hard to maintain a strong inclusive culture where we continue to invest in our peoples' skills, personal and career development and well-being. Our people are critical to our long term success; by maintaining a strong culture and empowering decision making at all levels of the business, we can deliver on our purpose. Respect for our environment and the communities in which we operate is also key in delivering our purpose.

Employee matters

The Society believes it is important to help safeguard the well-being of its people and has a number of policies in place to ensure that their working environment is one of respect and where they are valued. These policies include, but are not limited to, a flexible working policy, a career break policy, a carer's leave policy, a diversity policy, a family friendly policy and a health and safety policy. In 2019, the Society was accredited by the Living Wage Foundation as a Living Wage Employer. The Living Wage Foundation are an independent organisation who oversee the calculation of the living wage and also champion and celebrate organisations that go further than the government minimum in supporting their people.

Encouraging a diverse and inclusive culture is a really important part of our core values and we appreciate the value the unique differences in our people can bring. We seek to attract, develop and keep hold of talented people who, together, will help us build a stronger Society that's able to better meet our customers' needs. We want our people to feel supported when they come to work and we have recently introduced a well-being strategy that is designed to empower and inspire our people to positively influence their own well-being. In this way we are leading the way as an organisation with an innovative and holistic well-being offering focused on educating and supporting our people in their financial, mental and physical well-being.

The Society also has a modern slavery policy which fully supports the objectives of the Modern Slavery Act 2015, further details of which can be found at skipton.co.uk/about-us/governance. These policies are drafted by appropriately qualified experts and monitored on an ongoing basis to ensure they remain fit for purpose. For further details on our diversity and inclusion framework and our diversity policy, see page 22 of this report.

The Society is committed to ensuring that there are no instances of bribery or corruption across any area of our business. We have an anti-corruption and anti-bribery policy in place, drafted in line with government guidelines, which prohibits the offering, giving, solicitation or the acceptance of any bribe to or from any person or company by any individual employee, agent or other person or body acting on behalf of the Society. The policy is readily available for all employees to view on our internal intranet and we require our employees to receive annual refresher training on it.

Social matters

We are committed to encouraging and enabling our people to participate in activities, and to help them learn vital skills, to help the Society deliver benefits to the communities in which we operate and contribute to Building a better Society. In 2019 we launched an innovative 'Community Giving' campaign targeted at helping mortgage intermediaries support housing projects and initiatives to help the homeless in their local communities. 40 charities and community groups nominated by the Society's mortgage brokers each received a donation of £1,000, to support their work helping homeless people or people living in poverty.

The Society is committed to delivering fair experiences and outcomes to all our customers and taking account of individual circumstances is a key element of this. We have a vulnerable customer policy in place to ensure that we treat all our customers fairly throughout the whole customer lifecycle, regardless of their personal circumstances or characteristics. We recognise that customer vulnerability can happen at any time and in some cases cannot be predicted. It is therefore essential that we have the appropriate policies, procedures and trained people to help identify and support our customers in a sensitive and empathetic manner through any periods of vulnerability.

Our initiative to create a Society where no-one is left out started in 2017, when our charity partnership with Alzheimer's Society and Alzheimer Scotland started. Within a year of teaming up with them, we had at least one official Dementia Friend in every branch, which contributes to our ongoing efforts to provide a more inclusive environment for people living with dementia. In 2019, we raised over £70,000 for Alzheimers charities and in the Society's three year charity partnership with Alzheimer's Society and Alzheimer Scotland, which ended in 2019, we have raised a grand total of a quarter of a million pounds. In October 2019, our people voted for Mental Health UK to be our new charity partnership for 2020-2022. Looking after our mental health is something we know our people are passionate about and we look forward to working with Mental Health UK over the next three years.

The Society also has a volunteering policy in place to encourage our people to participate in volunteering activities to benefit the community. To support this, all our people receive up to three days additional leave to volunteer in their local communities.

For more information, including activities we have undertaken during the year to demonstrate our commitment to making a positive change to our society see our Sustainability Report on pages 36 to 40.

Environmental matters

We realise that as a responsible business we have an obligation to operate in a manner that minimises our impact on the environment. We're passionate about protecting our planet for future generations and aim to always have a positive impact on our environment to build a sustainable Society. Our key aim is that our contribution to the environment is always greater than the impact we have on it and mitigating our carbon footprint is something that we have been working on for a number of years. Last year we launched our sustainability strategy aligned to the United Nations Sustainable Development Goals; as part of this we have set ourselves challenging targets to address four goals where we feel we can have the greatest impact. One of these goals centres around responsible consumption and production to strengthen the global response to the threat of climate change, further details of which can be found in the Sustainability Report on pages 36 to 40. We follow all relevant environmental legislation in carrying out our business and further information on how we are performing against our commitment to environmental matters can be found on pages 39 and 40 in the Sustainability Report.

Our business relationships

Our business relationships with our key suppliers are closely monitored and we work in partnership with them to safeguard our customer service. We assess, on an ongoing basis, any risk of an adverse impact on our customers, our people and the environment in which we operate as a result of these relationships, or as a result of our policies. As part of our commitment to building strong and collaborative relationships with our suppliers we assess our performance as a customer by monitoring our better than industry average payment terms and through supplier feedback requests. We also closely monitor our suppliers' service delivery against key performance indicators to ensure the service provided is of an acceptable standard, the results of which are shared with the Board on an ongoing basis.

The Society also has regard to the above matters as part of our risk assessment processes; a full description of our principal risks and how we manage these is found in the Risk Management Report on pages 65 to 73.

Corporate governance

The Board is responsible for determining the Society's strategy for managing risk and overseeing its systems of internal control. The ongoing effectiveness of these internal controls is reviewed by the Board on a regular basis as described on page 56 of the Directors' Report on Corporate Governance.

The Society maintains a high standard of corporate governance for the benefit of its current and future members and in order to conduct its business in a prudent and well organised manner. The Board's terms of reference clearly set out its responsibility for the overall stewardship of the Group within the context of the Society's 'Principles of Governance' as set out on pages 52 to 53 of the Directors' Report on Corporate Governance.

Decision making

Achieving the right balance of risk and reward is essential to ensuring the long term sustainability of the Society and enables us to deliver on our strategic priorities. Through the Board Risk Committee approved risk management framework and governance structure, the Group has a formal mechanism for identifying and managing risks throughout the business, further details of which can be found on page 66 of the Risk Management Report.

The corporate plan is delivered in line with the risk management framework and was approved by the Board following a comprehensive review of our strategic priorities. In setting our strategic priorities we engaged with our customers to find out what is important to them and how we can best meet their needs. By listening to and understanding what is important to our customers we are able to use this knowledge and insight to inform and shape everything we do. We have continued to increase the use of digital technology to service and engage with customers, which is of particular importance to our Lifetime ISA (LISA) customers. During the year we renewed our focus to develop and enhance our technology, data and digital capabilities to improve the customer experience and support our strategic goals. Despite expected ongoing pressures on mortgage and savings margins, and the continuation of a subdued housing market, our plan includes significant investment to support and drive improvements to the customer experience. The external environment is rapidly changing and the Society continues to monitor material risks to business plans as detailed on page 65 of the Risk Management Report.

Strategy and objectives

Our strategy is to differentiate on service and provide long term value to our members through the products we offer. We want to continue to provide a great customer experience to our members and develop deep mutually beneficial relationships, delivered in an efficient manner by our people and our processes.

Our people are critical to delivering our strategy and we ensure that the Society has skilled, engaged and high performing people who deliver the human touch. We work as a team, taking ownership, trusting one another and living up to the trust our customers place in us.

We remain committed to mutuality because we believe it is in the best interests of our current and future members. This means we are not required to pay dividends to shareholders. Instead we have developed objectives to support the above strategy and to ensure we are generating sufficient profits to maintain a strong capital position. We also optimise the balance between risk and reward in order to build a sustainable future. This allows us to take long term decisions to invest in the development of the business for the benefit of our current and future members, whilst keeping our purpose at the heart of everything we do.

The Society's medium term objectives are built around the following four pillars: Our Customers, Our People, Our Proposition and Our Financial Strength.

Our Customers

Our customer strategy is to put the customer at the heart of our business, providing a compelling and differentiated proposition that resonates with our customers and makes them want to become and remain Skipton customers.

Our strategy is based upon a deep understanding of the needs of our customers gained through research, customer feedback and analysis. We use the insight this provides us to continuously refine, develop and improve the products and services we offer.

Our core savings and investment customers are those saving for a new home (including our LISA customers) or planning for their life ahead. We are focused on ensuring we have a compelling proposition to meet the needs of these customers which includes offering a broad and attractive range of savings products, together with access to financial advice to support investment and pension planning. It is never been more important for our customers to have access to financial advice and that's why in 2019 we launched a revised financial advice strategy to significantly transform and expand our offering. The more competitive proposition is now accessible to a wider range of customers and our ongoing services are tailored to individual needs.

2019 has seen continued success in attracting LISA customers to the Society, bringing the total number to 158,850 (2018: 129,707) and total balances to £876.5m (2018: £602.4m). LISA customers benefited from Government bonuses of £89.0m paid during the year. LISA fits perfectly with our purpose as a building society – helping customers aged 18 to 39 to save to own their own home or for their future needs in retirement.

We continue to offer above-market-average savings rates to our savers and by introducing tiered products across our savings range it has allowed us to offer products that meet our customers' individual savings needs.

We continue to provide good value mortgages together with excellent personal service, to both our direct mortgage customers and intermediary partners, as well as providing buy-to-let mortgages to landlords to support the rented housing sector. In 2019, we have focused on our mortgage strategy, reviewing various customer journeys to ensure we deliver the best possible experience and our internal processes are as efficient and simple as possible.

We have sought to increase the attractiveness of our mortgage offering to first time buyers by extending our participation in the shared ownership market to include 95% loan-to-value mortgages following a rigorous assessment by our Credit Risk team. We know from research that almost 90% of our LISA customers are saving with the objective of buying their first home

Our Customers *(continued)*

and we are well placed to help them on this journey through the provision of help, advice and suitable mortgage products. In 2019 we have developed a range of first time buyer mortgage products exclusively available to our LISA savers supporting the home ownership aspirations of our growing LISA customer base.

A review of performance in the year against our customer strategy is set out on pages 20 and 21.

Our People

Our people strategy is to ensure we have knowledgeable, highly skilled and engaged colleagues, who work collaboratively across channels, to deliver a great experience for our customers both now and in the future.

From small beginnings, we have grown into one of the UK's largest building societies and now, over 2,300 people work at our head office in Skipton and throughout our UK branch network. We continue to invest in our people and our culture, ensuring alignment to the delivery of our purpose and our vision of 'Building a better Society'. Our culture is defined as one that is customer-focused and based on our mutual values of One Team, Trust and Ownership. We embed these values into all aspects of people management including recruitment, induction, development, performance management and remuneration. Our people are proud to work for Skipton, we were on *The Sunday Times* 25 Best Big Companies to Work For list and we're only one of a handful of accredited organisations in the UK to achieve Investors in People platinum status.

One of the aspects setting our service apart for our members is our human touch and we ensure that a focus on members, people and relationships is at the heart of our culture. We create a learning culture and develop our people to deliver our customer propositions, building deep and lasting relationships with our customers and our people. We support our people to develop the knowledge and expertise needed to provide support and advice for our customers now and in the future. We seek to attract, develop and retain a diverse range of talented people, reflecting the communities in which we operate.

We develop leadership capability, to allow current and future leaders to grow and adapt their leadership skills and create the right culture for now and the future. We offer a number of leadership programmes to give our people the tools they need to deliver our strategy and lead change effectively across the business. We invest in developing the skills needed in the future in a variety of ways such as apprenticeships, career development programmes and succession planning.

Our reward strategy is an important part of retaining the right skills and experience and reinforcing our culture. Ensuring we always deliver a fair outcome for our customers will remain at the forefront of our minds and so we ensure that any remuneration package relating to performance encourages the right behaviours and customer outcomes. We are committed to ensuring our rewards are future focused and relevant to all demographics and life stages of our people.

We seek to design an organisation that is fit for the future. This includes developing the roles, skills and organisational flexibility for a changing world, ensuring that our work is rewarding for our people and creating a great experience for our customers. We have a keen eye on the capabilities we require to continue to deliver for our customers.

A review of performance in the year against our people strategy is set out on pages 21 and 22.

Our Proposition

Our proposition seeks to provide good value products and consistently excellent service to our customers however they choose to interact with us.

Our savings, mortgage and financial advice propositions are all based on continually striving to understand what is important to our customers, listening to their feedback and ensuring that the products and services we offer are aligned with their needs. Our savings and financial advice proposition focuses on helping our customers save for life ahead and supporting their long term financial well-being, whilst our mortgage proposition focuses on building strong relationships with our mortgage customers and intermediary partners in order to help more people into homes.

A key strategic objective is to provide customers with choice as to how they engage with us: face-to-face (branch or home-based advice), through Skipton Direct by telephone, video, social media and web-chat, online or through our new mobile app which was launched in July 2019, in order that they experience a high quality, empathetic and personalised service. We continually look for better ways to make every customer interaction value-adding, easy and efficient to ensure we delight our customers however they choose to engage with us.

Investment in enhanced digital capability continues to be a particular area of focus to support and drive improvements to the customer experience. Our mortgage transformation programme has this year delivered enhancements to our online customer retention system and our underwriting capabilities and is building the foundations for connections into a digitising mortgage market.

To ensure our branch network is evolving with the changing needs of our customers, we have continued to refurbish our branches and invested in increasing the skills of our people so that they can deliver the services our customers value.

A review of performance in the year against our proposition strategy is set out on page 23.

Our Financial Strength

Our financial strength objective is to maintain our strong capital position in order to be here for our members over the long term. We do this by sustainably growing our mortgage and savings balances, supplemented by dividends principally from our estate agency business, whilst applying strong cost control and a prudent approach to risk management.

We have again grown our mortgage and savings balances, with mortgage balances mostly funded by retail deposits in line with our mutual ethos. We continue to see less appetite amongst our savings members for longer term savings products, whereas longer term mortgage products are currently proving attractive to customers. We have responded proactively to meet our members' needs, whilst also making greater use of longer term funding from the wholesale markets. This helps us to align the duration of our funding with the longer term mortgages our members are seeking, but also allows us to broaden our wholesale funding base and continue to offer competitive savings rates to our members. It is however also important to ensure that our funding costs are sustainable, allowing us to generate sufficient profits to maintain our capital strength for our current and future members.

The Group maintains sufficient levels of high quality liquid assets in order to support growth plans and recognise market uncertainty. Stress testing scenarios are regularly run to help ensure we remain within our liquidity risk appetite and meet all regulatory requirements. Extreme economic scenarios are also run to ensure our contingency plans remain robust.

Close management of our cost base is a key component of our financial strategy, and we focus on driving efficiencies across all areas of our business in order to create capacity to invest in our people, processes and systems. This includes the use of robotics and other automated processes to increase the efficiency of our operations.

Proactively managing losses in our mortgage portfolios is also an important part of our objectives. We closely monitor and manage mortgages that have fallen into arrears and, where necessary, always aim to seek solutions that are appropriate for our borrowers and minimise the risk of the Society incurring financial loss.

The Group's investment in its subsidiaries, primarily Connells, remains a key part of our financial strategy, creating additional financial strength for the Society through the regular receipt of dividend payments.

A review of our financial strength is set out on pages 24 to 34.

Economic and market background

In 2019 the global economy entered a period of more subdued growth and increased trade tensions, and it has not been possible for central banks to raise interest rates meaningfully above historically low levels. After lengthy negotiations the UK left the EU on 31 January 2020, but discussions over future arrangements will continue and are likely to mean further uncertainty in 2020 and subdued economic growth. In the UK, employment reached all-time records, earnings increased and inflation remained low.

Whilst the Group's UK focus means it is not necessarily directly impacted by Brexit, discussions over trading arrangements with the EU, uncertainty and the expected short term subdued economic growth could impact the Society and its subsidiaries. In particular, the Monetary Policy Committee may remain cautious about the pace of future interest rate rises, which may make it difficult for lenders to maintain sustainable margins, and any adverse impact on house prices and housing transaction volumes could impact the performance of the Group's mortgage portfolio and also the performance of Connells' business, which has experienced a subdued housing market over the last year. We continue to lend prudently within our credit risk appetite, managing impairment losses closely.

Competition within the UK residential mortgage market remains intense. We expect the factors influencing interest margins in 2019 to continue in 2020 and, whilst we are responding to these in a number of ways, we expect to see reduced profitability.

The Society does however remain in a strong position, with strong capital and liquidity ratios, healthy and sustainable growth seen in mortgages and savings balances and strong underlying profitability and is therefore well placed to serve both current and future members. Performance during 2019 is discussed in more detail on the following pages.

Performance in the year

We monitor our progress against our vision and strategic goals using a number of key performance indicators (KPIs), aligned to each of our strategic pillars. These indicators are reported to the Board and senior management on an ongoing basis and are key to the Board's management of the business and to its decision making process.

Our Customers

Key Performance Indicator	Strategic Goal	Year	Value
Our Customers			
Total member numbers (Society only)	To ensure we are attracting and retaining members	2019	1,046,294
		2018	1,010,426
		2017	919,060
Growth in membership numbers (Society only)*	To ensure we are attracting and retaining members	2019	35,868
		2018	91,366
		2017	58,657
Increase in member savings balances (Society only)	To help more members save for their future	2019	£1,234m
		2018	£1,154m
		2017	£881m
Group gross mortgage advances	To help us to meet our goal of helping more people into homes through prudent and controlled lending	2019	£4,894m
		2018	£4,329m
		2017	£4,476m
Group net mortgage growth	To help us to meet our goal of helping more people into homes through prudent and controlled lending	2019	£1,870m
		2018	£1,648m
		2017	£1,290m

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 74 to 93.

Membership numbers

A key part of our strategy is to grow the Society's membership in a sustainable manner, bringing the benefits of membership to an increasing number of people going forward.

In 2019, Society membership numbers grew by 35,868 to take our total membership base to 1,046,294. The cash Lifetime ISA (LISA) continued to be a key driver in the growth in new customers to the Society. A total of 46,194 LISA accounts were opened in 2019, bringing the total number to 158,850 at the end of 2019.

Mortgage and savings balances

We remain committed to our purpose to help more people into homes and to help them save for their life ahead by offering competitive rates and attractive products, whilst maintaining high levels of customer service.

We grew Group mortgage balances by 10.3% (2018: 10.0%) whilst maintaining our prudent credit risk appetite. Despite the highly competitive mortgage market, our mortgage growth in the year was significantly ahead of the UK residential mortgage market where net mortgage growth was 3.4% (source: Bank of England statistics, December 2019), which demonstrated our success in delivering mortgage products and services that are valued by both new and existing Skipton members.

Gross mortgage advances totalled £4,894m (2018: £4,329m) across the Group during 2019, representing an increase of 13.1% compared to 2018. During the year we helped a broad spectrum of homeowners, by offering loans requiring only a 5% deposit for first and next-time buyers, a targeted range of new-build mortgages including 'Help to Buy' equity loans, shared ownership mortgages and a suite of buy-to-let loans alongside our core mortgage range.

In 2019 Society savings balances grew by 7.6% (2018: 7.7%) compared to the UK savings market where net savings growth was 4.3% (source: Bank of England statistics, December 2019). We paid on average 0.54% higher interest than the rest of market average for banks and building societies during 2019 (2018: 0.59%) (source: CACI Current Account & Savings Database Stock).

Our People

Key Performance Indicator	Strategic Goal	Year	Value
Our People			
Employee engagement (Society only)* (note 1)	To ensure our people are passionate, loyal and committed	2019	89%
		2018	89%
		2017	88%

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 74 to 93.

Note
1. As measured by Willis Towers Watson, an independent company who provide benchmarking on employee surveys in both the UK and globally.

Employee engagement

Our people are fundamental to our success, and we are committed to providing a great environment for our people to work in, where their development and well-being is a focus of our employee ethos.

The delivery of the Society's people strategy is primarily measured by employee engagement which remained strong at 89% when measured in June 2019, well above financial services industry norms. Sustaining high engagement is achieved through a range of activities reflecting all aspects of our people strategy including learning and development, recruitment and reward. We are also proud that for the sixth year running we have been named as one of *The Sunday Times* Best Companies to Work For, achieving 8th place in the '25 Best Big Companies to Work For 2020' list.

We have been an Investors in People accredited organisation for over 25 years and it is an important part of helping us understand how our people practices measure up to other organisations. The review gives us an impartial view from outside the business and inspires us to continually develop as an organisation to attract the best talent and deliver the best services for our customers. We have maintained our Platinum Investors in People accreditation, the highest accolade that can be achieved against this standard, for two years running.

Training and recruitment

In 2019, all of our branch colleagues were educated on our revised financial advice offering which aims to help more customers get the right financial advice and planning for them. As part of our well-being policy introduced in 2019 we have trained 75 of our people to act as Mental Health First Aiders and will be rolling out mental health awareness to all our leaders in 2020, to help with colleague well-being and support.

To support the delivery of our strategy we have invested in attracting the right people with the right skills into the Society. Our aim is to create an inclusive and diverse

Strategic Report *(continued)*

culture and that's why we have trained our recruitment team and the majority of our leadership team on inclusive recruitment, ensuring they adopt fair and transparent recruitment and selection practices when hiring new colleagues. To further invest in the early careers of our young people we have recruited another eight apprentices onto our 'Connecting Our Futures' programme and nine onto our 'Aspiring Leaders' programme.

Diversity and inclusion

We believe that having a diverse and inclusive culture, representative of the world we live in, is an integral part of our core values at Skipton. This inclusive culture creates an environment where everyone is encouraged and able to fulfil their full potential, irrespective of their age, gender, ethnicity, any disability or sexual orientation. We have been raising awareness of unconscious bias amongst our leadership community at Skipton; by recognising and then challenging unconscious bias we will strengthen our culture for the benefit of our people, our customers and our communities. In order to focus on the underlying themes of diversity and inclusion we have established a number of workstreams aiming to drive change and ensure all of our people have the same opportunities to progress their careers to their full potential. We have also launched a diversity and inclusion hub on the Society's intranet site where our people can find information and resources on a range of topics including LGBT+ disability, gender and ethnicity as well as information on unconscious bias.

We aim to make further progress to ensure our people feel valued, respected and able to perform to their potential. We seek to provide a work environment that is safe and accessible, free from unfair treatment, discrimination and harassment and gives fair access to learning, development, reward and promotion opportunities. We have a range of policies and practices which support these aims and monitor their application. In relation to gender specifically, the Society would like to see a higher representation of women amongst its Senior Leadership Team, which is 32% at present. The Society is proud to have signed up to the Women in Finance Charter in March 2019 and initiatives to improve the Society's gender mix, and progress reports thereon, are included in our Gender Pay Report, published annually.

At Skipton we believe a balanced workforce is good for business. We are committed to the view that the more diverse and integrated our senior leadership teams are, the fairer the working environment is, which in turn boosts creativity and productivity that better serves our customers.

The number of employees of each gender employed in the Society and the Group as at 31 December 2019 is outlined below:

Society	Male	Female	Total	Percentage female
Executive Directors	4	-	4	**-**
Other members of the Society's Senior Leadership team	41	21	62	**33.9%**
Senior leadership team	**45**	**21**	**66**	**31.8%**
Non-Executive Directors	4	4	8	**50.0%**
Other employees	893	1,383	2,276	**60.8%**
	942	**1,408**	**2,350**	**59.9%**

Group	Male	Female	Total	Percentage female
Executive Directors (note 1)	4	-	4	**-**
Senior managers (note 2)	50	22	72	**30.6%**
	54	**22**	**76**	**28.9%**
Non-Executive Directors (note 1)	4	4	8	**50.0%**
Other employees (note 3)	4,063	5,406	9,469	**57.1%**
	4,121	**5,432**	**9,553**	**56.9%**

Notes
1. Society Board Directors only.
2. Consists of the Society's Senior Leadership team (other than Executive Directors) and the Executive Directors of the subsidiaries.
3. Including senior managers of the subsidiaries.

More detailed reporting on diversity and pay by gender within the Society is available on our website, skipton.co.uk.

Our Proposition

Key Performance Indicator	Strategic Goal	Year	Result
Our Proposition			
Society net customer satisfaction score* (note 1)	To ensure we are putting the customer at the heart of our business	2019	86%
		2018	94%
		2017	92%
Society Financial Ombudsman Service (FOS) complaints - change in outcome rate (note 2)	To ensure we are treating customers fairly	2019	18%
		2018	21%
		2017	15%

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 74 to 93.

Notes
1. As measured from an in-house survey of Society customers with 5,338 responses. The net customer satisfaction score is calculated by subtracting the percentage of customers who are dissatisfied (those scoring satisfaction with the Society as 1-3 on a scale of 1-7) from the percentage of customers who are satisfied (those scoring satisfaction as 5-7 on the same scale). This replaces the previous third party survey with 2,400 customer responses per year on which the 2018 and 2017 comparative results are based and therefore 2019 results are not directly comparable.
2. For the six months ended 30 June 2019, being the latest available comparable market data.

Customer experience

Central to our strategy is to ensure a truly customer centric proposition, focusing on providing an excellent customer experience across all the ways our customers interact with us.

One of the ways in which we monitor the success of this is by measuring net customer satisfaction. Previously, we carried this out quarterly by telephone, using an independent third party to ask our customers about their levels of satisfaction with the service and products they have received, but from March 2019 we now carry out the survey in-house by email, which enables us to survey a larger, more representative sample of our customer base on a more frequent basis. As well as attracting a more representative customer base, the new email approach encourages responses from across the satisfaction spectrum and has resulted in more neutral responses from our customers. In 2019 net customer satisfaction was 86% (2018: 94%); if we had adopted a similar email approach in 2018, we would also have expected our net customer satisfaction score to have been 86% based on parallel testing between the two methodologies.

In May, the Society was represented along with our social media partners at the Adobe Summit, the biggest digital experience conference in Europe aiming to connect delegates from different organisations to share best practice and the latest technologies in order to deliver an engaging customer experience. The Society's social media proposition has been an area of ongoing investment over the last 18 months and we have increased our online social presence by more than 600% since the launch of LISA. Our Digital Customer Service team are working in very different ways to represent Skipton in this space and deliver an excellent experience as a growing number of customers choose to interact with us through social media platforms.

Whilst we strive to get things right for our customers first time, every time, we recognise that on occasion things can go wrong and our customers may have cause for complaint. We aim to deal with these complaints efficiently and with empathy, putting right what has gone wrong. A measure of our success in doing this is the proportion of the Society's complaints going to the FOS that have their outcomes changed. The Society's change in outcome rate for the first six months of 2019 was 18% (full year 2018: 21%). This compared favourably with the financial services industry average of 29% for the first six months of 2019, being the latest available comparable market data (source: FOS complaints data (resolved cases)).

Products and services recognition

Independent third party recognition of our products and services is a key demonstration of the value we are delivering to our members. We received a number of awards for the quality of both our products and service offered, including the winner of What Mortgage Awards 2019 for 'Best National Building Society'. We were awarded 'Five star mortgage lender' in the Financial Adviser Service Awards 2019. We also won 'Best Remortgage Provider' and were highly commended as 'Best Building Society Mortgage Provider' by Moneyfacts Awards 2019.

Our Financial Strength

Although profits reduced, the financial performance of the Society was strong during 2019 as we grew both mortgage and savings balances well above market averages but within our risk appetite and invested further in the future of the Society, all while improving our management expense ratio and upholding strong capital ratios and healthy levels of liquidity.

Key Performance Indicator	Strategic Goal	Year	Value	Discussed further
Our Financial Strength				
Total Group profit before tax^	To ensure we generate the necessary capital to grow the business	2019	£153.2m	Page 28
		2018	£188.7m	
		2017	£207.8m	
Underlying Group profit before tax*^	To ensure we generate the necessary capital to grow the business regardless of any costs or benefits not arising from the Group's ongoing trading operations	2019	£155.2m	Page 29
		2018	£186.6m	
		2017	£173.4m	
Group net interest margin (% of mean assets)	To manage the earnings of our core Mortgages and Savings division	2019	0.98%	Page 26
		2018	1.09%	
		2017	1.10%	
Mortgages and Savings division cost income ratio*^ (note 1)	To maintain a manageable cost base to ensure the business remains efficient	2019	60.2%	Page 29
		2018	56.2%	
		2017	55.4%	
Mortgages and Savings division management expense ratio	To maintain a manageable cost base to ensure the business remains efficient	2019	0.65%	Page 27
		2018	0.68%	
		2017	0.72%	
Group residential mortgages in arrears by three months or more	To manage and monitor our arrears and credit risk management	2019	0.25%	Page 32
		2018	0.29%	
		2017	0.36%	
Liquidity Coverage Ratio	To ensure we hold sufficient levels and quality of liquidity	2019	207%	Pages 31 and 32
		2018	203%	
		2017	179%	
Group retail funding as a % of total funding	To ensure we fund the majority of our mortgages through retail savings, in line with our customer proposition	2019	79.8%	Page 32
		2018	81.6%	
		2017	84.6%	
Group Common Equity Tier 1 ratio^ (note 2)	To ensure the Group remains financially strong by having a strong (risk weighted) capital base	2019	39.1%	Pages 33 and 34
		2018	32.8%	
		2017	33.0%	
Group Leverage ratio^ (note 3)	To ensure the Group remains financially strong by having a strong (non-risk weighted) capital base	2019	6.0%	Pages 33 and 34
		2018	6.1%	
		2017	6.0%	

* Included as a key measure in the Executive Directors' remuneration policy calculations. For further details see the Directors' Remuneration Report on pages 74 to 93.
^ The comparative periods have been restated as outlined in note 1b) to the Accounts.

Notes
1. For the purposes of this ratio, costs and income exclude items that are not included in arriving at underlying Group profit before tax, as defined on page 25.
2. This ratio is calculated under the Internal Ratings Based (IRB) approach on a transitional basis; see pages 33 and 34 for further details.
3. This ratio is calculated on an end-point basis; see pages 33 and 34 for further details.

Alternative performance measures

The Board monitors and reports profits at both a statutory level, governed by accounting standards and practices, and at an 'underlying' level. The Board uses underlying profit to measure the progress of the Group against its strategic objectives and uses this measure to aid in strategic decision making in relation to the operation of the Group's business activities. As per the Group's policy on alternative performance measures as agreed by the Board Audit Committee, the following items are excluded from statutory profit to arrive at underlying profit: gains or losses on disposal of Group undertakings, impairment of Group undertakings, gains or losses on disposal of mortgage assets, fair value movements in relation to the equity release portfolio, fair value movements in equity share investments and the Financial Services Compensation Scheme (FSCS) levy.

This reflects the Group's current strategy and business model and the majority of these items are generated from the Group's investments in other entities not considered to be part of the Group's core strategy, and are excluded from underlying profit on that basis. The other items listed above are excluded from underlying profit on the following basis:

- Fair value movements in relation to the equity release portfolio and associated derivatives. Under IFRS 9, the Group's equity release portfolio is held entirely at fair value with resulting gains / losses taken to the Income Statement and as a result, the Group is exposed to significant income statement volatility. Such gains / losses are therefore excluded from underlying PBT on the grounds that they are not reflective of the underlying trading performance of the business.
- Fair value gains or losses on our equity share investments are recognised through the Income Statement. As detailed above, we exclude any gains or losses from the disposal of Group undertakings and therefore on the same basis fair value gains / losses on equity share investments are also excluded from underlying PBT.
- The FSCS levy in relation to the 2008/2009 banking failures (most notably Bradford and Bingley and the Icelandic banks) was added back or deducted in previous years to arrive at underlying profit as it was a significant cost borne by the Group as a result of the failure of a number of financial institutions and was not viewed as a long term ongoing cost to the Group. The credit received in 2019, which was deducted to arrive at underlying profit, represents a rebate in relation to the payment made in 2018 which represented the final payment made under the scheme in relation to these particular failures and thus this levy is not expected to be a cost to the Group in future years.

Underlying profit therefore provides greater transparency of the performance of the Group's ongoing trading activities and improves the comparability of information between reporting periods.

The Group also reports a cost income ratio at a Mortgages and Savings division level, as shown in the table on page 24. Any items that are excluded from underlying profit are also excluded from the calculation of this ratio in order that this measure too provides greater transparency of the performance of the Group's ongoing trading activities and improves the comparability of information between reporting periods.

IFRS 16

As outlined in note 1b) to the Accounts, the Group adopted new accounting standard IFRS 16 *Leases* with effect from 1 January 2019. For the purposes of transition to IFRS 16, the Group applied the modified retrospective method; under this method, comparative information for prior periods is not restated. As a result, the 2018 comparatives in this report (including 2018 alternative performance measures) are not presented on a comparable basis. Details of the impact of IFRS 16 adoption on the Group's financial statements are set out in note 1b) to the Accounts.

Financial performance

Underlying Group profit before tax for the year was £155.2m (2018: £186.6m) as shown below. Underlying PBT by division is shown on page 29.

	2019 £m	2018* £m
Total Group profit before tax	153.2	188.7
Less profit on disposal of subsidiary undertakings	(1.1)	(3.3)
Add back loss / less fair value gains in relation to the equity release portfolio (note 1)	3.4	(1.0)
Add back fair value losses on equity share investments	-	0.3
Add back impairment of goodwill	-	2.5
Less FSCS levy	(0.3)	(0.6)
Underlying Group profit before tax	155.2	186.6

* The comparative period total Group profit before tax has been restated as outlined in note 1b) to the Accounts.

Note
1. The £3.4m is comprised of fair value losses of £6.0m as shown in the 'Fair value gains / (losses) on financial instruments: Equity release portfolio' line in the Income Statement, and fair value gains of £2.6m on the associated derivatives held to economically hedge these fair value movements, as shown in the 'Fair value gains / (losses) on financial instruments: Other derivatives' line in the Income Statement.

For further details of the profit on disposal of subsidiary undertakings see page 27.

Strategic Report *(continued)*

A summary Group Income Statement is set out below:

	2019 £m	2018* £m
Net interest income	238.1	241.2
Net non-interest income	485.0	492.5
Fair value gains on financial instruments mandatorily held at FVTPL	1.2	1.7
Fair value movements in relation to the equity release portfolio	(3.4)	1.0
Profits on treasury assets	2.4	-
Profit on disposal of subsidiary undertakings	1.1	3.3
Share of profits from joint ventures	1.7	0.8
Total income	726.1	740.5
Administrative expenses	(554.0)	(536.5)
Operating profit before impairment losses and provisions	172.1	204.0
Impairment losses on loans and advances to customers	(0.5)	(2.5)
Impairment credit / (losses) on liquid assets	0.2	(0.1)
Realised losses on equity release portfolio	(0.5)	(0.7)
Provisions for liabilities	(18.1)	(12.0)
Total Group profit before tax	153.2	188.7
Tax expense	(30.8)	(40.7)
Profit after tax	122.4	148.0

* The comparative period has been restated as outlined in note 1b) to the Accounts.

The movements in the Income Statement during the year are attributable to the following key Income Statement items.

Net interest income

Our net interest income, the main source of income for the Mortgages and Savings division, was £238.1m (2018: £241.2m). The Group net interest margin, a key profitability and performance indicator that measures net interest income as a percentage of mean total assets, reduced to 0.98% (2018: 1.09%). This reflects the increased competition in the mortgage market from a combination of new entrants and an increased appetite to lend from the larger banks.

The decrease in net interest income is driven by our mortgage book repricing, as mortgages written three to five years ago at higher margins are being replaced by mortgages at lower margins. In 2019 we have increased mortgage retention by making it easier for our customers to switch products, both directly and with our brokers. This has promoted a greater degree of switch activity and along with the increased market focus on re-mortgage activity contributes to the rate at which our book reprices. During 2019, we have also introduced a discounted Mortgage Variable Rate (MVR) on some of our products giving us the opportunity to retain more customers in the future by offering a lower reversion rate at the end of their initial mortgage deal.

Whilst retail savings remain the primary source of funding, we have made greater use of longer term funding from the wholesale markets, accessing funds from a number of diverse sources including a covered bond programme to minimise refinance risk, further details of which can be seen on page 33.

Net non-interest income

The Group's net non-interest income (or 'other income') by division is set out below:

	2019 £m	2018* £m
Mortgages and Savings	29.7	31.9
Estate Agency	441.1	444.0
Investment Portfolio	26.9	30.3
Inter-divisional adjustments^	(12.7)	(13.7)
	485.0	492.5

^ Inter-divisional adjustments relate primarily to the elimination of inter-divisional trading.

* The comparative period has been restated as outlined in note 1b) to the Accounts, resulting in an increase to net non-interest income for the year ended 31 December 2018 of £15.5m.

The majority of the Group's other income is generated by the Estate Agency division, which remained broadly in line with 2018, despite the subdued UK housing market. Details of Connells' performance can be found on page 30.

The Mortgages and Savings division's net non-interest income, which is predominantly made up of financial advice activities, was £29.7m (2018: £31.9m). A revised financial advice proposition was introduced in the year; this involved taking our advisers off the road for a period of time and contributed to a small drop in income as the proposition was implemented. Income levels have seen steady growth month on month as the new proposition is embedded.

The Investment Portfolio's net non-interest income was £26.9m (2018: £30.3m). Jade Software Corporation saw a reduction of £4.2m from slower than anticipated take up of digital products, whilst Skipton Business Finance's continued strong performance saw net non-interest income increase by £0.8m in the year.

The inter-divisional adjustments of £(12.7)m (2018: £(13.7)m) relate predominantly to income recognised in Connells in relation to fees paid by the Society to Connells for introducing mortgage customers and for surveys and valuations carried out by Connells for the Society and SIL. The corresponding cost to the Society and SIL is spread over the expected life of the mortgage product through net interest income.

Fair value movements in relation to the equity release portfolio

The equity release portfolio is held at fair value, with any fair value gains or losses taken to the Income Statement. The Group holds derivatives to economically hedge these fair value movements, which are also held at fair value. As these derivatives are not designated as being in a hedge relationship for accounting purposes under IFRS 9, fair value movements in the derivatives do not exactly offset the fair value movements in the portfolio, thus income statement volatility arises. For the year there was a fair value loss of £6.0m on the portfolio and a £2.6m gain on the associated derivatives. The fair value movements are driven by changes in market expectations of long term interest rates, inflation and house price growth. The equity release portfolio is less sensitive to these movements than the associated derivatives as the mortgage cash flows are discounted more heavily than the associated derivatives, therefore creating volatility in the fair value. The net fair value loss of £3.4m is excluded from underlying profit, as shown in the table on page 25.

Profit on disposal of subsidiary undertakings

The profit on disposal of subsidiary undertakings during the year was £1.1m (2018: £3.3m).

The sale of Homeloan Management Limited (HML) to Computershare in 2014 included contingent consideration dependent on HML's performance over a period following the disposal. This resulted in contingent consideration being receivable by the Group of £32.5m between 2018 and 2022. The second instalment of £6.2m was received by the Group in May 2019 (May 2018: £6.9m) and the discounted contingent consideration asset stands at £17.9m at 31 December 2019 (2018: £23.0m). The profit recognised in the year of £1.1m (2018: £3.3m) comprises the unwind of the discounted cash flows.

Administrative expenses

The Group's administrative expenses by division are set out below:

	2019 £m	2018* £m
Mortgages and Savings	156.6	148.7
Estate Agency	373.4	374.8
Investment Portfolio	24.9	24.6
Sundry incl. inter-divisional adjustments^	(0.9)	(11.6)
	554.0	536.5

^ Sundry including inter-divisional adjustments relates to the elimination of inter-divisional trading and also includes the cost of the long term management incentive scheme for the senior managers at Connells Limited.

* The comparative period has been restated as outlined in note 1b) to the Accounts, resulting in an increase to administrative expenses for the year ended 31 December 2018 of £15.5m.

Administrative expenses across the Group increased by £17.5m (3.3%) to £554.0m (2018: £536.5m). During 2019, the Mortgages and Savings division maintained its focus on careful control of the cost base, which is reflected in an improved management expense ratio of 0.65% (2018: 0.68%). We achieved this improvement while continuing to invest in the future of the Society and enhancing our member offering. In 2019 we invested heavily in renewing our financial advice customer proposition to provide a tailored service, making financial advice more accessible to more of our customers.

Connells' administrative expenses of £373.4m decreased by 0.4% compared with 2018 (£374.8m) as a result of careful cost control despite normal inflationary pressures and an increase in pension contributions.

The movement in sundry / inter-divisional adjustments predominantly relates to the long term management incentive scheme in place for Connells' senior management; this was a charge of £1.8m (2018: £4.2m credit). Following the final exercise of options issued in 2012, new options were issued during the year to certain senior managers in the scheme and the associated charge is included in the figure above. The management incentive scheme cost is based on a number of assumptions relating to the performance of the Estate Agency division and is in place to retain the high performing management team at Connells in order to safeguard the financial contribution this business makes to the Group. The movement in the charge in the year is also a result of an update to the assumptions in relation to the scheme, the details of which can be found in note 28 to the Accounts. The remaining movement in sundry / inter-divisional adjustments is mainly in respect of the intra-Group adjustment between the Mortgages and Savings and Estate Agency divisions, as described on page 31, and resulted in a credit to administrative expenses in the year of £1.9m (2018: £6.0m credit).

Impairment on loans and advances to customers

Impairment on loans and advances to customers for the Group was a charge of £0.5m during the year (2018: £2.5m) and is broken down as follows:

	2019 £m	2018 £m
Residential mortgages	0.5	1.3
Commercial mortgages*	(0.2)	1.0
Other loans	0.2	0.2
	0.5	2.5

* Also known as loans fully secured on land.

Ongoing management of our credit risk exposure is a key strategic focus for the Group in order to keep losses to the Group to a minimum and help our customers through financial difficulties wherever possible.

The loan impairment charge on residential mortgages was £0.5m (2018: £1.3m). Arrears levels remain low even with interest rates being slightly higher on average than 2018. Similarly, in the commercial mortgage portfolio, arrears also remain low and continue to be managed proactively. We saw a small impairment credit of £0.2m for the year (2018: £1.0m charge) as a result of two higher risk loans redeeming in the year.

Provisions for liabilities

The Group's provisions for liabilities charge was £18.1m for the year (2018: £12.0m). The main component of this was commission clawbacks in the Connells group, which resulted in provisions charges of £15.2m (2018: £12.7m) and which arise in the ordinary course of business.

There was a £0.3m credit received in 2019 (2018: £0.6m credit), reflecting a rebate in respect of the Group's share of the 2018/2019 FSCS levy. The levy was charged to the Society and other regulated deposit takers to cover interest on the outstanding loan from HM Treasury used to bail out the failed banks during the financial crisis of 2008. The loan made by HM Treasury to the FSCS has now been repaid in full.

Taxation

The Group's effective tax rate is 20.3% (2018: 21.7%) compared with the standard rate of UK Corporation tax of 19.0% (2018: 19.0%). The effective rate is higher than the standard rate due to the impact of the 8% surcharge on bank profits introduced by the Finance (No.2) Act 2015, which is charged on the Society's taxable profits above £25m. The rate for the year is also increased by expenditure disallowable for tax purposes and reduced by the lower tax rate in Guernsey which applies to the taxable profits of Skipton International Limited.

The effective tax rate for the Society is 15.5% (2018: 13.5%). The major impact on the effective rate of tax is the non-taxable dividend income received of £38.5m (2018: £82.9m). This is partially offset by the £3.6m (2018: £5.2m) impact of the 8% surcharge on taxable profits above £25m, resulting in a tax charge of £17.3m (2018: £22.6m).

The table below shows the total UK tax contribution borne by the Group in the year:

UK taxes borne in the year	2019 £m	2018 £m
Corporation tax	33.3	36.4
Taxes on property	8.1	8.0
Employment taxes	31.0	29.5
Irrecoverable VAT	9.9	7.6
	82.3	81.5

More detailed tax disclosures are provided in notes 9 and 30 to the Accounts and in the Country by Country Reporting section on page 222. Further details of the Group's taxation strategy can be found at www.skipton.co.uk/about-us/governance.

Other comprehensive income

During the year the Group recorded a net expense of £6.8m through other comprehensive income (net of tax) (2018: net expense of £3.3m). The 2019 figure included a £0.5m profit (before tax) (2018: £3.1m loss) from the re-measurement of retirement benefit obligations, with further details provided in note 31. Various other movements in the Group's fair value, cost of hedging and cash flow hedging reserves account for the remainder of the overall movement.

Performance by division

The Group's total profit before tax by division was as follows:

	2019 £m	2018* £m
Mortgages and Savings	100.8	114.8
Estate Agency	50.1	56.9
Investment Portfolio	4.0	7.6
Sundry incl. inter-divisional adjustments^	(1.7)	9.4
Profit before tax	153.2	188.7

^ Sundry including inter-divisional adjustments relate primarily to the elimination of inter-divisional trading, the impact of the Connells long term management incentive scheme (£1.8m charge; 2018: £4.2m credit), and additional profit on disposal recognised in relation to the sale of HML in 2014 (£1.1m; 2018: £3.3m).

* The comparative period Mortgages and Savings division profit before tax has been restated as outlined in note 1b) to the Accounts.

The Group's underlying profit before tax by division, determined in the same way as underlying Group PBT (as defined on page 25), was as follows:

	2019 £m	2018* £m
Mortgages and Savings	103.9	113.2
Estate Agency	50.1	59.7
Investment Portfolio	4.0	7.6
Sundry incl. inter-divisional adjustments^	(2.8)	6.1
Underlying Group profit before tax	155.2	186.6

^ Sundry including inter-divisional adjustments relate primarily to the elimination of inter-divisional trading and the cost of the Connells long term management incentive scheme.

* The comparative period Mortgages and Savings division underlying profit before tax has been restated as outlined in note 1b) to the Accounts.

The Group's underlying profit before tax in the year was £155.2m (2018: £186.6m). The decrease in the Mortgages and Savings division's underlying profits to £103.9m (2018: £113.2m) reflects the competitive trading environment and the significant investment made in our strategic priorities in 2019. Group mortgage and savings balances have seen good growth, of 10.3% and 7.6% respectively (2018: 10.0% and 7.7% respectively).

The fall in the Estate Agency division's underlying profit can be attributed primarily to the subdued UK housing market; the fall in market confidence during political and economic uncertainty resulted in lower levels of activity within the housing market.

The Investment Portfolio delivered underlying profits of £4.0m (2018: £7.6m) following continued strong performance by Skipton Business Finance generating a profit of £4.0m (2018: £3.8m) whilst Jade Software Corporation broke even during the year (2018: £3.8m profit) reflecting the slower than anticipated take up of digital products.

The movement in sundry / inter-divisional adjustments during the year is predominantly as a result of a charge with respect to the Connells long term management incentive scheme of £1.8m (2018: £4.2m credit). For further details, refer to the administrative expenses section on page 27 of this report, and for details of the calculation and the assumptions used see note 28 to the Accounts.

We anticipate that Group profits in 2020 will be lower due to a combination of ongoing pressures on mortgage and savings margins.

Mortgages and Savings

The Mortgages and Savings division performed well during the year in an uncertain and competitive market. Continuing margin pressures as a result of increased competition in the mortgage market have squeezed net interest margins further this year and underlying profit for the year was £103.9m (2018: £113.2m).

Our broad range of competitive mortgage products and strong intermediary partnerships have contributed to continued growth in our mortgage book during 2019 of 10.3% (2018: 10.0%). Our competitive savings rates and broad range of savings products offered have helped us to grow our retail savings balances, by £1.2bn up to £17.4bn.

The revised financial advice proposition which launched in July 2019 is designed to provide guidance to more of our customers on their journey to and through retirement. Financial advice generated £29.3m of income (2018: £31.2m) and during the year, £284m of new money was invested (2018: £313m). Funds under management increased to £3.4bn (2018: £3.2bn).

The division saw an overall increase in costs during the year of £7.9m to £156.6m as outlined on page 27, and as we continue to invest in the Society for the long term benefit of our members the division's cost income ratio increased from the previous year to 60.2% (2018: 56.2%). Increased activity, inflationary increases and the aforementioned pressures on margins also contributed to the increase in the cost income ratio. Despite this, the management expense ratio improved to 0.65% (2018: 0.68%) as we continue to focus on efficiencies.

The charge for mortgage impairment losses was £0.3m (2018: £2.3m) as discussed on page 28, and the provisions for liabilities charges for the division was a £1.2m credit (2018: £1.2m credit), the majority of which relates to the release of provisions in relation to customer compensation.

The division's Channel Islands operation, SIL, had another strong year, achieving profits of £21.2m (2018: £20.0m) as it grew its mortgage and savings balances to £1.4bn and £1.6bn respectively (2018: £1.2bn and £1.5bn respectively). SIL's mortgage book is of a high quality and continues to perform well, with no accounts in arrears by three months or more at the end of the year.

Our specialist lending businesses, Amber and NYM, reported an aggregate profit before tax of £8.3m (2018: £10.3m). Due to the specialist nature of these mortgage portfolios, loan impairment provisions and arrears are generally higher than those reported in the Society, and the aim of these businesses is to manage the mortgage portfolios carefully with a view to running down these closed books. During the year the number of mortgages in arrears by three months or more was low at 2.1% (2018: 1.6%), and the aggregate mortgage balances in these businesses decreased to £659m (2018: £745m).

Strategic Report *(continued)*

Estate Agency

The Group's estate agency operations are carried out through the Connells group. Performance highlights are outlined below:

	2019	2018*
Total income (note1)	£442.9m	£444.8m
Profit before tax	£50.1m	£56.9m
Movement in:		
Estate agency property exchanges	-7%	-7%
Residential lettings properties under management	+2%	+3%
Number of mortgages arranged	-2%	+9%
Surveys and valuations completed	+0%	-2%
Number of conveyancing transactions arranged	+1%	-5%

* The comparative period total income has been restated as outlined in note 1b) to the Accounts, resulting in an increase to income for the year ended 31 December 2018 of £15.5m.

Note

1. Total income is as defined in note 40 to the Accounts 'Group segmental reporting'.

The Estate Agency division reported a profit before tax for the year of £50.1m (2018: £56.9m). With political and Brexit related uncertainty continuing throughout 2019, the number of UK housing transactions fell once again and vendor and purchaser confidence was subdued. Consequently, the number of properties that Connells exchanged contracts on was 7% lower than in 2018. Nevertheless, Connells maintained its focus on winning new instructions and produced a creditable performance during the year. At 31 December 2019 Connells operated through 578 branches.

Connells' financial services proposition also continues to perform strongly and the number of mortgages arranged by Connells fell by only 2% despite the higher fall in the number of properties sold. The total value of mortgages arranged increased slightly to £10.7bn in 2019 (2018: £10.6bn) and Connells remains focused on helping more customers to buy homes or reduce their mortgage outgoings by providing them with a good experience and outcome.

Within its lettings operation, the prohibition on charging fees to tenants came into force during 2019, and Connells has addressed this by implementing a range of revenue enhancing initiatives. Properties under management increased by 2% during the year and total lettings income was 3% lower than 2018. Connells' lettings division also continued its investment in people and technology to improve productivity and drive down its administrative costs. The underlying market conditions in the rental market remained broadly stable during the year, with a modest increase in average rents and an adequate level of demand from tenants.

Connells Survey & Valuation continues to invest heavily in new technology and process improvements to drive productivity, support clients' risk management and improve customer outcomes. It also invests in its people, training new surveyors through its AssocRICS development programme. The focus remains on delivering great customer service and it has secured a number of new long term client contracts during 2019 and also renewed contracts with existing clients. It maintained the number of cases carried out during the year despite the faltering market.

The Connells group remains committed to invest in all parts of its business, aiming at delivering an efficient, customer focused proposition, with its diverse business model being well positioned to manage fluctuations in the housing market. Within its estate agency operations Connells maintains its focus on the service provided to customers through its high street presence. It invests in digital products and solutions, including the continued enhancement of its customer communications and online portal to support its branch operations in winning and retaining business and achieving successful transaction outcomes for customers.

Building upon the successes achieved through coordinated national campaigns, Connells has expanded its use of digital and social media advertising. These activities are centrally managed and fully tracked via its lead management platform. This approach provides flexibility, allowing the business to adapt quickly during changing market conditions.

The Connells group continues to innovate, invest and partner within the industry where it sees opportunities to enhance customer outcomes. In partnership with TM Group, the Move It On (MIO) application was launched during 2019; this innovative and flexible solution is designed to reduce transaction times across the industry and improve the customer journey.

The group continues to explore and invest in a number of opportunities within both the residential sales and the mortgage market. These will provide additional business opportunities and a range of tools and services to help maintain the positive relationship already maintained with customers and clients.

The Connells group made three small business acquisitions during the year, each of which will complement and add to its proposition.

Investment Portfolio

The Investment Portfolio reported a profit of £4.0m during the year (2018: £7.6m). Skipton Business Finance Limited (a provider of debt factoring and invoice discounting to small and medium-sized enterprises) again performed well, producing a pre-tax profit of £4.0m (2018: £3.8m). Jade Software Corporation (a software solutions provider specialising in delivering digital business solutions and the provider of the Society's core database and software development language), broke even (2018: £3.8m) which, after a strong 2018 performance, reflects the slower than anticipated take up of digital products.

Sundry, including inter-divisional adjustments

Sundry, including inter-divisional adjustments, of £1.7m charge (2018: £9.4m credit) mainly comprises a £1.8m charge (2018: £4.2m credit) in respect of the Connells long term management incentive scheme and profit in relation to contingent consideration on the 2014 disposal of HML of £1.1m (2018: £3.3m), as described on page 27 of this report. For further details on the charge / credit for the management incentive scheme refer to the administrative expenses section on page 27 of this report, and for details of the calculation of the scheme and the assumptions used see note 28 to the Accounts.

Other inter-divisional adjustments during the period of £1.0m expense (2018: £1.9m income) relate to the elimination of inter-divisional trading, which is primarily in respect of introducer and valuation fees paid by the Society and SIL to Connells, as well as certain costs incurred by Connells in relation to this. The income and costs are recognised up-front by Connells but on consolidation are spread over the expected life of the mortgage product through net interest income.

Financial position

A summary Statement of Financial Position is set out below:

	2019 £m	2018* £m
Assets		
Liquid assets	4,522.6	4,201.5
Loans and advances to customers	20,067.1	18,120.9
Equity release portfolio	410.0	410.9
Derivatives	38.5	72.3
Fixed and other assets	451.2	386.3
Total assets	25,489.4	23,191.9
Liabilities		
Shares	17,364.1	16,113.5
Borrowings	5,797.8	4,988.8
Derivatives	361.1	279.4
Other liabilities	292.6	252.0
Subscribed capital	41.6	41.6
Reserves	1,632.2	1,516.6
Total liabilities and equity	25,489.4	23,191.9

* The comparative period has been restated as outlined in note 1b) to the Accounts, resulting in a change to loans and advances to customers held at amortised cost, fixed and other assets, total assets, borrowings, other liabilities, reserves and total liabilities and equity.

Our financial position is analysed below by our key balance sheet areas – liquidity, loans and advances to customers, and retail and wholesale funding.

Liquidity

The Group continues to hold healthy levels of liquid assets to ensure it can meet its liabilities as they fall due and to help mitigate economic uncertainty, with the Liquidity Coverage Ratio (LCR), a measure designed to ensure that financial institutions have sufficient high quality assets available to meet their liquidity needs for a 30 day liquidity stress scenario, at 207% at 31 December 2019 (2018: 203%). When measured as a percentage of shares and deposit liabilities the liquidity ratio was 19.5% (2018: 19.9%).

The Group's liquidity levels are closely managed by senior management and have remained above internal and regulatory limits throughout the period. Liquid assets at 31 December 2019 were £4.5bn (31 December 2018: £4.2bn), providing the Group flexibility in what may be an unpredictable market.

At 31 December 2019, the Society held £3.6bn (2018: £3.1bn) of High Quality Liquid Assets (HQLA) as analysed below:

	2019 £m	2018 £m
Balances with the Bank of England	1,732.2	2,342.1
Gilts	291.9	105.0
Treasury Bills	510.1	26.9
Fixed rate bonds	445.8	210.8
Floating rate notes	204.2	20.0
Residential mortgage backed securities	143.5	207.1
Covered bonds	252.4	208.6
	3,580.1	3,120.5

The Society also holds a portfolio of other liquid assets, which are not categorised as HQLA, as shown below:

	2019 £m	2018 £m
Cash with other institutions	29.1	50.1
Certificates of deposit	31.0	301.5
Fixed rate bonds	-	31.5
Residential mortgage backed securities	-	0.3
	60.1	383.4

The above tables showing HQLA and non-HQLA are different to the total amount of liquid assets held within the Society's Statement of Financial Position (£4.3bn) due to certain items that are excluded from the above tables, such as liquid assets used as collateral and those used in repurchase, or 'repo', transactions.

The Group's treasury investments are held to provide liquidity and 93.6% (2018: 95.7%) of the Group's treasury investments are rated A3 or better. The Group's policy is that initial investments in treasury assets are typically A3 or better (with the exception of some unrated building societies where separate credit analysis is undertaken). Increased regulation means we hold a certain percentage of our cash collateral against derivative exposures with the London Clearing House (LCH); these amounts have increased in 2019 to 4.6% (2018: 2.5%) and are unrated.

The Net Stable Funding Ratio (NSFR) is a longer term stable funding metric, which measures the stability of our funding sources relative to the assets (e.g. mortgage balances) we are required to fund. The Group's NSFR (147.5% at 31 December 2019; 143.3% at 31 December 2018) is well in excess of the regulatory requirement of 100%, which was introduced on 1 January 2018, confirming that the Group holds sufficient stable funding to meet the new requirement.

The Group regularly conducts an Internal Liquidity Adequacy Assessment Process (ILAAP) in accordance with the Prudential Regulation Authority's (PRA) liquidity guidelines and the Board remains satisfied that the Group has sufficient liquid assets at its disposal in order to meet its obligations as they fall due.

Loans and advances to customers

Lending to our members is at the core of the Society's purpose. The majority of the Society's mortgage lending is secured on residential property, including owner-occupied and buy-to-let mortgages. The Group also holds the Amber and NYM specialist lending portfolios and a legacy commercial mortgage portfolio, all of which ceased lending in 2008.

During the year, the Group achieved strong net mortgage growth of 10.3%, with net mortgage lending totalling £1.9bn (excluding impairment and fair value adjustments for hedged risk) (2018: £1.6bn). The Group's new lending, delivered through both mortgage intermediaries and our own distribution channels, amounted to £4.9bn (2018: £4.3bn).

The Society's average residential loan-to-value (LTV) ratio (valuation-weighted) on new lending has fallen slightly to 56.2% (2018: 57.1%). The average valuation-weighted LTV on the Group residential mortgage book remained low at 46.8% (2018: 46.1%).

Our well-managed spread of risk ensures that the quality of the Group's lending remains high. This is evidenced by our low proportion of residential mortgage accounts in arrears by three months or more reducing to 0.25% (2018: 0.29%) or 0.25% (2018: 0.30%) excluding non-UK lending, which compares with the industry average of 0.72% of UK mortgages in arrears by more than three months (source: UK Finance).

The mortgage balances of Amber and NYM continued to run off during the period, with the average LTV reducing to 54.0% from 55.4%. Close monitoring of the Group's exposure to potential losses on these outstanding loans remains a key part of our credit risk strategy.

The Group's commercial mortgage portfolio reduced in the year by 11.5% to £236.7m as we continue to actively manage down these balances. The average LTV of this portfolio reduced to 49.1% from 50.0% and the proportion of accounts in arrears by three months or more in this portfolio remains low at 0.62% (2018: 0.84%).

We support our customers who find themselves in financial difficulty and where appropriate we will apply a policy of forbearance which could include arrears capitalisation, a reduction in the monthly payment, a conversion to interest only or a mortgage term extension, based on the customer's individual circumstances and needs. Ensuring a fair outcome for our customers is central to our strategy of forbearance, and further details on this can be found in note 38 to the Accounts.

Fixed and other assets

The Group's fixed and other assets comprise of current and deferred tax assets, investments in joint ventures and equity share investments, fixed and intangible assets, right-of-use assets and other assets. These have increased by £64.9m in total to £451.2m (2018: £386.3m), the majority of which relates to £67.4m of right-of-use assets recognised in the year following the adoption of IFRS 16. Details of the impact of IFRS 16 adoption on the Group's financial statements are set out in note 1b) to the Accounts.

Funding

The Society continues to manage the mix of retail and wholesale funding in the best interests of our members but remains primarily funded by retail savings. Optimising our mix of retail and wholesale funding is essential to the Group achieving both its retail savings and lending growth objectives. We maintain a diverse funding portfolio to prevent over-reliance on one source, and, taking into consideration the term profile of our lending, closely manage the term of our funding in order to manage the risks of duration mis-match.

During the year, we took the opportunity to raise wholesale funding both to diversify our portfolio and take advantage of favourable funding rates. This reduced the proportion of funding from retail savings to 79.8% (2018: 81.6%), which is in line with our balance sheet strategy.

Retail funding

As a mutual building society we remain committed to providing savers with competitive returns along with offering excellent customer service, which is reflected in the increase in retail savings balances of 7.6% during the year, as detailed on page 21.

In addition to our UK retail funding, the Group also accepts deposits through our Channel Islands based subsidiary, SIL. SIL has increased its funding base in the year, to £1.6bn (2018: £1.5bn). These balances are included in 'Amounts owed to other customers' within the Group Statement of Financial Position.

Wholesale funding

At 31 December 2019, £4.2bn (2018: £3.5bn) of our funding came from the wholesale markets, as analysed below:

	2019 £m	2018 £m
Repo and other secured agreements	**1,653.4**	1,853.7
Deposits	**197.1**	190.4
Certificates of deposit	**-**	4.0
Senior unsecured funding	**349.1**	348.8
Covered bonds	**1,889.1**	846.3
Securitisation	**100.4**	219.6
Fair value adjustments	**(36.0)**	1.6
	4,153.1	3,464.4

The Group's wholesale funding balances in the above table exclude offshore funding in our Channel Islands based subsidiary, SIL, as shown below:

	2019 £m	2018* £m
Amounts owed to credit institutions	**1,678.3**	1,878.0
Amounts owed to other customers	**1,816.9**	1,690.5
Debt securities in issue	**2,302.6**	1,420.3
Less: SIL funding	**(1,644.7)**	(1,524.4)
	4,153.1	3,464.4

* The comparative period has been restated resulting in a change to SIL funding as outlined in note 1b) to the Accounts.

In March 2019, the Society successfully raised £600m of wholesale funding through a covered bond transaction with a term of five years, and a further €500m in September 2019 through a five year Euro covered bond transaction, further diversifying the Society's wholesale funding base.

The Society has made use of the Government's Term Funding Scheme (TFS), which is included in 'Repo and other secured agreements' in the table above. The scheme was closed to new lending in February 2018 and the Society has repaid £200m of funding in the year (2018: £550m). As at 31 December 2019, the Society had outstanding TFS drawings of £1,650m (2018: £1,850m).

The credit ratings of the Society are assigned by two major credit rating agencies, Fitch and Moody's. Our long and short term ratings did not change from 2018. However in November 2019, Moody's changed their outlook on the UK sovereign debt rating and other UK financial organisations. In line with this action, Moody's revised the outlook of the Society from Positive to Stable. Our credit ratings are summarised in the table below:

	Long term	**Short term**	**Outlook**	**Date of last change of rating**
Fitch	A-	F1	Stable	26 May 2016
Moody's	Baa1	P-2	Stable	10 April 2017

The Class A Notes of our rated securitisation transaction (Darrowby No. 4 plc) remain Aaa rated by both agencies.

Capital *(unaudited)*

Capital comprises principally the general reserve and subscribed capital provided through Permanent Interest Bearing Shares (PIBS). Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses.

We monitor our capital at a prudential consolidation group level by applying the Capital Requirement Directive (CRD IV) and Capital Requirements Regulation (CRR). The prudential group comprises the entire Group except Connells and a small number of other entities whose activities are not closely aligned with the core business.

Total regulatory capital has increased by £92.8m during 2019 to £1,533.2m (2018: £1,440.4m). This is mainly due to retained profits, including dividend income from Connells, accumulated during the year, which are added to the general reserve.

Risk weighted assets (RWAs) have decreased by £455.4m during 2019 to £3,819.4m (31 December 2018: £4,274.8m) This decrease is primarily driven by the following key changes to the Society's methodology for calculating the capital required under the IRB approach during 2019. Each change was subject to independent validation and regulatory approval.

- A new behavioural scorecard was implemented, which removed the Society's reliance on a third party supplier;
- A probability of default model calibrated to the above behavioural scorecard was introduced; and
- Refinements were made to the component of the Society's Loss Given Default model which captures the fall in the value of a property due to house price deflation.

As a result of the increase in regulatory capital and reduction in RWAs, the CET 1 ratio has increased to 39.1% from 32.8% at 31 December 2018.

The leverage ratio, a non-risk based capital measure, has decreased to 6.0% at 31 December 2019 (31 December 2018: 6.1%) showing that the impact of the growth in mortgage lending has outweighed the impact of profits and dividend income accumulated during the year.

The following table shows the composition of the prudential group's regulatory capital as at 31 December 2019. More detailed disclosures can be found in the Pillar

3 document available on our website. The capital ratios are reported on a CRD IV transitional basis. On a transitional basis £40m of PIBS are being phased out of Additional Tier 1 capital over the period to 2022 and under CRD IV end-point rules the PIBS are fully transitioned into Tier 2 capital. On an end-point basis our CET 1 ratio would remain the same at 39.1%, the Tier 1 ratio would be 39.1% and the total capital ratio would remain the same at 40.1%. The leverage ratio is reported on an end-point basis.

Unaudited	2019 £m	2018* £m
Capital resources:		
Common Equity Tier 1 capital	**1,493.2**	1,400.4
Total Tier 1 capital	**1,520.2**	1,436.4
Total Tier 2 capital	**13.0**	4.0
Total regulatory capital	**1,533.2**	1,440.4
Risk weighted assets	**3,819.4**	4,274.8
Capital and leverage ratios (note 1)		
Common Equity Tier 1 ratio (CET 1)	**39.1%**	32.8%
Tier 1 ratio	**39.8%**	33.6%
Total capital ratio	**40.1%**	33.7%
Leverage ratio	**6.0%**	6.1%
UK leverage ratio (note 2)	**6.5%**	6.9%

* The comparative period has been restated as outlined in note 1b) to the Accounts, resulting in a decrease to Common Equity Tier 1 capital, Total Tier 1 capital and Total regulatory capital for the year ended 31 December 2018 of £8.0m. The corresponding capital and leverage ratios have also been restated.

Notes

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

Capital management

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

Pillar 1

The Group holds capital to meet Pillar 1 requirements for credit risk, operational risk and market risk. The IRB approach is applied to calculate the capital requirement for residential mortgages in the Society, Amber and NYM and to equity and non-credit obligation exposures. The standardised approach is applied to all other exposures, operational risk, market risk and credit valuation adjustments.

Pillar 2A

The PRA requires the Group to hold additional Pillar 2A capital for the risks not covered under Pillar 1. At 31 December 2019 this was 3.5% of risk weighted assets, a point in time estimate set by the PRA during 2018.

Capital buffers

CRD IV requires the holding of capital buffers that can be used to absorb the impact of a stress scenario. For the Society the buffer framework comprises a sector-wide Capital Conservation Buffer set at 2.5% of RWAs in CRD IV and a macro-prudential Countercyclical Capital Buffer currently set at 1% of RWAs for exposures to the UK. The Countercyclical Capital Buffer rate varies depending on the country within which the exposure resides and is set by the designated authority in each member state. In addition, the Internal Capital Adequacy Assessment Process (ICAAP) considers whether any additional capital is required over and above the regulatory buffers, to satisfy our risk appetite over the planning horizon, and to absorb the impact of a severe stress scenario. The ICAAP is reviewed by the PRA when setting the Group's Total Capital Requirement (Pillar 1 and Pillar 2A).

The Group has performed regular stress tests on its capital base and these tests have consistently demonstrated a capital surplus above minimum requirements after applying management actions.

Further information is provided in the Risk Management Report on pages 65 to 73.

The Group publishes further information about its exposures and risk management processes and policies within the Pillar 3 disclosures on the Society's website www.skipton.co.uk.

Minimum Requirement for Own Funds and Eligible Liabilities

Minimum Requirement for Own Funds and Eligible Liabilities (MREL) is a regulatory requirement set by the Bank of England to ensure institutions can cover losses that would need to be absorbed in the event of a resolution scenario. This is being phased in over a transitional period to 1 January 2022.

The MREL set for the Society, by the Bank of England, for the transitional period is equal to the minimum regulatory capital requirements for the period to 31 December 2019, then changes to the higher rate of 18% of the prudential group's risk weighted assets by 1 January 2020 for the period to 31 December 2021. MREL at the end of the transitional period is subject to review by the Bank of England and may change. Compliance with MREL is reflected in the Society's corporate plans.

Pension funds

The Group manages two funded defined benefit schemes and a hybrid scheme as described in note 31 to the Accounts. The aggregate valuation of the two defined benefit schemes and the hybrid scheme at 31 December 2019 resulted in a combined deficit of £87.0m (2018: £99.5m) using the methodology set out in IAS 19. The hybrid scheme is a legacy scheme acquired on the merger with Holmesdale Building Society and is not material to the Group.

We continue to take steps to manage the deficit and all three schemes are closed to new members and to future accrual of benefit. The actuarial valuation deficits, as described in note 31 to the Accounts, are used to judge the level of contributions that should be made and contributions totalling £38.3m have been paid into the schemes in the last five years. We have also undertaken a number of other initiatives aimed at managing the funding deficit of the above-mentioned defined benefit schemes and associated long-tail risk including early retirement exercises and pension transfer exercises.

We will continue to monitor the deficit on the schemes to manage the funds in a responsible manner with the aim of ultimately eliminating the actuarial funding deficit.

We also operate defined contribution schemes into which eligible employees are automatically enrolled.

Non-financial information statement

The Society, although not required to follow the Companies Act 2006, has sought to comply with the non-financial reporting requirements of s414CB of the Act by including certain non-financial information within our Annual Report and Accounts to provide our stakeholders with a fuller picture of our performance.

Information regarding the following matters can be found on the following pages:

Non-financial information	Discussed further
Business model	Page 14
Key performance indicators	Page 20, 21, 23 and 24
Key risks	Page 65
Environmental matters	Page 16
Employees	Page 15
Social matters	Page 15 and 16
Respect for human rights	Page 48
Anti-corruption and anti-bribery matters	Page 15

Principal risks and uncertainties

As a result of its normal business activities, the Group is exposed to a variety of risks. The Group has established a number of committees and policies to successfully manage these risks. These principal risks and uncertainties are set out in the Risk Management Report on pages 65 to 73 and in notes 36 to 38 to the Accounts.

This Strategic Report was approved by the Board of Directors on 25 February 2020 and signed on behalf of the Board by:

Bobby Ndawula
Group Finance Director

Sustainability Report

Taking action where we can have the most impact

As a mutual we work hard to help our members build better futures for themselves and their families, creating a Society where no one feels left out. We are proud of the way we work together, building a sustainable Society for our members, our people and the communities in which we serve.

Last year we launched our sustainability strategy aligned to the United Nations Sustainable Development Goals. We chose to focus on four goals where we feel we can have the greatest impact. We set ourselves three challenging targets against each of these goals that support our strategy and vision to build a sustainable society.

Our vision is to build a better society

We're taking action where we have the greatest impact.

Global Sustainable Development Goal

8 DECENT WORK AND ECONOMIC GROWTH	11 SUSTAINABLE CITIES AND COMMUNITIES	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	16 PEACE, JUSTICE AND STRONG INSTITUTIONS
We will be one of the best places to work.	**We will help more people into homes and support our local communities.**	**We will give more to the planet than we take.**	**We will always be owned by and responsible to our members, not shareholders.**
Our target			
Increasing the number of young people who gain employment following our apprenticeship programmes by 200% by 2022. Offering 50% of places on our talent development programmes to women, to foster a healthy pipeline of female talent. Maintaining our Investors in People platinum accreditation.	Helping 30,000 first-time buyers into homes by 2022. Supporting 1,000 homeless people by 2022. Increasing the time our people spend volunteering in the community by 100% by 2022.	Eliminating single-use plastics by 2020. Sending zero waste to landfill by 2022. Halving our carbon footprint by 2022.	Becoming a Disability Smart accredited organisation by 2020. Showing that we care about our customers by delivering a customer empathy score in excess of 60%. Ensuring that out net customer satisfaction levels are always above 85%.
How we will contribute to the Sustainable Development Goals			
8.6 By 2020, substantially reduce the proportion of youth not in employment, education or training 8.5 By 2030, achieve full and productive employment and decent work for all women and men, including young people and people with disabilities, and equal pay for work of equal values.	11.1 By 2030, ensure access for all to adequate, safe and affordable housing and basic services and upgrade slums. Make cities and human settlements inclusive, safe, resilient and sustainable,	12.5 By 2030, substantially reduce waste generation through prevention, reduction, recycling and reuse. 12.6 Encourage companies, especially large and transnational companies, to adopt sustainable practices and integrate sustainability information into their reporting cycle.	16.7 Ensure responsible, inclusive, participatory and representative decision-making at all levels. 16.6 Develop an effective, accountable and transparent institution at all levels.

Decent Work and Economic Growth

8 DECENT WORK AND ECONOMIC GROWTH

Being one of the best places to work

We continue to evolve our customer-centric culture and in 2019 focused on developing and embedding diversity and inclusion across the Society. We have used colleague engagement events, such as our annual leadership event, to highlight the work we have been doing to embed our approach. We have achieved wider colleague engagement through participation in national events and cultural festivals such as National Inclusion Week, Ramadan and International Women's Day.

Diversity & Inclusion

We continue to focus on creating a Society where no one feels left out and this is as important for our people as it is for our customers.

We celebrated diversity and inclusion week with a series of interactive and experiential events helping to foster an environment where difference is valued and sought after. This included sessions on neurodiversity, mental health, the menopause and accessibility. For a third year we took part in Leeds Pride, demonstrating our commitment to inclusion and in celebration of the LGBT+ community.

Well-being

Colleague well-being continues to be a focus at Skipton, with our new well-being strategy communicated to all our people in 2019. Our work on being advocates of mental health has continued with over 150 people leaders going through training to be mental health champions. Mental health first aid training now forms part of all leadership induction and development and will become embedded into our culture.

We have put additional focus on the financial well-being agenda with our first 'Money Matters' sessions running in October 2019. These were a great success and 100 of our head office people attended alongside our branch people participating in their own financial well-being session; this work will continue in 2020.

Flexible Working

We know how important it is for people to have flexibility in their working lives to create a healthy work/life balance that enables people to meet their work, family and personal needs. In offering our people flexibility, they have more control over their time giving them the working pattern that fits individual lifestyles and reduces time spent commuting.

We aim to be attractive to a diverse and talented workforce and recognise that offering this flexibility in both how and when we work provides advantage to the Society and individuals.

Reward & Recognition

We recognise the added value our people bring and are committed to supporting them to build better futures and reach their full potential.

We invest in a range of benefits to support the changing needs of our people to help them to tailor their package accordingly. This includes helping them to achieve their career aspirations, saving for the future, or practical support in relation to health and well-being.

We have invested in a new reward platform to enable our people to see the full value of their rewards package and our annual STAR (Special Thanks and Recognition) awards recognise and celebrate the achievement of our people.

Pension scheme

We have continued to invest in the pension contributions of our people as well as offering practical support through pension planning workshops and a visit from the Scottish Widows pensions awareness bus at our head office. This helped to raise awareness of the importance of pension planning, with over 500 of our people attending.

In 2019, we invested £6.1m in colleagues' pension contributions, with our people contributing an additional £5.5m. 42% of people made additional contributions to their pensions of 8% or more, ensuring they benefitted from the maximum contribution from the Society.

Salary

The Society invests year on year to ensure all salaries are at least in line with the Living Wage Foundation's living wage. In September 2019 we formalised this commitment by becoming an accredited Living Wage Employer.

Apprenticeships

Target - Increasing the number of young people who gain employment following our apprenticeship programmes by 200% by 2022

In 2019 we set ourselves the target to increase the number of young people who gain employment following an apprenticeship programme by 200% by the end of 2022. To deliver this we are developing an early careers strategy to support and develop younger people (aged 16 to 24) and provide opportunities for them within the Society. In 2019 we recruited a further eight people onto our apprenticeship programme, Connecting our Future, bringing the total to 43 over the past five years.

We are continuing to review the apprenticeships that we offer to 16-24 year olds to allow them to build their career with us and that will enable us to achieve the ambitious target we have set.

We will continue to build specific skills and capabilities through our apprenticeship programmes and will expand our approach over the coming years, maintaining our focus on younger people, as well as making the most of opportunities presented by the national apprenticeship levy to support colleague development.

Gender Diversity

Target - Offering 50% of places on our talent development programmes to women to foster a healthy pipeline of female talent

To support this target and increase the gender balance, we have made several changes to be more inclusive in our recruitment and selection processes. This includes balanced shortlists (male and female) for senior roles, anonymous CVs, inclusive recruitment training and balanced interview panels.

In March 2019 we signed the HM Treasury's Women in Finance Charter demonstrating our commitment to gender equality.

Colleague Engagement

Target - Maintaining our Investors in People platinum accreditation

Colleague engagement remains high at 89%, measured by our independent colleague engagement survey in May every year. Colleague engagement remains a priority and in 2019 we also maintained our Investors in People Platinum accreditation. This puts Skipton in the top 2% of UK employers and one of only two financial services organisations in Northern England to reach this level of accreditation. We are proud that for the sixth year running we have been named as one of *The Sunday Times* Best Companies to Work For and were placed 8th in The Sunday Times 25 Best Big Companies list.

11 SUSTAINABLE CITIES AND COMMUNITIES

Sustainable Cities and Communities

Helping more people into homes and supporting our local communities

Developing and supporting sustainable cities and communities is at the very foundation of who we are. We are proud of the impact we have through fundraising, volunteering and building relationships across diverse communities. Our people are passionate about making a difference in our communities; it is at the very heart of what we do.

As a mutual, and one of the UK's largest building societies, it is important that we continue to support a wide range of community activity. As well as supporting our corporate charities, we continue to support community groups and charities that are important to our people, customers and intermediary partners.

Charity Partnerships

Alzheimer's Society and Alzheimer Scotland

In December 2016, our people voted overwhelmingly to support the Alzheimer's Society and Alzheimer Scotland as a charity partner and over the past three years we have raised a quarter of a million pounds.

This partnership came to an end in December 2019 and we are proud that we have left a lasting legacy for our people, our members and in our wider communities. We are committed to continuing to support people impacted by dementia. We will continue to offer Dementia Friends Information sessions to all new colleagues and ensure there is a Dementia Friend in all our branches.

Mental Health UK

Every year in the UK, one in four of us experiences poor mental health. It can be devastating, affecting so many of the things we value most: relationships, family, finances, and our working life.

At the end of 2019 we asked our people to vote for one of three charities to replace Alzheimer's Society and Alzheimer Scotland as our corporate charity for the next three years and Mental Health UK have been selected as our charity partner for 2020 – 2022.

Mental Health UK work across the UK to provide advice, support, training and information for people affected by poor mental health.

This partnership will help us create a society where no-one feels left out and we'll work with them to raise awareness, learn about mental health and look at how we can better support our people, our customers and our communities.

Charitable Foundation

The Skipton Building Society Charitable Foundation was established in 2000 and has given over £2.2m to charity. Grants of up to £3,000 provide vital funding for charities to continue the fantastic work they already do in our local communities.

In 2019 our Charitable Foundation gave £160,326 to 95 charities.

Matched Funding

Matched funding was introduced in 2019 to support our people who are fundraising for charities and community groups they are passionate about.

From sky dives to sponsored walks, marathons to quiz nights, the creativity and imagination of colleague fundraising meant the Society topped up our people's fundraising efforts by an additional £33,460 donated to 63 different charities.

Community Giving

Target - Supporting 1,000 homeless people by 2022

Community Giving was introduced in 2019 to support mortgage brokers and our mortgage intermediary partners who are making a difference in their communities. To support our target of helping 1,000 homeless people by the end of 2022 we invited mortgage brokers to nominate a charity or community group in their area that actively supports housing and homelessness initiatives.

After a tough shortlisting process, 40 successful charities and community groups each received a donation of £1,000 to support their work helping homeless people or people living in poverty.

Volunteering

Target - Increasing the time our people spend volunteering in the community by 100% by 2022

In 2019 we set ourselves the target of doubling the amount of time our people spend volunteering. To support this, all our people receive up to three days additional leave to volunteer in their local communities. In 2019 our people gave 3,826 hours of their time volunteering in the local community.

We encourage our people to think about using volunteering to support their continued professional development, offering volunteering opportunities in three different ways: unskilled, skilled and professional. This has helped further engage our people and raise awareness of the benefits of volunteering, making a difference both to themselves and their local areas.

First Time Buyers

Target - Helping 30,000 first time buyers into homes by 2022

In 2019 we helped 5,923 customers into homes through a Skipton first time buyer mortgage. This equates to almost 20% of our target to support 30,000 first time buyers by 2022.

Responsible Consumption and Production

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

Taking action where we have the greatest impact

Our aim is to protect our planet for future generations, and we know our customers and our people agree this is a priority. We are committed to ensuring the contribution we make to the environment is always greater than the impact we are having.

Sustainable Supply Chain

In 2019, we piloted an initiative to understand how we can introduce sustainability into our large supply chain. Following the pilot and further investigation, our approach has been agreed and from 2020 sustainability will form part of our expectations for both new and existing suppliers.

Going Plastic Free

Target - Eliminating single use plastic by the end of 2020

In 2019 we began our journey to eliminate single use plastic across the Society and we have made significant progress towards this target in the year as demonstrated by the various actions detailed below.

We have introduced compostable takeaway items in our café areas and removed single use coffee cups from the coffee machines in over 50% of head office departments.

Removing single use plastic is a challenge and we continue to work on understanding the overall impact of removing single use plastic from the Society by the end of 2020.

In May 2019 we introduced an eco-shop at head office selling a wide variety of recycled and sustainable products. Not only has this created a positive impact, but it is also challenging purchasing patterns and encouraging our people not to use single use cups in our head office café facility by replacing these with their own cups. In 2019 this resulted in a saving of 12,993 disposable single use cups.

Reducing Waste

Target - Sending less than 1% of waste to landfill by the end of 2022

In 2019 our focus on waste reduction has resulted in 84.2% waste being recycled, 15.2% recovered and just 0.6% residual waste being diverted to landfill. This is a huge achievement that we are very proud to meet three years ahead of our target. Whilst we recognise there will always be an element of residual waste, we will continue to focus on the waste that we create across the wider society.

In the year we have introduced segregated recycling bins at head office and in our branches, and this means we are minimising the amount of contaminated waste which cannot be recycled.

In addition, we have introduced innovative solutions, such as the food waste generated at head office being sent to an anaerobic digestion facility for transformation into energy. However, the real challenge is to produce less food waste in the first instance and where possible we continue to re-use or recycle our waste; this will be our focus over the next three years.

Working to become Carbon Neutral

Target - Halving our carbon footprint by the end of 2022

Our original target set at the end of 2018 included colleague commuting in our carbon footprint reporting. However, following a review, and to allow us to compare our impact with our peers we have amended our target to report on the carbon emissions of the Society and our people when travelling on business. However, it is still our aspiration to reduce the impact our people have through commuting and in 2020 we will continue to support and encourage our people to look at alternatives to how they travel to work.

In May 2019 we switched our electricity tariff to a renewable energy source, which means that our electricity usage in branches and at head office no longer impacts our carbon footprint. We have also introduced two electric cars into our fleet of cars for business usage. This equates to 20% of our fleet no longer impacting our carbon footprint. These are just two of the initiatives which have reduced our 2019 carbon footprint by 29.9% to 1,627 tonnes CO_2.

To mitigate our carbon footprint in 2019 we committed to plant 15,000 trees in the Woodland Trust Northern Forest initiative and we have supported Skipton Town Council in creating a community orchard and planting wildflower meadows to support the wider carbon footprint across our head office community.

Building a Sustainable Society

Our vision is to build a better society, taking action where we can have the greatest impact. We will continue to focus on the United Nations Sustainable Development Goals, creating and supporting a society that is sustainable now and in the future.

If you have any questions on the Skipton Building Society Sustainability Strategy and our commitment to the Sustainable Development Goals please email Sustainability@skipton.co.uk.

Peace, Justice and Strong Institutions

Always being owned by and responsible to our members, not shareholders

We believe that around 50% of our customers have some form of disability, impairment or long term condition, which can mean that they need tailored ways for us to help them to access our products, services and communications. As part of our work towards becoming a Disability Smart accredited organisation, we have been working on a variety of different initiatives throughout the year to be more inclusive and accessible for everyone as detailed below.

Delivering for our customers

Throughout 2019 we have been asking people specifically with different disabilities, impairments and long-term conditions about some of our services and the way we communicate. This has given us valuable insight into the different ways customers interact with us and how we can improve further.

Results show that changes we have already made are improving the customer experience for everyone, not just those with additional needs.

A Society where nobody is left out

Target - Becoming a Disability Smart accredited organisation by 2020

We have been building on the work we completed last year with AccessAble and creating our online guides that contain helpful information about the accessibility of our branches. The guides are free to use and allow customers to view the accessibility of our premises before visiting the branch. The handy guides can be found on our branch finder pages on our website or on AccessAble's website and in 2019 our guides were used 8,249 times.

As a result of this work we are working hard to make our branches even more accessible. This includes ensuring the colours in our branches have greater contrast between the floors and walls; providing coloured transparencies that may be useful for some people when reading documents, where possible installing handrails on ramps and steps along with many other changes identified by continued review of our premises.

We have also become an early adopter of a project with Communication Access UK, and we are the first financial services organisation to show our support of this initiative. Communication Access UK is a partnership between charities and organisations which aims to improve the lives of people living with additional communication needs and difficulties.

Two of our branches have undergone specific training in 2019 to help them better support the needs of people with communication difficulties. As a representative of financial services, we are feeding back to help shape the project for national roll-out. We plan to roll this out across all our branches and head office throughout 2020 and will be displaying a unique symbol in our branches to highlight this pioneering work.

Customer satisfaction and customer empathy

Target - Showing that we care about our customers by delivering a customer empathy score in excess of 60%

Target - Ensuring that our net customer satisfaction levels are always above 85%

We are passionate about delivering the best possible experience for our customers and so we have looked at the way we gather feedback. In 2019 we changed the way we survey our customers and now use an online survey to gather feedback. Being more transparent and accessible has increased the number of respondents and provides a more representative view from our customers. However, we believe it has resulted in a larger proportion of respondents selecting a neutral option, i.e. 4 out of 7, which has impacted the overall satisfaction and empathy scores. This change to the way we report on customer satisfaction and customer empathy scores has resulted in a change to our targets.

2 Governance

The Board of Directors

Robert East

Chair of the Board, Nominations and Non-Executive Remuneration Committees.

Robert joined the Board in 2011, bringing more than 40 years' experience in, and understanding of, retail and commercial banking in the UK and internationally. He brings in-depth knowledge of building and leading financial services businesses. During his 32 years at Barclays Bank he was Chief Risk Officer of Absa South Africa amongst other roles. He has also had other leadership roles in retail and commercial banking. He led the restructuring of the Cattles Group, becoming its Chief Executive in 2010 until completion of its wind down in 2019. He is Chair of Vanquis Bank Limited and a Non-Executive Director of Provident Financial plc and Hampshire Trust Bank plc.

"In 1976, I joined a branch of Barclays as the office junior. Since then, I have worked in many roles and have learned that well-led and motivated people will give great service to, and do the right thing for, customers. I really believe in this. I joined Skipton because it has the same ambition and I can use my experience to help it deliver that ambition both now and in the future. I feel proud to chair Skipton Building Society because of its history, values, the importance it has for our members and the dedication of our people."

David Cutter

Group Chief Executive, Chair of the Executive and Retail Credit Committees and member of the Asset & Liability and Non-Executive Remuneration Committees.

David has a wealth of experience of the Society having been its Chief Executive for the last 11 years. The Board believes he is the right person to continue to lead the Society and its team in delivering value to members, whilst continuing to develop its financial strength. He has had roles in many areas of our business, including periods as Operations Director, Group Corporate Development Director and Head of Internal Audit. He joined the Board in 2000. He is a qualified chartered accountant, Trustee of the Moorlands Learning Trust and a former Chair of the Building Societies Association.

"I have been with Skipton for over 25 years and remain passionate about its purpose, focused on its customers and continual improvement. Skipton is a trusted business that aspires to consistently provide excellent service and build strong relationships with its customers. It is important to me that I can lead a team to build a trusted, values-driven Society, which inspires its people. My ambition for the business is for Skipton to thrive and be a beacon for our customers in a confusing financial world."

Andrew Bottomley

Customer Director and a member of the Executive Committee and the Non-Executive Remuneration Committee.

Andrew has more than 30 years' experience in leading customer service and sales teams in financial services. He leads the development and delivery of our financial advice proposition, as well as the Society's branch network and contact centre. He has previously served as Mortgage and Bancassurance Director at Lloyds Bank, held various senior roles at the Halifax, encompassing branches, mortgages and head office positions, and was Chair of Halifax Sharedealing. He joined the Board in 2016.

"It is important to me to work for an organisation that cares for both its customers and colleagues. I thrive on a challenge and in an environment where the team has strong values that won't be compromised. I am keen to help people develop and grow and I have dealt with many cultures and segments of the financial services industry. I also have wide experience in conduct risk and change management. I am pragmatic and bring energy and a clear set of values to work every day."

Amanda Burton

A member of the Audit, Nominations and Remuneration Committees and a Non-Executive Director of Connells Limited.

As a qualified solicitor coupled with her experience as Global Chief Operating Officer of Clifford Chance LLP (until 2014), Amanda is able to support Board discussions on legal matters whilst also offering invaluable insight on operational performance and customer issues. She was previously an Executive Director of Meyer International and joined the Board in 2016, bringing more than 20 years' Non-Executive Director experience. Her other directorships are Senior Independent Director and Chair of Remuneration Committee of HSS Hire Group plc and Non-Executive Director and Chair of Remuneration Committee (Countryside Properties plc). Amanda is also Chair of Battersea Dogs' and Cats' Home.

"I am a strong believer in continuous improvement and making sure everything starts with the customer's perception of value. I was attracted to Skipton because it has a strong culture in customer focus and uses continuous improvement methodology to ensure that the customer proposition is delivered effectively and efficiently. I have a strong operational, legal and corporate governance background in a number of diverse industries."

The Board of Directors *(continued)*

Richard Coates

Chair of the Audit Committee and a member of the Nominations and Risk Committees.

Richard is a very experienced financial services auditor and Chair of audit and risk committees. He brings vital finance and corporate governance insight to the Board which the Board views as essential to its long-term success. A chartered accountant, Richard was a senior partner at KPMG before joining the Skipton Group in 2003 as Managing Director of Baseline Capital Limited, which he retired from in 2008. Since then, he has held non-executive director roles at Northern Rock (until 2010) and The Co-operative Bank (until 2016), where he chaired the audit committees and was also a member of their risk committees. He is a non-executive director of TPT Retirement Solutions and the Veterinary Defence Society and is also the chair of the audit committee of both of these organisations.

"Living in the Skipton area and having previously been part of the Group, I welcomed the opportunity to join the Board. The Society stays true to its mutual ethos and has its members at the centre of its thinking. I aim to bring my experience of strong corporate governance to the Board to support the Society's ongoing financial strength and growth strategy."

Denise Cockrem

A member of the Audit and Nominations Committees.

Denise is a practising finance director with considerable experience of leading banking and insurance businesses and brings current practical experience of finance and control matters to the Board and Board Audit Committee. She joined the Board in 2015, with more than 20 years' experience in financial services from roles at Barclays, RBS, Direct Line and RSA Insurance. She is currently the Group Chief Financial Officer at Ecclesiastical Insurance Group, which is wholly owned by a charitable trust. Denise is also an independent Trustee of MacIntyre Academies Trust, which supports children with learning disabilities.

"Customer service is really important to me. Skipton's reputation for this and its investment in the people who deliver it were strong drivers in attracting me to join. I enjoy being part of an organisation that has a purpose and seeks to make a difference to its customers, colleagues and local communities. I have experience in financial services in a variety of finance roles as well as being part of regulated, customer-centric and growing businesses."

Ian Cornelius

Commercial & Strategy Director, member of the Executive, Retail Credit, Asset & Liability and Non-Executive Remuneration Committees and Chair of the Skipton International Limited Board.

Ian has extensive experience in financial services customer management and marketing and has developed the Society's customer proposition. He successfully oversees its implementation with the development of products and services designed to support our customers. Ian has been a Board member since 2012. He previously held senior positions at Homeloan Management Limited, Virgin Money, Bradford & Bingley, Capital One and Boots. He is also a non-executive director of Incommunities Group Ltd and Governor and Trustee of Giggleswick School.

"I am proud to be a Director of an organisation that has a strong set of values and genuinely seeks to put customers at the heart of everything we do. Skipton Building Society has successfully focused on helping people to save and have a home of their own since 1853. My role is to support and enable colleagues to build on this great legacy by constantly seeking to improve the products and services we offer to ensure that we meet the needs of both current and future members."

Denis Hall

Chair of the Risk Committee and a member of the Audit and Nominations Committees.

Denis has worked in senior risk roles and brings a wide knowledge of risk management, regulation and financial services enabling him to chair the Board Risk Committee and provide support, advice and challenge to the Executive on risk management issues. He started his career with Barclays Bank in 1974. He worked for Citibank for 16 years holding various positions including Head of Risk. He was Chief Risk Officer at Deutsche Bank in their retail bank in Europe (2001-2007) and was Global Head of Risk for GE Capital Consumer Bank (2007 to 2016). Denis is also a director and sits on the Audit and Risk Committee of Switzerland's Cembra Bank and is a director and member of the Risk Committee and the Audit Committee of Moneta Bank in the Czech Republic.

"I love Skipton's principle that puts members first and services their needs without pressure. What excites me is being a part of a team that makes things happen and delivers with excellence. I also have a unique opportunity to serve on the boards of other financial institutions in Europe, which keeps me up to date with current issues, so I can contribute to the Society by being able to weigh up different approaches to common challenges."

The Board of Directors *(continued)*

Heather Jackson

A member of the Nominations, Remuneration and Risk Committees.

Heather brings her strong operational performance and IT background which is vital as the Society invests further in its IT and digital platforms. Heather also has 25 years' experience in senior roles at Lloyds plc, Capital One, Boots the Chemist, Asda and Burton Group plc. She is currently a Non-Executive Director of Ikano Bank AB, JD Sports & Fashion plc and Lookers plc.

"I have huge respect for Skipton, which plays such a large part in helping people shape better financial futures for themselves. I think organisations that really focus on their customers' needs are the ones that succeed in the long term. I have worked in large corporations and small start-ups and a common thread for making a positive difference is that they all focus on doing the right thing for their customers. Even though technology and large change projects help drive innovation, the key ingredients are always customers and people – ensuring members and colleagues are at the centre of everything."

Mark Lund

Deputy Chair of the Board, Senior Independent Director and a member of the Audit, Nominations and Remuneration Committees.

Mark's experience at senior leadership level in financial advice and investment management enables him to provide relevant insight which is particularly important as the Society develops its financial advice business. He has more than 30 years' experience in commercial and financial services. His previous roles include CEO of St James's Place plc, CEO of Virgin Direct and Director of Henderson Investors plc. He is Chair of the Employee Benefit Trust, Acting Chair of the mutual company MyCSP Ltd, a Non-Executive Director of Coutts & Co and Chair of Equiniti Financial Services Limited.

"I joined the Society's Board in 2016 following a period as an independent director with Skipton's financial advice business. I know the broader business of the Society well and importantly what it stands for – particularly in terms of its genuine customer focus. My goal remains to play my part in ensuring that we understand our customers' needs and provide them with the most appropriate solutions from a business that remains in robust financial health."

Bobby Ndawula

Group Finance Director, Chairman of the Asset & Liability Committee, member of the Executive, Retail Credit and Non-Executive Remuneration Committees.

Bobby is an experienced finance professional and leads the Society's finance and treasury functions, amongst other areas, which are essential to the success of the Society. A chartered accountant, he previously held a number of senior positions in Group Finance and Financial Risk. With over 20 years' experience in IT, finance and risk, he is responsible for ensuring that the Society's accounting and finance practices remain at a high standard. Bobby has been a member of the Board since 2015. He is also a Trustee of Yorkshire Cancer Research.

"Being part of a values-led organisation that has its members at the heart of everything it does is important to me and keeps me highly motivated. I enjoy leading teams that embrace change and continuously improve the financial strength of the Society for the long-term benefit of our members. My ambition for the business is for it to grow sustainably, so we can continue to help more people achieve their financial goals."

Helen Stevenson

Chair of the Remuneration Committee and a member of the Risk and Nominations Committees.

Helen brings extensive marketing and digital experience together with strong customer focus which the Board regards as essential. She is also experienced in remuneration issues and leads Board discussions on these matters. Helen joined the Board in 2013. She spent 19 years with Mars Inc, was Group Marketing Director of Lloyds TSB and Chief Marketing Officer of Yell Group. She is now Senior Independent Director on the Boards of Reach plc and Kin & Carta plc and is a member of Henley Business School Advisory Board and a Governor at Wellington College.

"I believe the mutual model serves financial services particularly well. Skipton is well placed to continue to strengthen both its excellent customer service and financial stability and I am delighted to serve on its Board. I am interested in encouraging the Board to maintain a powerful connection between members and our business and to evolve our strategy so that it continues to thrive in a changing marketplace."

Directors' Report

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2019.

The financial information included in this Directors' Report is taken from the statutory Accounts on pages 106 to 220 prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). Further unaudited information which allows comparison between 2019 and 2018 is set out on pages 20 to 34 of the Strategic Report.

Business objectives

The business objectives of the Group are set out on pages 17 to 19 of the Strategic Report.

Business review and future developments

The Chairman's Statement set out on pages 8 and 9, the Group Chief Executive's Report set out on pages 10 to 13 and the Strategic Report set out on pages 14 to 35 report on the performance of the business and its future objectives.

Profits and capital

Group profit before tax was £153.2m (2018 restated: £188.7m). Total profit after tax transferred to the general reserve was £122.4m (2018 restated: £148.0m).

Total Group reserves at 31 December 2019 were £1,632.2m (2018 restated: £1,516.6m) including the fair value reserve of £1.4m (2018: £1.6m), the cash flow hedging reserve of £(3.3)m (2018 restated: £(0.4)m), the cost of hedging reserve of £(4.3)m (2018: £(0.5)m), and the translation reserve of £4.5m (2018: £5.2m).

Gross capital at 31 December 2019 was £1,673.8m (2018 restated: £1,558.2m) including £41.6m (2018: £41.6m) of subscribed capital. The ratio of gross capital as a percentage of shares, deposits and borrowings at 31 December 2019 was 7.23% (2018 restated: 7.38%) and the free capital ratio was 5.87% (2018 restated: 6.19%). The Annual Business Statement on pages 224 to 226 gives an explanation of these ratios.

Mortgage arrears

Group mortgage balances at 31 December 2019 included 46 cases (2018: 72) either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £6.0m (2018: £9.9m). The total amount of arrears on these loans was £0.4m (2018: £0.6m).

Charitable donations

During the year the Group made charitable donations of £0.3m (2018: £0.3m), primarily to the Skipton Building Society Charitable Foundation. No contributions were made for political purposes (2018: £nil).

Creditor payment policy

The Group's policy concerning the payment of suppliers is to negotiate and agree terms and conditions with all suppliers and upon complete provision of goods and services, unless there is an express provision for stage payments, undertake to pay suppliers within the agreed payment period, usually 30 days. The number of trade payable days as at 31 December 2019 for the Group was 16 days (2018: 13 days).

Principal risks and uncertainties

The principal risks and uncertainties are set out on pages 67 to 73 of the Risk Management Report and in notes 36 to 38 to the Accounts.

Financial risk management objectives and policies

Details of the key risks to which the Group is exposed in relation to its financial instruments, and how these risks are managed, are set out on pages 67 to 73 of the Risk Management Report and in notes 36 to 38 of the Accounts.

Employees

The Group remains committed to its policy of treating all employees and job applicants equally at all times. Our policy is that no employee, or potential employee, is treated less favourably on the grounds of age, race, colour, religion, nationality, ethnic origin, gender, marital status or sexual orientation. We also give all applications from disabled people full consideration in relation to the vacancy concerned and their own aptitudes and abilities. In the event of an existing employee becoming disabled, we make every effort to maintain their present position or to employ them in alternative suitable work.

We also aim to provide high quality relevant training and development opportunities to all employees, which enables them to achieve their full potential and helps the Group meet its corporate objectives.

The Board meets 10 times a year and is briefed regularly on key employee matters as they arise. There is a comprehensive internal communications structure to cascade relevant business information to employees throughout the organisation in an appropriate and timely way. The Society's subsidiary companies have similar arrangements in place to ensure effective communication of relevant matters.

The Society recognises an independent employee trade union (Aegis) with which management meets regularly to consult and negotiate on a wide variety of matters and to which employees may make their views known on issues affecting their interests.

Property, plant and equipment

The Directors consider that the overall market value of the freehold and leasehold properties occupied by the Group, excluding the principal office of the Society, is in excess of the corresponding book value that is included within property, plant and equipment (per note 18). In arriving at this view, the Directors have taken account of internal and external valuations of the Group's property portfolio. It is difficult to ascertain a reliable market value for the principal office of the Society, which is a special purpose facility, however the Board considers that its value in use to the Group is greater than its book value.

Directors' responsibilities in respect of the preparation of the Annual Report, Annual Business Statement, Directors' Report and Annual Accounts

This statement, which should be read in conjunction with the Independent Auditor's Report on pages 96 to 105, is made by the Directors to explain their responsibilities in relation to the preparation of the Annual Report and Accounts.

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

The Building Societies Act 1986 (the Act) requires the Directors to prepare Group and Society Annual Accounts for each financial year. Under that law they are required to prepare the Group Annual Accounts in accordance with IFRS as adopted by the EU and applicable law and have elected to prepare the Society Annual Accounts on the same basis.

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

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

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU;
- assess the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

In addition to the Annual Accounts, the Act requires the Directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Group. The Annual Business Statement can be found on pages 224 to 226.

The Directors are also required by the Disclosure and Transparency Rules of the Financial Conduct Authority to include a management report containing a fair review of the business, which is set out on pages 20 to 35 of the Strategic Report, and a description of the principal risks and uncertainties facing the Group which is set out on pages 67 to 73 of the Risk Management Report.

The Directors have decided to prepare voluntarily a report on corporate governance as if the Society were required to comply with the Listing Rules and the Disclosure and Transparency Rules of the Financial Conduct Authority in relation to those matters.

A copy of these Annual Report and Accounts is placed on the Society's website. Information in respect of the Capital Requirements (Country-by-Country Reporting) Regulations 2014 is included as an annex to these Annual Accounts on pages 222 and 223.

Directors' responsibilities for accounting records and internal controls

The Directors are responsible for ensuring that the Group:

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

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

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

Directors' responsibilities in respect of going concern

The Group's business activities together with its financial position, capital resources and the factors likely to affect its future development and performance are set out on pages 20 to 35 of the Strategic Report and on pages 65 to 73 of the Risk Management Report. In addition, notes 36 to 38 of the Annual Accounts include the Group's objectives, policies and processes for managing its liquidity risk, details of financial instruments and hedging activities, and its exposure to credit risk, liquidity risk and market risk.

In common with many financial institutions, the Group meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources, and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The Group's forecasts and objectives, which take into account potential changes in trading performance and funding retention, indicate that the Group expects to be able to operate at adequate levels of both liquidity and capital for the foreseeable future.

Consequently, after reviewing the Group's forecasts and the risks it faces, the Directors are satisfied that there are no material uncertainties that may cast significant doubt about the Group's ability to continue as a going concern and have, therefore, continued to adopt the going concern basis in preparing these Annual Accounts, as explained in note 1a) to the Accounts.

Directors' statement of longer term viability

In accordance with the UK Corporate Governance Code, the Directors have assessed the prospects and the ongoing viability of the Group over a longer period than the 12 month period required by the going concern basis of accounting.

The Directors' assessment of the medium term prospects of the Group is based on the Group's corporate plans, which project the Group's performance, profitability, capital, liquidity and funding position over a five year period. The assessment included a review of the Group's current position relative to the market and a review of the Group's strategic priorities over the medium term including management actions to achieve these strategic goals.

The assessment also included a robust review of the Group's principal risks and uncertainties (outlined on pages 67 to 73), which were taken into account to ensure that the possible likelihood or impact of these risks materialising would not materially impact the prospects of the Group and to ensure that the necessary control framework was in place to mitigate the impact of these risks on the future prospects of the business. Specifically, the Directors took account of those risks that could result in events or circumstances that might threaten the Group's business model, future performance, solvency or liquidity and reputation, including the economic, regulatory and political environments.

The Directors concluded that the medium term prospects of the Group are satisfactory and that the financial strength of the business remains healthy throughout the period of assessment.

The Directors have assessed the viability of the Group with the period of assessment being a five year period, to the end of 2024. Having considered various options, the Directors determined that a five year period is an appropriate period for the purposes of the Group's viability assessment. This period reflects the Group's five year corporate planning horizon over which the prospects of the Group and principal risks threatening these prospects are assessed as outlined above, and also the period for which associated stress testing is performed.

In arriving at their conclusion on the longer term viability of the Group, the Directors considered the following:

- The Group's prospects over the five year period as outlined above.
- Stress testing carried out on the 2020 – 2024 business plans through the Group's Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process. The key economic stress test modelled reflected a market-wide fall in residential house prices of 33%, unemployment reaching 9.2% and the Bank Base Rate increasing to 4.0% during the five year period, each of which would adversely impact on the level of losses experienced within the Group's loan portfolio. The Directors concluded that the impact of this severe economic environment would not threaten the longer term viability of the Group.
- Reverse stress testing carried out by the Group, which considers scenarios specific to the Group that could cause the Group to fail. The Directors have concluded that any such scenarios are unlikely to materialise.
- The potential impact of emerging regulation, where there is sufficient information regarding the future regulation.
- The principal risks facing the Group and the control framework in place to manage and mitigate these risks (as outlined in the Risk Management Report), including an assessment of the likelihood and impact of these risks on the Group. This includes specific consideration of the potential impacts that may result from the UK's departure from the EU on 31 January 2020.
- A number of severe but plausible scenarios, arising from the principal risks, which are remote, but if they arose could threaten the longer term viability of the Group.

There are inherent limitations in preparing long term financial plans with regard to a number of factors including, but not limited to, economic, political and regulatory factors. The Directors consider that the outer years of the financial planning period are more difficult to predict and therefore these years have a greater degree of uncertainty. In particular, the Group may be affected, albeit more indirectly than businesses with international trade relationships, by the impact of the UK leaving the EU and the associated political and economic implications that may arise. These impacts may have an effect on the performance of the Group within the Group's financial planning period; the extent of the impact is currently unknown.

However, based on the results of this assessment, the Directors concluded that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the next five years.

Directors

The Directors of the Society during the year were as follows:

Mr R D East	(Chair)
Mr M J Lund	(Deputy Chair)
Mr A P Bottomley*	
Miss A J Burton	
Ms M Cassoni	(retired 29 April 2019)
Mr J R Coates	
Mrs D P Cockrem	
Mr I M Cornelius*	
Mr D J Cutter*	(Group Chief Executive)
Mr D A Hall	
Ms H L Jackson	
Mr R S D M Ndawula*	
Ms H C Stevenson	

* Executive Directors

Details of Directors' service contracts are disclosed in the Directors' Report on Corporate Governance on page 55. No Director of the Society had any interest in the shares of any Group undertaking as at 31 December 2019.

Auditor

As outlined in the Audit Committee Report on pages 63 and 64, the Society appointed a new external auditor during the year, taking account of legal rotation requirements. Following a robust tendering and selection process held in 2018, the Board approved the Audit Committee's recommendation to appoint Ernst & Young (EY) as the Society's external auditor for the year ended 31 December 2019, subject to approval by the Society's members at the Annual General Meeting (AGM) on 29 April 2019; the Society's members approved this proposal. KPMG LLP therefore resigned as the Society's external auditor at the AGM and, in accordance with Section 77 of the Building Societies Act 1986, EY was formally appointed as the Society's external auditor on 10 May 2019.

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

Responsibility statement of the Directors in respect of the Annual Report and Accounts

The Directors who held office at the date of approval of this Directors' Report confirm that, to the best of their knowledge:

- the Annual Accounts, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society; and
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

We consider the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the Group's and Society's position and performance, business model and strategy.

Signed on behalf of the Board

Robert East
Chairman

25 February 2020

Directors’ Report on Corporate Governance

As Chair of the Society and, in line with the Society’s ethos, I view good governance as being at the heart of a well-run business and am committed to complying with prevailing best practice. This report sets out the framework of how the Society oversees its business in a prudent and well organised manner, thereby maintaining high standards of governance for the benefit of our current and future members.

Our approach is based on the principles and provisions of the UK Corporate Governance Code (‘the Code’) published by the Financial Reporting Council (FRC) which applies to listed companies. This report benchmarks the Society against the latest version of the Code, which is applicable to listed entities with accounting periods commencing on or after 1 January 2019. A copy of the Code is available at frc.org.uk.

The Board’s philosophy is to comply with the Code and the guidance issued. Provision 3 of the new Code requires the Chair to discuss governance matters with major shareholders and relay their views to the Board as a whole. As a mutual organisation, owned by its members, with each voting member having one vote, there are no major shareholders and hence this specific requirement is not relevant to the Society. For the same reasons, Provision 36 requiring remuneration schemes to promote long term shareholdings by executive directors is not applicable to the Society. Provision 38 of the Code expects the pension contribution rates for Directors to be aligned to those of the workforce; whilst all new appointments to executive roles will align to this requirement there are a small number of historical arrangements in place for our current executive team which do not.

During 2019, other than the points listed above, the Board believes that the Society complied with all other relevant aspects of the Code.

Governance Framework

The Skipton Group comprises Skipton Building Society (the Society), which is regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), and its direct and indirect holdings in a number of legal entities, some of which are also regulated by the FCA. Skipton International Limited is regulated by the Guernsey Financial Services Commission.

The Society’s governance arrangements are designed to ensure that it meets the requirements and expectations of its members, employees and regulators through a framework which organises the Group into three divisions:

- Mortgages and Savings (including financial advice)
- Estate Agency
- Investment Portfolio

The Society sits within the Mortgages and Savings division which also includes related subsidiaries Amber Homeloans Limited, North Yorkshire Mortgages Limited and Skipton International Limited, our Guernsey-based banking subsidiary.

On a day-to-day basis the Group Chief Executive, Mr Cutter, is responsible for ensuring that the Group meets its strategic and operational objectives as defined in the corporate plan. Mr Cutter is assisted by the Executive Committee, comprising the Executive Directors and other senior Society executives, which he chairs.

Each subsidiary of the Group is governed by a board, which normally contains at least two Society executives as shareholder Non-Executive Directors (appointed by the Society) and the business’ own executive management. In addition, Miss Burton, a Society Non-Executive Director, is also a Non-Executive Director of Connells Limited, being the only Non-Executive Director of the Society to hold such a role. These Boards are responsible for the prudent management of their businesses, operating within delegated authorities, to deliver agreed corporate plan objectives.

The Board’s ‘Principles of Governance’, which are summarised below, provide the framework through which the Society establishes its systems and processes concerned with the overall direction, effectiveness and control of the Group.

Directors

The role of the Board

The Board’s terms of reference clearly set out its responsibility for the overall stewardship of the Group within the context of the Society’s ‘Principles of Governance’ which are:

- **Governing body** - *The Society is headed by an effective Board which is responsible for the long term success of the Group.*

  The Board formulates strategy and establishes the Society’s risk appetite and balance sheet strategy. It is organised so as to have a proper understanding of, and competence to deal with, the current and emerging issues facing the business of the Group, exercising independent judgement and effectively reviewing and challenging the performance of management.

- **Management and oversight** - *The Society’s management and oversight framework enables the Board to provide strategic guidance to, and effective oversight of, management throughout the Group.*

  The governance framework clarifies the respective roles and responsibilities of Directors and senior executives in order to facilitate Board and management accountability to both the Society and its members. This ensures a balance of authority such that no single individual has unfettered powers. It has clear lines of sight into activities to enable challenge and oversight, allowing the Board to obtain assurance over performance, the integrity of reporting and effectiveness of control implementation.

- **Recognise and manage risk** - *The Board has a sound system of risk oversight, risk management and internal control supported by timely and transparent reporting.*

  This framework identifies, assesses, manages and monitors risk on an ongoing basis. It informs management and the Board of material changes to the risk profile of the Society or any of its subsidiaries and facilitates challenge of the effectiveness of actions taken to mitigate risk. It is designed to be forward-looking in approach so as to reduce both the likelihood and the impact of known risks crystallising.

  To support delivery of this, it has established a framework of authorities that maps out the structure of high level delegation below Board level and specifies those issues which remain the responsibility of the Board. The Board also has a general duty to ensure that the Group operates within the Society’s Rules, relevant laws, regulations and guidance issued by relevant regulatory authorities and that proper accounting records and effective systems of internal control are established, maintained and audited.

Culture

The Board has agreed purpose, values and culture statements for the Society to ensure there is clear direction for the business and expectations of how we wish our people to behave. Our purpose remains constant: we are here to help more people into homes, help people save for life ahead and support long term financial well-being. Our cultural goal is to maintain a working environment where the customer is at the centre of our thinking and the benefits of diversity amongst our workforce and the communities we serve is recognised.

The Board monitors culture in a number of ways such as through customer feedback and employee surveys (internally and externally facilitated) but aggregates this through a ‘culture dashboard’ reporting mechanism which reports on performance metrics under the following headings: ethical behaviour, people MI (management information), colleague feedback, customer, risk & control and strategy understanding.

Board Meetings

The Board meets at least 10 times per year and the Non-Executive Directors also meet, without the Executive Directors present, at least once a year. The attendance record of each Director at these Board meetings and each committee member at relevant Board committee meetings is set out on page 57.

The Board also holds two strategy meetings each year, in June and December, where the Group’s strategic objectives are agreed, as are the financial and operational resources to deliver these.

Through the Secretary, the Chair ensures that Directors receive accurate, timely and clear information to facilitate effective contribution to Board discussions and decision making. Each month, the Board receives a Board pack containing matters for review and approval, as well as a comprehensive management information pack covering financial and non-financial information (including operational and customer service metrics), with risk management being an integral part of the reporting. This is issued the week prior to the meeting to ensure that it reflects the most up to date position of the Group whilst allowing Directors sufficient time to review the content.

The Board agenda also includes:

- Minutes of Board committee meetings held before the previous Board meeting and verbal updates from the chairs of Board committees on the main issues discussed and matters agreed at recent meetings (usually held the day before the Board meeting) for which minutes are not yet available. This ensures that all Board members are kept up to date on the key discussions and decisions made by the committees;
- Reports from the Chair, Group Chief Executive and Group Finance Director;
- Items for decision and key matters that need to be debated, including any new business initiatives;
- Matters for review which include updates on specific areas of strategy allowing the Board to keep up to date with developments, identify opportunities and challenge progress; and
- Matters for information aimed at drawing to the Board’s attention matters it should be aware of, such as proposed regulatory change.

For the Board to be effective, the relationship between the Executive and Non-Executive Directors must be constructive and one of openness and respect. The Boardroom environment at Skipton is collegiate with all encouraged to contribute. The role of the Non-Executive Directors is not only to challenge but to support the executive team and bring their experience to bear. To this end, the Non-Executive Directors are welcomed to meetings outside of the Board committee structure which develops their understanding of the business, whilst allowing the management teams to benefit from their experience and fully understand the non-executive perspective on particular issues.

Board Composition

The Rules of the Society detail the appointment process for Directors and require that the Board comprises not less than six and not more than 15 Directors. At 31 December 2019, the Board comprised 12 Directors, being four Executive Directors and eight Non-Executive Directors. Details of the Directors are set out on pages 42 to 47. This composition is designed to be able to meet the needs of the business and allow for efficient operation of the Board’s committees.

The Board considers all the Non-Executive Directors to have been independent at the time of their appointment and to have continued to be so in accordance with the criteria set out in the Code. One Director, Mr Coates, appointed in 2017 was previously Managing Director of a former Society subsidiary, Baseline Limited, but retired from the Group’s employment in 2008.

No Board members have any direct business relations with the Society or any of its subsidiaries or have any personal or family ties with any of the businesses’ advisers, other Directors or senior employees.

The Chair regularly reviews the size and composition of the Board and its committees which are reviewed formally by the Nominations Committee at least annually. This ensures that there exists the required mix of skills and experience on the Board and that succession planning is adequately addressed; our Board Composition Policy is available on the Society’s website at skipton.co.uk/about-us/governance/board-composition-policy. The Nominations Committee aims to ensure that the Board’s committees are optimally resourced and are refreshed at appropriate intervals to avoid reliance on any one individual.

Non-Executive Directors

As part of their Board responsibilities, the Non-Executive Directors are responsible for bringing independent judgement to the Board and for constructively challenging the executive team. The Non-Executive Directors meet,

Governance

without the Executive Directors present, at least annually to discuss relevant matters, including the performance of the executive team.

Mr Lund (Deputy Chair) is the Senior Independent Director on the Board. Whilst the Senior Independent Director role is more pertinent within a quoted company, the role does provide a point of contact for members and other stakeholders with concerns which have failed to be resolved or would not be appropriate to pursue through the normal channels of the Chair, Group Chief Executive or Group Finance Director. The Senior Independent Director also provides a sounding board for the Chair and serves as a trusted intermediary for other members of the Board, if necessary. As part of our governance regime, he meets annually with the other Directors, without the Chair present, in order to appraise the performance of the Chair.

One of the criteria which the Board takes into consideration when recruiting a Non-Executive Director is their ability to have sufficient time to take on the position. In addition, throughout their term of office with the Society, Directors are required to inform the Board in advance of any other positions that they wish to take up so that the time commitment and any potential conflict of interest can be considered. The Society's letter of appointment to Non-Executive Directors gives an indication of the time commitment required, although this will depend on Board committee memberships; typically it involves at least three days per month on Society business. For the Chair this will usually be, on average, two days per week.

The letters of appointment also identify the key responsibilities of the Non-Executive Directors in relation to:

- Strategy – constructive challenge and contribution to the development of strategy.
- Performance – scrutiny of the performance of management in meeting agreed business goals and objectives.
- Risk – obtaining assurance that financial controls and systems of risk management are robust and allow for production of accurate financial reporting.
- People – determination of appropriate levels of remuneration for Executive Directors and oversight of succession planning.

Copies of the letter of appointment for each of the Non-Executive Directors are available for inspection on request from the Society's Secretary.

Chair and Group Chief Executive

The offices of the Chair and the Group Chief Executive are distinct and held by different individuals. The role of each is set out in their role profiles and terms of appointment.

As Chair I am responsible for leading the Board, ensuring it performs effectively, and for promoting high standards of corporate governance. The Chair is also responsible for communicating with the Society's members on behalf of the Board. I can confirm that I am independent and have no conflicting relationships or circumstances that might affect my judgement on Group matters.

The Group Chief Executive has overall responsibility for managing the Society and its subsidiaries. He leads the executive team and is responsible for implementing the strategies and policies agreed by the Board.

The Board elects its Chair and Deputy Chair annually at the Board meeting immediately following the Annual General Meeting (AGM).

Appointments to the Board

The Nominations Committee, which comprises all the Society's Non-Executive Directors, is chaired by myself, as the Society Chair, and leads the process for Board appointments and succession planning. The Committee has succession planning as a key area of focus and at least annually reviews the structure, size and composition of the Board to ensure it contains the required balance of skills, knowledge and experience relevant to the activities of the Group and that it will continue to do so. This review assesses what is required both in the short term and the longer term to deliver the Society's strategy in light of its strategic priorities and changing customer behaviours.

All appointments to the Board are made on merit. In so doing, the Board considers all aspects of diversity, including age, experience and gender when reviewing its composition. It has a Composition policy which, in line with the recommendations of the Davies Report, seeks to ensure that at least 33% of its composition will be female.

A 'Women on Boards' (Davies review) progress report issued in October 2015 recommended that FTSE 350 boards should endeavour to achieve this target by 2020. At 31 December 2019, four members (33%) of the Society's Board were female. The Society is also a signatory to the Women in Financial Services Charter to underline the Board's commitment to gender equality.

Appointments to the committees of the Board (see page 56 for details) are made by the Board on the recommendation of the Nominations Committee, in consultation with the relevant committee's Chair. Both the Nominations Committee and the Board have regard to ensuring a range of skills, experience, knowledge and professional qualifications exist on each Board committee to enable it to fulfil its duties effectively.

Succession requirements must cater for both planned and unplanned events. To this end, the Nominations Committee carries out an annual review of succession planning for Directors and senior executives. The succession plan ensures ongoing recruitment of Directors so that the Board continues to have the relevant skills and experience throughout any period of change in its composition. Senior executive succession planning is reviewed at least annually by the Committee to ensure that those identified with having potential at this level and in the talent pool below are provided with relevant development opportunities and, where appropriate, that effective contingency arrangements are in place.

Succession plans at executive level allow for both permanent and temporary cover should a key post-holder become unexpectedly unavailable.

Induction and Professional Development

On appointment, new Directors receive a comprehensive and tailored induction programme covering the Group's business and regulatory environment. Ongoing training and development needs are identified and addressed through regular review and usually take the form of attendance at external seminars and Board training sessions led by relevant internal and external specialists. Those Directors from a non-banking background are provided with specific training on the capital and liquidity regimes governing the Society's operations. Non-Executive Directors are encouraged to contact individual members of the executive team to demonstrate support and to undertake subsidiary, branch and department visits on an ongoing basis.

Directors have access to the advice and services of the Secretary who is responsible for advising the Board on all governance matters and who is responsible for ensuring that Board procedures are followed. The appointment of the Secretary is a matter reserved to the Board.

All Directors also have access to independent professional advice, if required, at the Society's expense and have the benefit of appropriate liability insurance cover.

Board Evaluation

The Board undertakes an annual performance and effectiveness evaluation of the Board and its committees. At least every three years, this review is conducted by an external facilitator. The reviews address matters including the balance of skills on the Board, its diversity, how the Board and its committees work together and other factors relevant to its effectiveness.

In 2019, after a competitive tendering process, the Board engaged Praesta Partners LLP to undertake the annual performance evaluation of the Board and its committees. Praesta also carried out the 2016 Board evaluation and provided a thorough and insightful report making value-adding recommendations. Part of the 2019 review involved assessment of how well these recommendations had been implemented.

The evaluation involved the independent reviewer reviewing the papers and minutes of the Board and its committees for the year leading up to the start of the review and then observing a meeting of the Board and its committees. A digital questionnaire was prepared by the reviewer, the content of which was informed by the review of the previous meetings, for completion by Directors and members of the Executive Committee and the Chief Internal Auditor. This was then discussed by the reviewer with the individuals in one-to-one meetings. The final report was discussed by the Board and Executive Committee members in a round-table meeting facilitated by the independent reviewer.

The 2019 review found that the Board and its committees are considered to be operating effectively whilst the culture of the Board continues to be regarded positively. Steps taken following the 2016 Praesta review are thought to have been effective and should be continued. The review identified several areas where the Board could improve, including increased focus and oversight of major projects, the executive articulating options considered by them to provide better context to the final proposal being presented and seeking Board guidance at an earlier point on key initiatives to ensure final proposals meet expectations; Non-Executive Directors should ensure that their guidance to the executive is unambiguous. The recommendations were fully endorsed by the Board and agreement on how to best to take forward, agreed.

Individual Review

Individual Non-Executive Directors are evaluated on a one-to-one basis by the Chair. Executive Directors are evaluated by the Group Chief Executive against agreed performance targets for their areas of responsibility and their own personal performance. The Chair evaluates the Group Chief Executive's performance whilst the Deputy Chair and Senior Independent Director lead the Board evaluation of the Chair's performance. All such reviews are conducted at least annually and documented accordingly.

Re-election Policy

The Code recommends that all Directors of FTSE 350 companies should stand for annual re-election. Adopting this best practice, the Society's Rules require that Directors stand for re-election every year. Generally, Non-Executive Directors are initially appointed for a period of three years and, whilst expected to serve for six years, this may be extended to nine years in total.

The Board and Nominations Committee, in 2018, agreed with my recommendation that, as a very effective member of the Board, Ms Stevenson's tenure as a Non-Executive Director be extended to nine years. The Society was reviewing its Group remuneration governance arrangements and it was considered efficient and appropriate to extend the term of office of Ms Stevenson as Chair of the Remuneration Committee to oversee developments.

Remuneration

Details relating to Directors' remuneration are contained in the Directors' Remuneration Report on pages 74 to 93.

Directors' Service Contracts and Notice Periods

The Executive Directors are employed on rolling service contracts which can be terminated by either the Society or the Director giving one year's notice. Unless notice to terminate is given by either party, the contracts continue automatically.

Non-Executive Directors do not have service contracts.

Accountability and Audit

Financial Reporting

The Directors, after making appropriate enquiries and on review of internal management reports and completion of the external audit, consider that these Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for members to assess the Group's performance, business model and strategy. Further details on how this conclusion has been arrived at can be found on page 61 of the Audit Committee Report.

The responsibilities of the Directors in relation to the preparation of the Group's Annual Accounts and a statement that the Group is a going concern are contained in the statements of Directors' responsibilities on pages 49 and 50 in the Directors' Report.

Risk Management and Internal Control

The Board is responsible for determining the Society's strategy for managing risk and overseeing its systems of internal control which includes reviewing and approving its risk appetite on, at least, an annual basis.

The Executive Directors and senior management are responsible for the continuous operation of an effective risk management framework based on a robust system of internal control. Such systems are designed to manage rather than eliminate the risk of failure to achieve the Society's business objectives. The principal categories of risk confronting the Group are described in greater detail in the Risk Management Report on pages 65 to 73, together with an explanation of the framework adopted by the Group for managing risk.

The Board reviews the ongoing effectiveness of its internal control systems through a combination of processes including:

- Regular reports to the Board by the Chairs of its various committees;
- Presentations to the Board by divisional leaders relating to the strategy and performance of businesses within each of the divisions, summarising business performance, key business risks, issues and strategies;
- Regular reports to the Board, through the Audit Committee, from the Internal Audit function in respect of its independent audits of risk management processes and effectiveness of internal controls across the Society and its subsidiaries. The Chief Internal Auditor reports to the Chair of the Audit Committee and attends Audit Committee meetings; and
- Regular reports to the Board, through the Board Risk Committee, from the Risk functions on the principal conduct, operational, credit, market and liquidity risks facing the Group and the strength of the controls in place to mitigate these.

The Society has a comprehensive system for reporting financial results to the Board. Each division prepares monthly results with comparisons against budget which the Board reviews and challenges, as appropriate, where performance is not in line with expectations.

The Society has a number of central oversight and control functions, including Finance, Risk and Compliance, which establish and monitor the implementation of compliance and operational standards across the Group. Each of these functions is subject to review by the Internal Audit function.

The Internal Audit function is responsible for independently reviewing and reporting on the adequacy and effectiveness of internal controls operated by management throughout the Group, thereby helping to evaluate and improve the effectiveness of risk management. Through its programme of work, approved by the Audit Committee, the Internal Audit function is able to provide assurance on control effectiveness.

To ensure sufficient focus is devoted to all areas of risk, the Society operates two discrete risk functions headed by the Chief Financial Risk and Data Officer and the Chief Conduct Risk Officer. These are senior executive positions with both post holders being members of the Executive Committee. The Board Risk Committee and Board receive regular reports from the two risk officers throughout the year. The Board is satisfied that it understands the risks confronting the business and that senior management take appropriate action to mitigate these. More detail is provided on these in the Risk Management Report on pages 65 to 73.

The Board is satisfied that, during 2019, the Group maintained an adequate system of internal control and managed the risks confronting the business effectively. This was carried out in a manner that met the requirements of the Code and good business practice generally.

Board Committees

The Board has delegated certain matters to its committees (comprised only of Non-Executive Directors) in order that these can be considered in more detail.

The Board committee structure includes:

- The Audit Committee – further detail is contained in the Audit Committee Report on pages 59 to 64;
- The Board Risk Committee – further detail is contained in the Risk Management Report on pages 65 to 73;
- The Remuneration Committee and Non-Executive Directors' Remuneration Committee – further detail is contained in the Directors' Remuneration Report on pages 74 to 93; and
- The Nominations Committee – further detail is contained in the section on 'Appointments to the Board' on page 54 of this report.

The terms of reference of Board Committees are available on the Society's website (www.skipton.co.uk) or from the Secretary, on request.

Board and Committee Membership Attendance Record

The attendance of Directors at scheduled Board and committee meetings during the year is set out below:

	Board	Audit Committee	Nominations Committee	Remuneration Committee	Board Risk Committee
Mr R D East	10/10	-	3/3	-	-
Mr A P Bottomley	10/10	-	-	-	-
Miss A J Burton	10/10	5/5	3/3	5/5	-
Ms M Cassoni (note 1)	3/3	3/3	-	-	-
Mr J R Coates	10/10	5/5	3/3	-	7/7
Mrs D P Cockrem	10/10	5/5	3/3	2/2	-
Mr I M Cornelius	10/10	-	-	-	-
Mr D J Cutter	10/10	-	-	-	-
Mr D A Hall	10/10	4/5	3/3	2/2	7/7
Ms H L Jackson	10/10	-	3/3	5/5	7/7
Mr M J Lund	10/10	5/5	3/3	5/5	-
Mr R S D M Ndawula	10/10	-	-	-	-
Ms H C Stevenson	10/10	-	3/3	5/5	6/7

Note
1. Ms Cassoni retired from the Board at the 2019 AGM in April.
Where Directors are not available to attend meetings, they, nonetheless, receive all papers and provide feedback as appropriate.

Relations with Stakeholders

The Board understands the importance of engaging with its stakeholders and ensuring that it is aware of their views and alert to their concerns. It has identified its key stakeholders as:

- Our members and customers;
- Our people;
- Our suppliers;
- Our banking counterparties; and
- Our regulators.

Members and Customers

The Society's membership comprises its savers, borrowers, holders of its Permanent Interest Bearing Shares (PIBS) and non-corporate borrowers which is different to the shareholders of a listed company, whose owners may include institutional shareholders. The vast majority of the Society's customers are, therefore, its members and the Society encourages feedback from them on any aspect of its activities and seeks to respond quickly to all enquiries received.

We conduct regular large-scale market research with members to evaluate their experience of dealing with the Society and how satisfied they are with their relationship with us. This consists of both instant feedback following their interaction with the Society and more detailed feedback on how well the Society is engaging with them and meeting their needs, expectations and continually increasing demands. In 2019 we conducted a large research programme to meet one-to-one with customers in their own homes. Members of the Board, our Executive Committee and senior leaders across the Society took part and the insights from this have formed our strategic plans, future product design, customer journey changes and communication plans. In addition we conduct a large number of smaller research projects on particular areas of focus, whether that be based on customer feedback, Society initiatives or from a regulatory perspective. These can be conducted either face-to-face, by telephone, online surveys or via our members' customer panel. All research is conducted by Market Research Society registered practitioners both in-house and with carefully selected partners.

Due to our continued focus on gathering and acting on feedback from our members the Society has consistently achieved extremely high levels of net customer satisfaction, at 86% in 2019. Based on member insight in 2019 we were one of the first non-current account based building societies to launch an app. In addition to this we regularly appear in the Nunwood Customer Experience Excellence survey; in 2019 we achieved 29th position across all brands in all sectors across the UK, and 5th within banks and building societies which demonstrates externally our focus on understanding and meeting our member's needs.

Whilst feedback from members has been very positive we operate in an environment where borrowing members continue to benefit from low interest rates but saving members have fared less well. Whilst appreciating that the Society continues to pay above market rates, saving members continue to express disappointment that savings rates are not higher.

Our People

To help understand the views of our people, we have used an independent adviser, Willis Towers Watson, to run an annual employee opinion survey (EOS). This is an anonymous questionnaire issued to all Society colleagues and gathers views on a very wide range of topics, from confidence in senior management to views on the Society's treatment of customers and general concerns. This provides a rich insight into colleague thinking and sees the head of each function agree action plans with their teams to address issues and concerns raised; the Executive Committee also prepares a higher level action plan to address any perceived systemic issues.

In line with the Code's requirements, the Board has appointed a Non-Executive Director, Heather Jackson, to be the Board member responsible for providing a further avenue for the voice of our people to be heard at the Board table. She has conducted a series of 'listening sessions' (eight in 2019) where up to 30 of our people at a time are invited to a meeting to share their views on the Society, how they feel in the workplace, how they feel customers are treated and ideas on what we could do better and any other topic they wish to raise. Ms Jackson then provides a written summary of the feedback to the Board. Examples of issues raised include frustrations arising from inefficient processes and remuneration levels. Three such reports were produced in 2019 which saw the senior management team undertake to incorporate actions within its EOS action plan. Progress will be reported back to the Board during 2020.

To supplement this process, those employees with more serious concerns have ready access to an established and internally well publicised whistleblowing process which protects their identity. As whistleblowing champion, I am advised of any whistleblowing reports received by the appointed whistleblow recipients. The Board receives an annual report on any whistleblowing concerns raised and is satisfied that these are appropriately and effectively addressed.

Suppliers

The Society closely monitors all its business relationships with suppliers, on an ongoing basis, assessing any risk of an adverse impact on our customers, our people and the environment in which we operate as a result of these relationships, or as a result of our policies. The Society has been developing its supplier management framework in recent years to strengthen the oversight and relationships we have with our suppliers. To develop this further, we introduced during 2019 a questionnaire for completion by suppliers to assess our performance as a customer. The topics covered included how timely and accurate the Society is when paying invoices, if our corporate responsibility values are clear and views on whether the Society lives these, strength of relationship and comparison of our approach to other clients. The feedback was very positive, providing the Board with assurance that the Society treats its suppliers appropriately. We propose to develop the questionnaire further in 2020 including anonymity for respondents. We also closely monitor our suppliers' service delivery against key performance indicators to ensure the service provided is of an acceptable standard, the results of which are shared with the Board on an ongoing basis.

Regulators

As might be expected, we have current and continuous dialogue with our regulators. This involves not only provision of prescribed reports but updates from the senior management team on matters we believe should be drawn to our regulators' attention. The Board sees it as important that the regulatory bodies are kept up to date with strategic and operational developments within the Group and have ongoing confidence in the Board and management team.

Banking Counterparties

The Society's senior executive and Treasury teams hold meetings with banks and debt investors, where appropriate, to update them on the Society's performance and respond to any questions. This is a long-established arrangement which is seen to work well.

The Annual General Meeting (AGM)

Each year the Society gives all eligible members at least 21 days' notice of its AGM. At the meeting, the Chair and Group Chief Executive address members on the previous year's performance and the main developments in the business. Members have the opportunity to raise questions and put forward their views. All Directors attend the AGM, unless their absence cannot be avoided, and are available for questions both during a 'question and answer' session in the meeting and on an individual basis before and after the meeting.

All eligible members are encouraged to vote at the AGM, either in person or by voting proxy, although the voting form includes a 'vote withheld' option. Members can vote either by post, in any of our branches, online at skipton.co.uk/agm or at the AGM itself. All votes are returned to independent scrutineers. A poll is called in relation to each resolution at the AGM and the results of the vote are published on the Society's website and in branches. As a minimum, the Society's members at the AGM are asked to vote on the Society's Annual Report and Accounts, election or re-election of the Directors, appointment or re-appointment of the external auditor and the Report on Directors' Remuneration.

I am pleased to report that no resolution received less than 80% support from members at the 2019 AGM.

Conclusion

In summary, I believe that the governance arrangements operated by the Society align with the Code's requirements and enable the Board to exercise effective oversight of business performance, regulatory requirements and delivery of our customer proposition.

On behalf of the Board

Robert East
Chairman

25 February 2020

Audit Committee Report

On behalf of the Committee, I am pleased to present this year's Audit Committee Report, which provides an overview of how we, as a Committee, have discharged our responsibilities, setting out the significant issues we have reviewed and concluded on during the year.

The report focuses mainly on the following three areas:

- The role and responsibilities of the Committee;
- The main activities of the Committee during the year; and
- A review of the effectiveness of the Committee.

Membership and attendees

The members of the Audit Committee during the year were:

Mr J R Coates	Non-Executive Director (Committee Chair, appointed to the position 30 April 2019)
Ms M Cassoni	Non-Executive Director (former Committee Chair, retired from the Committee 29 April 2019)
Miss A J Burton	Non-Executive Director (appointed to the Committee 1 January 2019)
Mrs D P Cockrem	Non-Executive Director
Mr D A Hall	Non-Executive Director (appointed to the Committee 1 January 2019)
Mr M J Lund	Non-Executive Director (appointed to the Committee 1 January 2019)

The Committee held five scheduled meetings during 2019 and the attendance of its members at these meetings is set out on page 57 in the Directors' Report on Corporate Governance. We also held private discussions during the year with the then external auditor KPMG LLP (KPMG), the new external auditor Ernst & Young LLP (EY), the Chief Conduct Risk Officer and Secretary, the Chief Financial Risk and Data Officer, the Group Finance Director, the Chief Internal Auditor, the Connells Group Finance and Commercial Director, the Finance Director of Jade, the Finance Director of Skipton Business Finance and the Finance Director of SIL, to provide an opportunity for any relevant issues to be raised directly with Committee members.

In addition to its members, the Group Chief Executive, the Group Finance Director, the Chief Conduct Risk Officer and Secretary, the Head of Compliance Monitoring, external audit representatives and the Chief Internal Auditor regularly attend meetings, by invitation.

The Committee is currently comprised of five members, all of whom are independent Non-Executive Directors. I was appointed to the position of Committee Chair at the end of April, following the retirement from the Board of Ms Cassoni; the Committee wishes to thank Ms Cassoni for her valuable contribution as Chair of the Audit Committee for the past six years.

Consideration is given towards ensuring that the Audit Committee as a whole has competence relevant to the financial services sector. The Board is satisfied that the composition of the Audit Committee includes Non-Executive Directors with recent, relevant financial experience to provide appropriate challenge to management. As Chair of the Committee, I am a Chartered Accountant with significant financial services audit experience, having spent 30 years in senior roles at KPMG. I have held non-Executive Director roles at Northern Rock (until December 2010) and The Co-operative Bank (until October 2016), and at each of these banks I both chaired the Audit Committee and sat on the Risk Committee.

Mrs Cockrem is a practicing Finance Director with more than 20 years' experience in financial services from roles at Barclays, RBS, Direct Line and RSA Insurance; she is currently Group Chief Financial Officer at the Ecclesiastical Insurance Group. Miss Burton has held senior legal and operational roles in a number of industries, including as Global Chief Operating Officer of Clifford Chance. Mr Hall has held senior leadership risk roles with a number of major banks, including Citibank, Deutsche Bank and GE Capital Bank; he currently holds Board and Audit Committee roles with several European banks. Mr Lund brings more than 30 years' experience in commercial and financial services, including senior leadership roles in financial advice and investment management.

In terms of good governance and to ensure holistic oversight, I am also a member of the Board Risk Committee (as is Mr Hall). As part of my role as Audit Committee Chair, I also attended a number of subsidiary board meetings.

Role and responsibilities of the Committee

The responsibilities of the Committee are delegated by the Board and are set out in its written terms of reference which are available on our website at skipton.co.uk/about-us/governance/board-committees. These are in line with the provisions of the Financial Reporting Council's (FRC) 'Guidance on Audit Committees' which was most recently updated in April 2016. Our primary responsibilities are:

- To keep under review the effectiveness of the Group's internal controls, including financial controls and risk management systems;
- To monitor the integrity of the Group's financial reporting process, specifically by reviewing, challenging and recommending the Group's annual and interim financial statements to the Board for approval, reviewing and approving any formal announcements relating to the Group's financial performance and reviewing and challenging, as necessary, the significant estimates and judgements in relation to the financial statements and reporting how these were addressed;
- To provide advice to the Board on whether the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the Group's strategy, business model and performance;
- To provide oversight of the external audit process by monitoring the relationship with the external auditor, agreeing their remuneration and terms of engagement, monitoring their performance, objectivity and independence, ensuring that the policy to provide non-audit services is appropriately applied and making recommendations to the Board on their appointment, re-appointment or removal;

- To review the effectiveness and independence of the Internal Audit and Compliance Monitoring functions, approve their annual plans, review performance against these plans on a quarterly basis, review their material findings and oversee plans to remedy any shortcomings; and
- To report to the Board on how we have discharged our responsibilities.

The minutes of the Audit Committee are distributed to the Board following each meeting and I, as Chair of the Committee, provide a verbal report to the next Board meeting after each meeting of the Committee.

Activities of the Committee during the year

During 2019 our work fell under three main areas, in line with our responsibilities, as follows:

a) Internal controls and risk

The Group recognises the importance of good systems of internal control in the achievement of its objectives and the safeguarding of its assets. Good internal controls also facilitate the effectiveness and efficiency of operations, help to ensure the reliability of internal and external reporting and assist in compliance with applicable laws and regulations.

The Group operates in a dynamic business environment and, as a result, the risks it faces change continually. Management is responsible for designing the internal control framework to ensure thorough and regular evaluation of the nature and extent of risk and the Group's ability to react accordingly. Management is also responsible for implementing the Board's policies on risk and control, noting that all employees are responsible for internal control as part of their individual objectives.

Further details of the Group's risk management practices are provided in the Risk Management Report on pages 65 to 73.

Through the Committee, the Group's Internal Audit function provides independent assurance to the Board on the effectiveness of the internal control framework. The information received and considered by the Committee during 2019 provided assurance that there were no significant control failings that would lead to a material impact on the Group's financial statements. The Group's internal risk and control framework did however help to identify weaknesses with regard to compliance with anti-money laundering procedures in the estate agency business and actions are underway to address these weaknesses as a matter of priority.

Internal Audit is supported, as required, by external advisers who are able to provide specialist technical support in connection with matters such as Treasury, Information Technology, Credit Risk and Operational Resilience. The Chief Internal Auditor reports to me and as a Committee we are responsible for ensuring that Internal Audit has adequate skills and resource levels that are sufficient to provide the level of assurance required. The Committee is satisfied that, throughout 2019, Internal Audit had an appropriate level of resources in order to carry out its responsibilities effectively and that it continues to do so.

The Audit Committee is also responsible for approving the annual budget of Internal Audit and for approving its annual plan of work. This is prepared on a risk-based approach by Internal Audit, reflecting input from management and the Committee.

We review reports produced by Internal Audit and, through Internal Audit, track management actions to completion; Internal Audit then verifies these periodically after management has reported them as complete. Internal Audit provides the Committee with reports on material findings and recommendations and updates on the progress made by management in addressing their findings.

We monitor and assess the role and effectiveness of the Internal Audit function in the overall context of the Group's risk management systems. The Committee assesses the effectiveness and independence of Internal Audit annually, immediately following the year end, and this is reported to and discussed at a meeting of the Committee shortly thereafter.

During the year, the main areas reviewed were as follows:

- the governance framework surrounding key prudential risk areas;
- Information Technology, cyber security and data protection risks to ensure that the Group has robust controls, in line with good practice, in this rapidly evolving area;
- the governance framework surrounding key significant system related projects, including the revised financial advice proposition;
- the Operational Resilience governance framework and controls, in line with the current regulatory focus in this area;
- a number of specific areas of internal control, in particular new and emerging regulatory changes to ensure that the Group meets regulatory expectations at all times; and
- internal controls, including monitoring and oversight activities within the Connells group.

The Committee also has oversight responsibility for the Group's Compliance Monitoring function which provides second line assurance over conduct risk on activities regulated by the FCA across the Group. The Compliance Monitoring annual plan includes both thematic reviews and customer outcomes testing which includes, but is not limited to, investment, pension, mortgage and protection advice, complaint handling and post-sale client outcomes. The outputs of the Compliance Monitoring function's monitoring activities are reported to the Committee, together with progress updates on management's implementation of the findings. The Compliance Monitoring function's annual plan of work is also approved by the Committee.

The Committee periodically reviews the use of the confidential reporting channel in the Group. Awareness of 'whistle blowing' arrangements is maintained through internal communication and is covered as part of employees' induction and ongoing development. The Committee receives annual updates from the Head of Financial Crime on the systems and controls in place for the detection and prevention of fraud. The Committee also receives biannual updates from the Head of Group Tax on tax matters impacting the Group.

As part of the external audit process, the Society's auditor provides us with internal control reports; no material control weaknesses were identified in the reports received during the year.

In line with good practice, the Committee requires an external effectiveness review of the Internal Audit function at least every five years, which considers the quality, experience and expertise of the function. A review was carried out during 2019 by an external firm appointed by the Committee and that review concluded that Internal Audit was operating effectively. The review also confirmed that the Internal Audit function conforms to the standards expected by the Institute of Internal Auditors. Some areas for enhancement were identified which have now been substantially addressed.

At the end of July 2019 the Society's then Chief Internal Auditor stood down from the role, after eleven years in post. There was a smooth transition to the new Chief Internal Auditor, who took up the role with effect from August 2019.

b) Financial reporting

The Committee considers the financial information published in the Group's annual and interim financial statements and considers the accounting policies adopted by the Group, presentation and disclosure of financial information and, in particular, the key estimates and judgements made by management in preparing the financial statements.

The Directors are responsible for preparing the Annual Report and Accounts. At the request of the Board, we considered whether the 2019 Annual Report and Accounts were fair, balanced and understandable and whether they provided the necessary information for members to assess the Group's position and performance, business model and strategy. This was assessed in the following ways:

- best practice guidance and recommendations, including those published by the Financial Reporting Council and leading audit firms, were reviewed and analysed against the Annual Report and Accounts, and enhancements implemented as a result of this analysis where necessary;
- the Executive Committee and the Board have been involved in reviewing and commenting on various drafts of the Annual Report and Accounts, to help ensure that the final draft is fair, balanced and understandable;
- the Committee reviewed and was satisfied that the alternative performance measure of underlying profit before tax (defined on page 25 in the Strategic Report), which is reported alongside the statutory profit measure, gives a clearer view of the underlying performance of the business for our members and is in line with the agreed policy; and
- a thorough review was undertaken by the Financial Reporting team to ensure there was appropriate supporting evidence for the content of the Annual Report and Accounts.

The Committee is satisfied that, taken as a whole, the 2019 Annual Report and Accounts are fair, balanced and understandable and include the necessary information as set out above. The Committee has confirmed this to the Board, whose statement in this regard is set out on page 51 of the Directors' Report.

We pay particular attention to matters we consider to be important by virtue of their impact on the Group's results, and particularly those which involve a high level of complexity, judgement or estimation by the Board. The key areas of estimate and judgement that we considered in reviewing the 2019 Annual Report and Accounts are set out below:

Significant matter	Committee action taken
Going concern and longer term viability review	The Committee reviewed the adoption of the going concern assumption for the Interim Accounts and the Annual Accounts, adopting the same comprehensive approach for both reporting periods. This involves rigorous consideration, based on reports produced by key risk functions around the business as requested by the Committee, of our current and projected liquidity, capital and funding positions, together with the potential risks (for example credit risk, liquidity risk, operational risk and conduct risk) which could also impact the business, as well as consideration of potential stress scenarios. Based on this review, we concluded that the adoption of the going concern assumption to prepare the financial statements remains appropriate. The Committee has reviewed the statement on the longer term viability of the Group in the Directors' Report on pages 50 to 51, together with papers produced by management and key risk functions in support of this statement. This includes consideration of the Group's latest corporate plans, the impact of these plans on the Group's liquidity, capital and funding positions, and the impact of potential risks and stress scenarios. The stress scenarios included consideration of scenarios that could cause the Group to fail, and the Committee agreed that any such scenarios are considered sufficiently unlikely to materialise and to thus threaten the Group's longer term viability. The Committee also gave consideration to the potential impacts on the Group of the UK's departure from the EU on 31 January 2020 and the related disclosures made by management. Based on this analysis, the longer term viability statement on pages 50 to 51 was recommended to, and approved by, the Board. On 30 September 2019 the FRC issued a revised going concern standard for UK auditors (ISA UK 570 Going Concern). This new standard significantly increases the work auditors are required to perform when assessing whether an entity is a going concern, including a new reporting

Governance

Audit Committee Report *(continued)*

Significant matter	Committee action taken
	requirement for the auditor of public interest entities (and certain other entities) to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect. Whilst the new audit standard is not mandatorily effective until 2020, the Committee considered the impact of its requirements when performing its own going concern assessments for the 2019 Annual Accounts.
Impairment of financial assets	The Committee has monitored loan impairment provisions, taking account of the requirements of IFRS 9 *Financial Instruments*. We have reviewed the appropriateness of critical judgements made by management, including the definition of default and the determination of significant increase in credit risk. We have considered the impact of key assumptions within the Group's loan impairment models (such as house prices and forward-looking economic scenarios) on the level of provisions made and the relevant disclosure in the Accounts; this includes noting that, in response to greater political and economic uncertainty, the Group has during the year increased the weighting attached to its downside scenario. We have examined and challenged the assumptions adopted and, by requesting and scrutinising reports produced by management, are satisfied with the models used during the year to calculate loan impairment provisions for both the residential and commercial mortgage portfolios. The Committee has also monitored the level of impairment held against treasury assets under IFRS 9, including scrutinising reports produced by the Market & Liquidity Risk function. We consider the level of impairment held against these assets to be appropriate.
Fair valuation of the equity release portfolio	The Group holds an equity release portfolio which is closed to new business. Under the terms and conditions of the mortgages in this portfolio, a no negative equity guarantee (NNEG) was given to customers. Under IFRS 9, the entire equity release asset (including the NNEG) is held at fair value with resulting gains / losses taken to the Income Statement. As outlined in note 1e) to the Accounts, there is no single industry pricing methodology for valuing the Group's equity release portfolio. The Group has therefore internally devised a fair valuation model, using inputs including mortality rates, voluntary prepayment rates, estimates of future RPI and a house price index, and associated volatility, to predict future cash flows on the portfolio. The valuation is also impacted by selection of an appropriate discount rate (which includes an illiquidity premium). As the valuation technique uses some inputs that are not based on observable market data, judgement is required in determining appropriate assumptions. The Committee has reviewed the assumptions within the equity release fair valuation model and scrutinised supporting papers prepared by management. Taking into account the specific characteristics of this portfolio and also general macro-economic indicators, the Committee considers that the inputs and assumptions are appropriate, and therefore that the valuation of the equity release portfolio is appropriate in the 2019 Annual Report and Accounts. The Group hedges the interest rate and inflation risk arising from its equity release portfolio through the use of derivatives. These derivatives are valued using discounted cash flow models which include estimated redemption profiles and, due to the long-dated nature of these derivatives, any changes to estimates or assumptions can have a significant effect on the valuation of the derivatives. As the underlying mortgage portfolio is not held at amortised cost under IFRS 9, hedge accounting cannot be applied. Both the equity release portfolio and the swaps are held at fair value through profit and loss. There is some natural offsetting between the changes in value of the portfolio and the derivatives but this is not perfect, partly due to the different discounting requirements. The Committee has reviewed papers prepared by management that support the assumptions used and which outline the control framework management has in place; the Committee is satisfied that the amounts recognised in the Income Statement are fairly stated and that the valuations of these derivatives are appropriate. Given the sensitivity of the fair value to certain key assumptions, the Committee also reviewed those key sensitivities and these are disclosed in note 1t) to the Accounts.
Effective interest rate accounting	Interest income on the Group's mortgages is measured under the effective interest rate method, as explained in note 1e) to the Accounts. This method includes an estimation of mortgage product lives which is based on observed historical data and Directors' judgement; management reviewed these estimates during the year and consider that the assumptions regarding mortgage product lives are appropriate. The Committee reviewed the reports prepared by management and is satisfied with the conclusions reached in this respect.

Significant matter	Committee action taken
Appropriateness of provisioning for legal or regulatory matters	The Committee received reports from management on the recognition and amounts of provisions, the existence of contingent liabilities, and the disclosures relating to provisions and contingent liabilities for legal and regulatory matters. The Committee examined these reports and concluded that all such provisions were appropriately accounted for and disclosed in these Accounts, and agreed with management's conclusion on the existence or otherwise of any contingent liabilities. Specific areas addressed included the assessment of the probability of future cash outflows arising following the Board's decision, in 2010, to remove the ceiling on the Society's Standard Variable Rate (SVR) in light of a judgment in 2016 by the Court of Appeal regarding a company's power to vary the rate of interest payable on a tracker mortgage. The Committee concluded that the probability of this issue resulting in future cash outflows for the Society remains remote. The Committee also considered the assessment of the probability of future cash outflows in relation to the legal proceedings against two Group companies that are disclosed as a contingent liability in note 34b). The Committee examined information received from management in support of its assessment and concluded that the treatment and disclosures in these Accounts are appropriate.
Defined benefit pension liability	The Group manages two funded defined benefit pension schemes and one hybrid scheme (with a funded defined benefit element) which at 31 December 2019 had a combined deficit of £87.0m (31 December 2018: £99.5m). The Committee has examined and challenged the pension scheme assumptions and is satisfied that these are reasonable and appropriate.
Prior period restatements	The Accounts include four prior period restatements, summarised below. As explained in note 1b) to the Accounts, the Group has reviewed its application of hedge accounting in accordance with the requirements of IFRS 9 and IAS 39. This review identified a material misstatement where the Group had not appropriately amortised certain fair value adjustments over the life of the hedge. The impacts on the prior period financial statements of the Group and of the Society are set out in note 1b) to the Accounts. The Committee has reviewed information and explanations received from management regarding this restatement, including the related disclosures in these Accounts; the Committee is satisfied with the conclusions reached and considers the disclosures to be appropriate. Each of the other three restatements in these Accounts is presentational only in nature and therefore has no impact on profits (neither current period nor prior periods) and no impact on reserves. These restatements impact the presentation of certain fees and commissions receivable (see note 4a)), the presentation of deferred tax assets and deferred tax liabilities (see note 30) and the presentation of certain interest payable amounts (see note 3). The Committee has received information and explanations from management regarding these restatements and is satisfied that each results in a more fair presentation of the items concerned. The Committee has reviewed the related disclosures in these Accounts and considers these disclosures to be appropriate.

Other matters

We considered matters raised during the statutory external audit and the half year independent review and, through discussion with senior management of the business and the external auditor, concluded that there were no adjustments required that were material to the financial statements as presented.

The Committee has considered the other risk identified by the external auditor within the external audit report on pages 96 to 105 relating to the recognition of revenue within the Estate Agency division and we are comfortable that this has been appropriately considered within the Accounts.

c) External auditor

As outlined in the 2018 Annual Report and Accounts, KPMG LLP, or its predecessor firm, had been the Society's auditor since the 1980s. The Corporate Governance Code recommends FTSE 350 companies put their external audit out to tender at least every 10 years. Due to an update to EU legislation, KPMG would have been legally required to rotate off the audit following the audit of the 2020 Annual Report and Accounts; however, to coincide with the required rotation of the KPMG audit partner, the Board considered it appropriate that a new auditor be appointed following completion by KPMG of the audit of the 2018 Annual Report and Accounts. The external audit process was therefore put out to formal tender during 2018 and, following a robust tendering and selection process that was overseen by the Committee, the Board approved the Committee's recommendation to appoint EY as the Society's external auditor for the year ended 31 December 2019, subject to approval by the Society's members at the Annual General Meeting (AGM) on 29 April 2019; the Society's members approved this proposal. KPMG therefore resigned as the Society's external auditor at the AGM and EY was formally appointed as the Society's external auditor on 10 May 2019.

Audit Committee Report *(continued)*

The Committee assesses the effectiveness and independence of the external auditor annually, following completion of their year-end audit, and this is reported to and discussed at a meeting of the Committee shortly thereafter. This assessment is facilitated by the Group's Financial Reporting function and is made by reference to the Financial Reporting Council's 'Guidance on Audit Committees', which details what is expected of the Audit Committee to ensure that the annual external audit cycle is effective. The assessment covers the external audit of the previous Annual Report and Accounts, whilst the proposed approach to the next audit is also discussed at this meeting, and includes consideration of matters such as:

- any risks to audit quality that the external auditor identified;
- the key controls that the external auditor relied on to address any identified risks to audit quality, such as appropriate audit methodologies, training and quality control policies and procedures;
- the findings from internal and external inspections of the external audit and the audit firm;
- whether the original audit plan was met;
- openness of communication between the external auditor and senior management;
- the skills and experience of the audit team including whether, in the opinion of the Committee, the external auditor demonstrated a sound understanding of the business by, inter alia, identifying the key risks of material misstatement to the financial statements;
- whether an appropriate degree of challenge and professional scepticism was applied by the external auditor; and
- the proposed strategy to be used in the next audit, including the proposed level of materiality to be used.

Based on the above, senior management in the Financial Reporting function prepared a report for the Committee which outlined the principles contained within the Financial Reporting Council's guidance and set out management's view on each principle. The Committee scrutinised this report and, together with its own experience, formed an opinion as to the effectiveness of the then external auditor (KPMG). We concluded that the relationship with the then external auditor had continued to work well and we were satisfied with their effectiveness and independence. Separately, the Committee also considered the proposed approach to the next audit of the Society's new external auditor (EY) and we are satisfied in this respect.

The Committee regularly monitors the Group's relationship with the external auditor and has adopted a policy for ensuring auditor independence and objectivity. This policy defines prohibited non-audit assignments (which include all tax-related assignments) and procedures for approval of other non-audit assignments across the Group. All non-audit assignments are required to be pre-approved by designated mandate holders and a limit is in place above which approval can only be given by the Committee; a report detailing any approved expenditure is also sent to the Committee every six months.

KPMG were the Society's external auditor until 29 April 2019 and undertook a number of non-audit related assignments for the Group between 1 January 2019 and that date; these were conducted in accordance with the Group's aforementioned policy and were consistent with the professional and ethical standards expected of the external auditor. Details of the fees paid to KPMG during that period for audit and non-audit services are set out in note 5 to the Annual Accounts.

EY have been the Society's external auditor with effect from 10 May 2019 and undertook a number of non-audit related assignments for the Group between that date and 31 December 2019; these were conducted in accordance with the Group's aforementioned policy and are consistent with the professional and ethical standards expected of the external auditor. Details of the fees paid to EY during that period for audit and non-audit services are set out in note 5 to the Annual Accounts and for the relevant period non-audit fees represented 15.0% of total EY audit fees for the Group (2018: not applicable). The Group continues to monitor the non-audit services ratio in preparation for changes to EU rules which will limit this percentage to 70%; we will comply with the new rules when they become effective for the Group in 2020.

To further maintain auditor independence, the Group has a policy, approved by the Committee, regarding the employment of former employees of the auditor.

Effectiveness of the Audit Committee

The effectiveness of the Committee is assessed annually and as part of the annual Board and Committee effectiveness review, further details of which are set out in the Directors' Report on Corporate Governance on page 55. The 2019 review, conducted by an external firm and recently completed, concluded that we operated effectively during the year.

Committee members are expected to undertake relevant training as part of their ongoing development and, periodically, the Committee as a whole receives training on current topics such as current sector challenges, regulatory developments, conduct risk issues and financial reporting 'hot topics' to ensure we remain effective in our role.

Richard Coates
Chair of the Audit Committee

25 February 2020

Risk Management Report

As the Chair of the Board Risk Committee, I am pleased to present the 2019 Risk Management Report. This report explains the risk oversight arrangements we operate at Skipton, and what we believe to be the principal risks facing the Group.

During the year the Group continued to monitor closely developments surrounding negotiations to leave the EU and the potential impact of this on the Group's principal risks. The Directors acknowledge that, whilst uncertainties remain regarding how the business environment may change over the coming years as the UK completes the exit process, the changing economic environment could directly impact some of the principal risks discussed in this report. The ongoing economic uncertainty emphasises the need to maintain a forward-looking focus and run appropriate stress scenarios to test the Group's resilience to unforeseen risk events and, where appropriate, build mitigating strategies. The Board is monitoring developments closely and is confident that the Group is well placed to react to any developments accordingly.

More generally the Group continues to maintain focus on the rapidly changing external environment. Throughout the year the Board Risk Committee has challenged management to ensure there are appropriate strategies in place to mitigate the risks identified, whilst enabling business plans to be progressed and maintaining the prudential strength of the Group.

The Committee has, during the year, ensured focus on:

- **Liquidity risk**, ensuring that the Group maintains a prudent liquidity position and is well placed to respond to the uncertain political and economic environment, whilst implementing our longer term funding strategy to diversify our funding base;
- **Interest rate risk**, to ensure that the Group has an effective balance sheet strategy and hedging arrangements in place to manage interest rate risk;
- **Credit risk**, to ensure that the Group appropriately balances risk and reward in a highly competitive mortgage market;
- **Capital management**, to ensure that the Group maintains and projects sufficient capital resources to support our corporate plan, in a period of changing capital rules;
- **Cyber risk**, to ensure that the Group has an appropriate risk framework in place to reduce the likelihood of a successful attack;
- **Financial planning and mortgage advice**, to ensure training and competence standards are appropriate, customers receive good advice and documentation standards substantiate this. As a result of the Society introducing a revised financial advice proposition the Committee has been closely monitoring the risks associated with its development and implementation;
- **Risk appetite**, to ensure that this remained appropriate against a changing business and economic backdrop; and
- **Business operational resilience**, to ensure that the Society has an effective resilience framework to be able to provide customers with a reliable service, free from extended interruption, and that the Society can recover in a swift and organised manner in the event of an operational failure.

To assist the Committee's deliberations, it receives regular reports from the Chief Financial Risk and Data Officer and Chief Conduct Risk Officer. These reports provide clarity of the key and emerging risks faced by the Group and direct the Committee's attention to those matters which the risk officers believe warrant further consideration, enabling challenge of first line management on the actions being taken to mitigate the risks.

Risk overview

Day-to-day operation of the business naturally exposes the Group to a range of potential risks. To limit the level of risk accepted by Group entities in the normal course of business, the Board has established a risk appetite which it reviews, at least annually, in the context of prevailing economic conditions. This covers a number of areas such as capital, liquidity and operational risk. In terms of core credit risk appetite, that for the Society and Skipton International Limited (SIL) is restricted to prime residential lending, either to owner occupiers or buy-to-let investors. The Board does not have any appetite for the Society or SIL to carry out new business in commercial or sub-prime lending.

Central to operating within this appetite is a management culture which promotes awareness of actual and potential risks and an understanding of their impact on the portfolio should they crystallise.

Governance structure

To enable appropriate focus on risk matters, the Board has delegated oversight of risk management to the Board Risk Committee although ultimate responsibility for risk management continues to reside with the Board.

The Board Risk Committee is responsible for considering and recommending the Group's risk appetite and capital adequacy and liquidity management policies to the Board. It is also responsible for ensuring that the Group maintains an effective risk governance structure to ensure that internal and external risks across the Group are identified, reviewed, managed and reported on.

Membership and attendees

The members of the Board Risk Committee during the period were:

Mr D A Hall (Chair)

Mr J R Coates, Non-Executive Director

Ms H L Jackson, Non-Executive Director

Ms H C Stevenson, Non-Executive Director

Risk Management Report *(continued)*

The Board Risk Committee is supported by a number of executive committees, which have day-to-day responsibility for risk management oversight, as outlined in the diagram below:

Non-Executive Board Committee		Board Risk Committee	
Executive Committee	Asset & Liability Committee (ALCO) (chaired by the Group Finance Director)	Retail Credit Committee (chaired by the Group Chief Executive)	Model Governance Committee (chaired by the Chief Financial Risk and Data Officer)
Remit	Develops and maintains policies on structural risk management, liquidity, funding and wholesale credit risk to ensure the prudential strength of the Group, and monitors adherence to the policies to ensure the Group remains within risk appetite.	Develops and maintains policies on credit quality of retail loan books and monitors implementation to ensure that Group lending does not create credit risk outside the agreed appetite.	Develops and maintains model build standards and reviews key models against these to ensure that the output from models can be relied on in decision making.

Whilst the committees operate under delegated Board authority, the success of the framework relies on effective reporting, rigorous challenge and appropriate escalation of issues to the Board Risk Committee where an enterprise-wide view of risk is held. The committees perform self-effectiveness reviews each year to ensure they continue to operate effectively.

Risk management framework

Through the Board Risk Committee approved risk management framework and governance structure, the Group has a formal mechanism for identifying and managing risks throughout the business. This framework is designed to deliver the corporate plan in line with the Board's overall risk appetite and is based upon the best practice 'three lines of defence' model which operates as follows:

First line of defence, being line management within the business who, through the implementation of the organisation's risk framework, identifies, assesses and manages risk.

Second line of defence, comprising independent risk functions (Operational, Credit and Market & Liquidity) and related independent compliance functions. These functions challenge, monitor, guide and support the business in managing its risk exposure. The risk framework includes the three sub-committees of the Board Risk Committee described above which are responsible for recommending and monitoring the Group's adherence to policy. The Board Risk Committee Chair is responsible for maintaining the independence of the second line of defence to ensure there are no obstacles to its independent challenge of first line operations.

Third line of defence, provided by Internal Audit, is designed to provide independent assurance to the Board (through the Board Audit Committee) of the adequacy and effectiveness of control systems operating within the first and second lines in identifying and managing risk.

The principal risks and uncertainties faced by the Group, which are managed within the framework described above, are set out later in this report.

Risk environment

As a business with a retail franchise in financial services offering our customers mortgages, savings, financial advice and estate agency services, the management of conduct and operational risk is key to the ongoing success of the Group. Central to managing these risks is maintenance of a robust product governance framework, to ensure that we develop and market compliant and fair products and services designed to meet the needs of our target market. At point of delivery, the competency and oversight of our advisers to ensure we provide good outcomes for our customers is then essential to maintain the confidence and trust upon which our brand is based.

The Group is predominantly active in the UK and, to a large extent, exposed to the UK property market. Therefore, the general UK macro-economic environment is a key factor in determining the success of the Group. The main drivers that impact the Group include:

- interest rates;
- inflation;
- unemployment; and
- the housing market (volume of transactions and house prices).

The Mortgages and Savings division continues to operate in a low interest rate and relatively benign economic environment, which has been supported in recent years by government initiatives such as the Term Funding Scheme. Initiatives such as this have provided much needed market liquidity with the consequence of dampening competition for retail savings. During 2019 we have seen increased competition in the UK mortgage market which has put pressure on net interest margins across the sector. Our robust product governance and risk management framework plays a key role in ensuring that the Society responds appropriately to this challenge, and remains within risk appetite.

Whilst levels of mortgage arrears have remained low throughout 2019 we remain cognisant that the situation can change at any time. A general downturn in the economy, a material increase in interest rates, higher unemployment or a material decline in house prices would impact the Mortgages and Savings division through higher levels of arrears and possessions and ultimately higher credit losses. Whilst the division's specialist mortgage portfolios of Amber Homeloans Limited (Amber) and North Yorkshire Mortgages Limited (NYM) are likely to be more susceptible to economic shock, these portfolios have been closed to new business since 2008 and are in run-off.

The results of the Estate Agency division are principally driven by the volume of UK property transactions, particularly second hand property sales. This market is heavily influenced by consumer confidence, driven by the general state of the economy, level of unemployment and interest rates, together with the availability of mortgages, particularly for first time buyers. A slowdown in the housing market puts pressure on Connells' income levels. However, the Estate Agency division is partially protected against the performance of its core business through its own diversification into complementary businesses such as property asset management and lettings.

It is clear that we are in a period of great uncertainty. Domestically it remains unclear what the eventual outcome will be of negotiations between the UK and the EU regarding implementation of the referendum result for the UK to leave the EU, and the associated political and economic implications that may arise from this. Globally we are seeing heightened political tensions, changing trading arrangements, and a slowing of economic growth across a number of key regions, whilst there remain question marks around the underlying health of the European financial sector.

Our response to this uncertainty is to maintain strong capital and liquidity positions, and to undertake stress analysis to consider how we may respond to secondary impacts to an economic stress should it arise. Our recent Internal Capital Adequacy Assessment Process (ICAAP) demonstrated that the Society is appropriately placed to deal with a severe economic stress of the severity outlined by the Bank of England of a poor outcome to the Brexit negotiations.

Principal risks and uncertainties

The principal risks and uncertainties presented below are those that are inherent to the Group's business model and strategy, as well as the economic environment within which the Group operates. These risks are identified by the chief risk officers, discussed at Board Risk Committee and then presented to the Board for further consideration and agreement.

The Risk Committee is also alive to the need to be alert to new, emerging risks. These are also considered by the chief risk officers in their quarterly reports to the Risk Committee and a watching brief then maintained, as appropriate, by both first and second line teams to determine whether the key risk profiles of any Group business need to be updated to incorporate the potential new risks. Our reporting process is designed to provide the Risk Committee with continuous assessment of the risk environment and allow it to challenge management on its mitigation plans in a timely manner.

Over the following pages, the prudential risks facing the Group are presented, followed by strategic and business risks and finally operational and conduct risks.

Risk	Risk mitigation and management
Credit risk	
Credit risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group. The Group faces this risk from its lending to: • individual customers (retail mortgages); • businesses through historical commercial lending and ongoing debt factoring and invoice discounting; and • wholesale counterparties for the purposes of liquidity management.	The Society's retail and commercial credit exposure is managed by a team of experienced professionals, with oversight provided by the Retail Credit Committee. Similarly, the Group Wholesale Credit Committee manages treasury credit exposures, with oversight provided by ALCO. The Group has established comprehensive risk management processes in accordance with the Board's credit risk appetite which defines a number of limits regarding concentration risk as well as customer and collateral credit quality to which all lending activity must adhere. The Group maintains what the Board considers to be a low risk approach to new lending and will continue to do so. The credit decision process utilises automated credit scoring and policy rules within lending policy criteria supported by manual underwriting. All aspects of the credit decision process are subject to regular development, as well as independent review by the Credit Risk function, ensuring they support decisions in line with the Board's risk appetite. The Group's collections and recoveries functions provide a responsive and effective arrears management process. We seek to engage in early communication with borrowers experiencing difficulty in meeting their repayments, to obtain their commitment to maintaining or re-establishing a regular payment plan. We consider forbearance options on a case-by-case basis in line with industry guidance and best practice. The impact of any such forbearance is recognised within our provisioning policy. The Society has a commercial mortgage portfolio which is UK-based and, following a reduction in the Group's risk appetite, was closed to new lending in November 2008. The.

Risk Management Report *(continued)*

Risk	Risk mitigation and management
Credit risk (continued)	
	gross carrying value of this portfolio as at 31 December 2019 was £236.7m, representing 1.2% of total Group loans and advances. In addition, the Group includes specialist lending businesses Amber and NYM which were also closed to new lending in 2008. The combined gross carrying value of these portfolios as at 31 December 2019 was £659.3m, representing 3.3% of total Group loans and advances. We have retained an appropriately skilled team of people to manage these loans. As with residential lending in the Society, we consider forbearance options on a case-by-case basis in line with industry guidance and best practice. The impact of any such forbearance is recognised within our provisioning policy. During 2019 arrears levels have remained at modest levels, reflective of the benign economic environment, which has held up in the face of the economic and political uncertainty over the period. Consequently the underlying risk within our portfolios remains low, although we remain alive to the impact that an economic stress would have on these metrics.
Liquidity risk	
Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due.	The Society's Treasury function is responsible for the day-to-day management of the Group's liquidity and wholesale funding. The Board sets the Group's liquidity risk appetite and limits over the level, composition and maturity of liquidity and deposit funding balances, reviewing these at least annually. Compliance with these limits is monitored daily by Finance and Risk personnel and, additionally, a series of liquidity stress tests are performed weekly by the Risk function. Liquidity stress testing is carried out against a number of scenarios including those prescribed by the PRA, considering a wide range of liquidity and economic factors. Early warning indicators are regularly assessed by a variety of functions across the Society to ensure liquidity is maintained at appropriate levels and reported to ALCO and the Board on a monthly basis. On an annual basis, a detailed and forward-looking assessment of our liquidity is undertaken as part of our corporate planning process. This formal review is known as our Internal Liquidity Adequacy Assessment Process (ILAAP) and is reviewed and approved by the Board and also passed to the PRA. In addition the PRA conduct a review every two years of our processes for managing liquidity. The most recent review in 2019 identified no material concerns. Our longer term funding strategy is to continue to diversify our funding sources, through increasing the volume and diversity of our longer term wholesale funding. During 2019, supplementing two covered bond issuances in 2018, we issued a further two covered bond transactions, raising £600m in March and €500m in September, the latter of which has been appropriately hedged by entering into a cross-currency swap transaction. We have also raised c.£877m of funding from our hugely successful Lifetime ISA product since its launch in June 2017, attracting 158,850 customers by the end of December 2019. This source of funding has helped to further diversify our funding base. We have also maintained the quality of the Group's liquidity portfolio, with 40% of total liquidity held within the Statement of Financial Position comprising balances held at the Bank of England, with a further 24% held in UK gilts and Treasury Bills. We also hold a portfolio of high quality but less liquid assets.
Interest rate risk	
Interest rate risk is the risk of loss arising from adverse movements in market interest rates.	Interest rate risk arises from the mortgages, savings and other financial products we offer. This risk is managed through the use of appropriate financial instruments, including derivatives used to hedge exposures, with established risk limits, reporting lines, mandates and other control procedures. Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between market rates), are also monitored closely and regularly reported to ALCO, the Board Risk Committee and the Board. This risk is also managed, where appropriate, through the use of derivatives, with established risk limits and other control procedures. Derivatives are only used to limit the extent to which the Group will be affected by changes in interest rates, foreign exchange rates or other indices which affect fair values or cash flows.

Risk	Risk mitigation and management
Interest rate risk (continued)	
	Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Group are interest rate contracts such as interest rate swaps. The Group holds capital to absorb potential losses for any risks that are unable to be mitigated through the use of derivatives. The Group's forecasts and plans take account of the risk of interest rate changes and are prepared and stressed accordingly, in line with PRA guidance.
Capital risk	
Capital risk is the risk that the business does not maintain sufficient capital levels to protect it against the principal risks it faces such as severe recession or business shocks.	The Group's Financial Risk team conducts an ICAAP at least annually to assess the Group's current and projected capital requirements to support the current risks in the business and future risks arising from the corporate plan. The ICAAP addresses all the Group's material risks and includes Board-approved stress scenarios which are intended, as a minimum, to meet regulatory requirements. The ICAAP is approved annually by the Board and reviewed by the PRA when setting the total capital requirements. The Group adopts the following approaches to calculating its Pillar 1 minimum capital requirements: • IRB approach for mortgage exposures of the Society, Amber and NYM; • IRB approach for exposures relating to investments in subsidiaries outside the regulatory group; • Standardised approach for other lending exposures; • Standardised approach for treasury portfolios; and • Standardised approach for operational risk. Within the ICAAP we consider the impact of emerging capital regulation. There are a number of material changes to future capital regulation which will impact the Society's capital position over the corporate plan horizon. CRD IV defines the regulatory framework that the Society is required to operate within and is the basis upon which the ICAAP has been prepared. CRD IV became effective on 1 January 2014, and some areas of the regulation are being phased in over the period to 1 January 2022. In addition to CRD IV, the Basel Committee have set out their proposed reforms of the Basel III regulation. These reforms impact the basis of calculation of the capital requirement within our ICAAP. These reforms are commonly referred to as Basel IV and are due to become effective from 1 January 2022. The regulatory changes outlined below represent a material recalibration in the amount of regulatory capital required to be held by the Society, despite no material change to the risk profile of the Society, and include: - Minimum Requirement for Own Funds and Eligible Liabilities (MREL) is the minimum amount of eligible liabilities we are required to hold to ensure the Society has sufficient capital to resolve itself in the event of a resolution scenario. As part of the Bank Recovery and Resolution Directive, the Bank of England published its policy for setting MREL and provided guidance on indicative MREL. Based on current guidance, indicative MREL for the Society will be 18% of risk weighted assets from 1 January 2020 to 31 December 2021, and from 1 January 2022 indicative MREL will be the greater of 2x (pillar 1 plus pillar 2A capital requirements) or 2x the leverage ratio. In addition, firms may be required to hold additional capital for capital or leverage buffers. The minimum leverage ratio could therefore be as high as 6.9%. - Basel IV is due to be implemented from 1 January 2022 and materially changes the approach to calculating our risk weighted assets along with the introduction of an IRB output floor, which sets minimum thresholds for IRB risk weights which will be phased in from 50% of standardised risk weights to 72.5% over the period January 2022 to January 2027. - In response to PRA policy statement PS13/17, the Society will be submitting to the PRA, in the first half of 2020, material changes to the IRB models used to evaluate risk within our mortgage portfolio and to calculate capital requirements. The key changes include a change in modelling philosophy from a 'point in time' assessment of risk to a hybrid model which seeks to incorporate in part an assessment of an economic cycle, a change in the definition of default within risk models, and a change to the evaluation of loss given default.

Risk	Risk mitigation and management
Capital risk (continued)	
	The anticipated cumulative impact of these changes will be a material increase in regulatory capital requirements, and a consequent reduction in our CET 1 ratio. Our ICAAP demonstrates that we anticipate having sufficient capital resources to deliver our corporate plan over the plan horizon. These reforms represent a significant recalibration of regulatory capital requirements across the industry, although there remains significant uncertainty on the final outcome of the existing proposals. The Society satisfies all of the current capital requirements under CRD IV.
Pension obligation risk	
Pension obligation risk is the risk that the value of the schemes' assets, together with ongoing contributions, will be insufficient to cover their obligations over time. The schemes are also exposed to possible changes in pension legislation.	The Group has funding obligations for three defined benefit schemes, the two primary schemes of which carry funding deficits. The two primary schemes were closed to new entrants on 5 April 1995 and closed to future accrual of benefit by 31 December 2009. Whilst the pensions Trustees oversee the investment strategy for the pension funds, it is for the boards of the Society and Connells to ensure that the schemes are adequately funded to meet all liabilities. To manage the Group's exposure to pension obligation risk: • The Board regularly reviews the Group's pension risk strategy; • The pension scheme Trustees meet at least quarterly to monitor the investment performance of scheme assets and make investment decisions, liaising with the principal employer in accordance with the scheme rules and taking advice from professional investment consultants; • The pension scheme Trustees also monitor the pension obligation position (on the Trustee's funding basis); and • The pension obligation position (on an IAS 19 basis) is updated every six months and reported, along with key pension risk metrics, to the Board Risk Committee.
Model risk	
Model risk is the risk that, as a result of weaknesses or failures in the design or use of a model, a financial loss occurs or a poor business or strategic decision is made.	To mitigate this risk the Model Governance Committee (MGC) provides a formal forum for monitoring and managing model risk in the Society, ensuring that all material models: • go through a formal review and approval process; • have a robust change control process; • undergo a consistent model, development and validation process; and • are monitored routinely and reviewed periodically in line with a risk based timetable. MGC manages model risk with reference to a defined model risk appetite and governance policy which have both been approved by the Board Risk Committee.
Business risk	
Business risk is the risk of changes in the environment in which the Group operates or the occurrence of events which damage the franchise or operating economics of the Group's businesses.	The Executive Committee of the Society and the boards of Group subsidiary firms are responsible for ensuring that business risk is effectively managed. Potential sources of business risk include revenue volatility due to factors such as macro-economic conditions, inflexible cost bases, structural inefficiencies or new market entrants with lower cost structures or innovative service propositions such as open banking. Delay or inability to respond to changing customer behaviours presents itself as a clear risk as customers' preferred means of accessing financial services evolves in a rapidly changing digital environment. The Group addresses these risks within its corporate plan which is approved by the Board along with the Group's key strategies. The Board Risk Committee is also provided with the results of stress and scenario tests to assess the potential impact on the Group of a stressed business environment such as a severe economic downturn. This enables the Committee to monitor the risk impact of business strategies and to determine whether changes to these may be required to protect the sustainability of the Group. In line with regulatory requirements the Society maintains a recovery plan detailing the steps it would take to sustain itself through such severe business stresses.

Risk	Risk mitigation and management
Climate change risk	
Climate change risk refers to the commercial impact that climate and environmental changes present to our business model.	The Society recognises that there are a number of potential risks associated with climate change, and a plan has been developed, and shared with the Prudential Regulation Authority at the Bank of England, outlining our response to these risks, compliant with supervisory statement SS3/19, which was issued in April 2019. A number of the actions included within the plan have been completed, whilst the majority are scheduled to be complete by December 2020. It is recognised however that the Society will need to be responsive to the evolving nature of these risks. The plan encompasses the following four key components: • **Governance** captures the oversight approach and key responsibilities in relation to our evaluation and response to climate change risks; • **Risk management** captures the identification of potential risks, a vulnerability assessment of these risks that assesses the likelihood and potential impact of potential risks, and the identification of opportunities to enhance the Society's response to climate change, including the establishment of key metrics to monitor risks and progress thereof; • **Scenario analysis** encompasses the consideration of data sources to enable modelling of potential outcomes and their impact upon the Society, and also includes the development of modelled scenarios for evaluating the impact of potential risks; and • **Disclosures** considers how the Society ensures that key stakeholders are fully aware of the activity and outcomes associated with our response to climate change. In addition to ensuring that the Society has considered and is addressing the potential financial risks associated with climate change, the Society has also identified a series of sustainable development goals, and a sustainability strategy, which outline the steps the Society is taking to ensure that it is acting responsibly in its individual response to climate change. The strategy incorporates a series of sustainability targets for the Society such as eliminating single use plastics by 2020, cutting and maintaining landfill waste at less than 1% by 2022 and halving the Society's carbon footprint by 50% by 2022.
Conduct risk	
Conduct risk is the risk of delivering poor or inappropriate outcomes for customers.	The Executive Committee of the Society and the boards of Group subsidiary firms are responsible for ensuring that conduct risk is effectively managed. The framework to control this area is maintained and overseen by the Board Risk Committee. The key risk areas are: *Mortgage advice* - Likely to be the largest financial commitment undertaken by customers, the need for reliable mortgage advice is paramount. The Society provides advice directly and through its Estate Agency division, Connells. Rigorous quality checking and compliance monitoring are operated by the Society and Connells to ensure that the quality of advice and service provided to customers is as expected. A shortcoming in our processes could see poor outcomes for our customers, possible regulatory censure and damage to our brand. The Society and SIL (which advances non-advised residential loans in the Channel Islands and 'expat' buy-to-let loans in the UK via the intermediary market) operate rigorous affordability assessments as part of the mortgage underwriting process. This is subject to regular review to ensure that arrears experience does not exceed expectations, thus enabling early preventative action. *Pensions and investment advice* - Whilst the Society prides itself on the quality of advice offered to customers, the provision of pensions and investment advice is inherently complex and, on occasion, can subsequently be found not to be suitable for the customer. The liberalisation of pensions by the Government has increased the complexity of this area significantly and with it the risk of providing unsuitable advice. Alert to this risk, the Group maintains a robust compliance capability which supports development of appropriate customer offerings and closely monitors the suitability of advice provided to customers. The Board agreed significant investment to develop the Society's financial advice proposition to deliver a more advanced and efficient service for our customers which was rolled out in the third quarter of 2019. This inevitably creates increased operational risk in development and conduct risk in delivery. The Board Risk Committee is alive to this and monitors how the risk profile changes and is managed.

Risk Management Report *(continued)*

Risk	Risk mitigation and management
Operational risk	
Operational risk is the risk of financial loss or reputational damage arising from inadequate or failed internal processes, systems or human error.	The Executive Committee of the Society and the boards of Group subsidiary firms are responsible for ensuring that operational risk is effectively managed. The framework to control this area is maintained and overseen by the Board Risk Committee. The principal risks here are: *Change management* - The scale and pace of regulatory change has been significant in recent years and shows little sign of abating. The scale of this change may impact our ability to progress defined business growth strategies as IT and project resource is directed to ensuring delivery of new regulatory requirements. The regulatory horizon is scanned continuously to enable us to respond in a timely manner to mitigation of this risk. Alongside this, the Society has an ambitious change programme designed to ensure that our customer proposition and service delivery are aligned to customer expectations. The Board and senior management are cognisant that a large and demanding change programme could, if inadequately managed, lead to the crystallisation of unforeseen risks resulting in poor service to customers. Focus and resource has been devoted to developing a robust governance regime to deliver effective oversight of projects from business case approval through to progress monitoring using standard project lifecycle methodology and capacity planning. *Information Technology* - The pace of technological development has created a period of significant change in financial services. The Society will continue to invest in its technology to provide an excellent level of customer service and manage risks in this area which include: *Cyber crime* – Cyber risk incorporates a wide array of potential threats to Group businesses. These can include network or perimeter threats, a breach of online controls leading to increased risk of online fraud as well as data leakage. These threats are of increasing significance given the expected growth in online customer transaction levels. In response to this, Group businesses continue to focus efforts on proactively managing the evolving nature of cyber threat to ensure that the Group is best placed to protect itself and its customers. This includes reviews of our plans to ensure disruption to our customers is minimised were an attack ever to succeed. *Business resilience* – Market experience has shown that executing IT change has significant risk attached to it and can lead to the loss of core systems and the ability to provide expected levels of customer service. The Society is aware of these inherent risks and continues to review its approach to business resilience and continuity to ensure that this is reflective of business changes over time and remains fit for purpose. A specialist team oversees this area and assists first line teams to assess and challenge their operational resilience and ability to deliver a reliable service to our customers. *Financial crime* – As an authorised deposit-taker, the Society carries the inherent risk of being used for money-laundering and fraud. The Society has a clear duty of care to our savers to protect their monies and ensure that customers can continue to save with trust and confidence. The market has seen a rise in scams such as authorised push payment fraud and financial abuse of vulnerable customers; where this occurs, it can have a devastating impact upon the customer whilst creating risk of regulatory censure and the commercial ramifications of loss of confidence in our brand. To manage this risk, customer facing Group businesses maintain financial crime teams which oversee their frameworks to reduce the likelihood of their services being used for the furtherance of crime. The teams are closely involved in the development of new products and services whilst the Society and SIL closely monitor the use of savings accounts for unusual activity. Colleague awareness of how to spot financial crime is a core element of our defence so training is a regular feature for all our teams. The buying and selling of properties is a known target for money launderers. Operating a large estate agency network increases the risk profile of the Group and, accordingly, this has been an area of Committee focus during the year to ensure that our anti-money laundering procedures are strengthened. *GDPR* - The extent of the GDPR regulations allied with the ongoing threat of cyber crime (referred to above) has increased the weighting attributed to this area within our risk profile, underlined by the scale of regulatory fines issued in 2019 within the industry.

Risk	Risk mitigation and management
Operational risk (continued)	
	Whilst protection of our customer data has always been a focus within the Group, the extent and detailed requirements of the new legislation has seen significant resource and investment dedicated to this area across the Group to build appropriate control frameworks and oversight arrangements. Our focus has been to embed our data culture as a business as usual activity rather than as a series of additional tasks to ensure compliance. As with our other conduct and operational risks the threat is solely not one of regulatory non-compliance but loss of customer confidence and lasting reputational damage.
Reputational risk	
Reputational risk is the risk to earnings, liquidity or capital arising from negative market or public opinion.	The Executive Committee of the Society and the boards of Group subsidiary firms are responsible for ensuring that reputational risk is effectively managed. Such risk effectively arises through the poor management of risks generally. The consequences would adversely impact the future prospects of the Group and could expose it to litigation and financial loss. This risk is managed by: • maintaining and investing in control structures; • continuing to focus on customer outcomes; • promoting the Society through marketing and external communications; • working within the risk management framework which has reputational risk as a key consideration; and • closely monitoring social media and press reference to Skipton Group businesses.

To meet the CRD IV Pillar 3 requirements, the Group publishes further information about its exposures and risk management processes and policies on the Society's website skipton.co.uk.

Conclusion

We continue to operate in a period of significant political and economic uncertainty, both domestically and globally. Whilst it may be difficult to predict the outcome of such uncertainty, I am confident that the risk management framework operated by the Skipton Group enables it to identify, assess and manage the risks confronting it and support business sustainability. To underpin this, the Board Risk Committee will continue to promote the embedding of a culture which views risk management not as an additional activity but the manner in which the business is run.

Denis Hall
Chair of Board Risk Committee

25 February 2020

Directors' Remuneration Report

Annual statement from the Chair of the Remuneration Committee

Dear Member,

I am pleased to share the Directors' Remuneration Report on behalf of the Remuneration Committee, which sets out the details of pay, incentive payments and benefits for the Directors for the year ended 31 December 2019.

In March 2019 Mrs Cockrem and Mr Hall stepped down as members of the Remuneration Committee and I would like to thank them for their contribution. On 1 January 2019 Ms Jackson and Mr Lund joined the Remuneration Committee.

The Committee comprises four Non-Executive Directors. The members of the Remuneration Committee during the period were:

Ms H C Stevenson	Non-Executive Director (Chair of the Committee)
Miss A J Burton	Non-Executive Director
Ms H L Jackson	Non-Executive Director
Mr M J Lund	Non-Executive Director

We constantly strive to maintain the highest standards of governance in relation to Directors' remuneration and to provide meaningful information to our members. We have therefore set out this Directors' Remuneration Report in four key sections:

- This annual statement.
- An 'at a glance' summary, highlighting the key performance measures which inform our remuneration awards and the outcomes for the Executive Directors for the year.
- An Overview of the Directors' Remuneration Policy, which is unchanged for 2020 and was approved at the Annual General Meeting (AGM) in April 2019.
- The Annual Report on Remuneration in 2019 on pages 82 to 93 which explains how we put our existing policy into practice in 2019 and how we intend to apply the policy in 2020.

Remuneration Policy

In line with the regulatory requirements for listed companies, we choose to put our policy to a member vote at least every three years. The Directors' Remuneration Policy was put to an advisory vote and approved at the AGM in April 2019.

We recognise that remuneration for our colleagues needs to be clearly aligned to our vision of 'Building a better Society'. Our policies, principles and practices are therefore designed to enable the business to attract, retain and reward people with the right skills, experience, knowledge and behaviours to support the achievement of business goals and objectives within a positive cultural environment, for the benefit of our members.

Variable pay incentive schemes for senior executives in the Society are designed to reward performance across a balanced scorecard of measures including people engagement, customer satisfaction and achievement of strategic goals as well as financial outturns and risk management.

We intend to be competitive within the market on fixed pay (including pensions and other benefits) but some way below total compensation opportunity for businesses which have a greater emphasis on performance related pay within their remuneration arrangements.

The key elements of the Society's Executive Directors remuneration policy and its implementation in 2019 are set out below:

- A Single Variable Pay Arrangement (SVPA) has been in place for Executive Directors and other members of the executive team since 2016. Payments from the legacy 2015-2017 Medium Term Incentive scheme were phased and will conclude in 2020.
- The SVPA, which has a maximum opportunity of 50% of base salary, is made up of a balanced scorecard of measures which are targeted and assessed annually and align with the corporate plan and are within agreed Board risk appetites.
- There is a 30% weighting for personal and strategic team objectives which is designed to give a continued focus on the achievement of longer term strategic objectives. For 2019 there is a small re-balancing with the weighting for strategic objectives increased from 10% to 15% and for personal objectives reduced from 20% to 15%.
- The long term focus of the scheme is further maintained by a requirement that at least 50% (or more if required by regulation) of any variable pay awarded from the scheme is deferred and will vest over a period of either five years or three to seven years (as required by regulation).
- In addition to normal malus and clawback arrangements, these deferred payments are subject to a sustainability assessment one year after award and can be reduced if the Committee determines that the performance which generated the award has not been materially sustained in line with Board expectations.

The structures within the current Directors' Remuneration Policy have remained stable during 2019 with no significant changes. The Committee has been engaged in a number of important projects considering the broader issues of remuneration in the Society.

- The Society has adopted and implemented, as far as is practicable, the remuneration requirements of the Financial Reporting Council's (FRC) revised UK Corporate Governance Code ('the Code') from 1 January 2019. Many of the Code's requirements were already long-established practice in the Society.
- The Society has included the reporting of the CEO pay ratio for 2019 in line with The Department of Business, Enterprise and Industrial Strategy (BEIS) amendments to Directors' Remuneration Reporting Regulations (for listed companies).
- An evaluation of the effectiveness of the Remuneration Committee had substantially positive results.
- Both the Senior Leadership Team (SLT) and the SVPA schemes were reviewed during the year. The Committee reviewed and amended the structure of the two schemes with a view to closer alignment.
- The Society's stance on fair pay is at the heart of the employment relationship. Discussions with the Executive Committee and colleagues showed strong alignment, with a focus on minimum standard of living, pay for performance, equal opportunity and competitive market forces. Becoming a 'Living Wage Employer' in 2019 cemented our ongoing commitment to a fair level of reward for all. The Society has developed fair pay principles which will underpin our reward strategy going forward.
- The Committee has maintained a close interest in our gender pay reporting and gender workstream activities. The Society is proud to have signed up to the Women in Finance Charter in March 2019 and initiatives to improve gender pay and bonus gaps and other key considerations for the Society can be found in a separate gender pay report on our website, skipton.co.uk.

Remuneration in respect of 2019

The Society's medium term objectives are built around four pillars and progress is measured using a number of key performance indicators aligned to these four pillars. For the purposes of the SVPA, targets for the balanced scorecard of measures were set at the beginning of 2019, taking into account the market competition, economic factors and our acceptable risk profile:

- **Our Customers** – in 2019, Society membership numbers grew by 35,868 to take our total membership base to 1,046,294. The cash Lifetime ISA (LISA) continued to be a key driver in the growth in new customers to the Society.
- **Our People** – employee engagement remained strong with a score of 89% when measured in June 2019 which compares very favourably to the financial services industry norm of around 80%.
- **Our Proposition** – in 2019 our net customer satisfaction score was 86% demonstrating delivery of quality products and services to our customers. The Society continues to benchmark well against our peers and ranked very positively in the 2019 KPMG Nunwood Customer Experience Excellence survey.
- **Our Financial Strength** – as described below, the financial performance of the Society was strong during 2019 as we grew both mortgage and savings balances within our risk appetite and invested further in the future of the Society, all while reducing our management expense ratio and upholding strong capital ratios and healthy levels of liquidity.

Group profit before tax in 2019 was £153.2m (2018 restated: £188.7m) and underlying profit before tax was £155.2m (2018 restated: £186.6m). The planned decrease reflects a challenging trading environment and the significant investment made in our strategic priorities in 2019. Political and economic uncertainty also resulted in lower levels of activity within the housing market.

The core Mortgages and Savings division profit before tax for 2019 was £100.8m (2018 restated: £114.8m), with underlying profit before tax for the division being £103.9m (2018 restated: £113.2m). The division performed well in an increasingly uncertain market despite continuing margin pressures as a result of increased competition in the mortgage market.

The Committee made awards under the Society's SVPA with respect to the 2019 outturn against the pre-set targets, taking into account any need for risk adjustment. The average variable pay awards, as a percentage of salary, are set out in the table below:

	2019 award	2018 award	Maximum achievable
Executive Directors	39.2%	45.5%	50.0%
Other Executive Committee members	31.5%	35.8%	40.0%
Senior Leadership Team	22.7%	29.0%	From 25% to 50%
Other colleagues	7.9%	7.7%	15%

The Committee approved a salary increase of 2.25% for the Group Chief Executive and an average increase of 2.6% for the other three Executive Directors. This was lower than the average increase applied in the Society as a whole of 2.8%. The Remuneration Committee continues to focus on managing risk in its remuneration schemes including risk adjustment arrangements.

Conclusion

On behalf of the Committee, I hope this report gives you a clear view of how we have implemented the policy in 2019. The Committee recommends that members vote in favour of the 2019 Annual Remuneration Report at the forthcoming AGM.

Helen Stevenson
Chair of the Remuneration Committee

25 February 2020

Directors’ Remuneration Report *(continued)*

At a glance summary

The tables below highlight the key metrics considered for remuneration and how they align with the Society’s strategy, as well as a focus on personal and strategic objectives.

	Generating profits for the Society...	...in a sustainable way...	...while delivering value to members and treating them fairly...	...and managing risks and processes while complying with regulation
SVPA Measures				
Group profit (adjusted)*	✓			
Mortgage and Savings division profit (adjusted)*	✓			
Efficiency measure	✓	✓	✓	
Net growth in Society members	✓		✓	
Net customer satisfaction	✓		✓	
Risk and governance		✓	✓	✓
People			✓	
Personal objectives		✓	✓	✓
Strategic team objectives	✓	✓		
Features of the Scheme				
Risk adjustment		✓	✓	✓
Sustainability review		✓	✓	✓
Deferral of at least 50% of incentive		✓		✓
Discretion to reduce/defer/recover payments		✓	✓	✓

* For bonus purposes, the Group profit and Mortgages and Savings division profit are adjusted for those items that are not considered part of the Group’s core strategy or those items that are outside of the Directors’ control, as set out in the scheme rules. The adjusted profit is calculated prior to dividends receivable from subsidiary undertakings, fair value gains or losses on financial instruments, fair value gains or losses in relation to the equity release portfolio, Connells management incentive scheme costs, the FSCS levy, profits or losses on disposal of Group undertakings and impairment of Group undertakings or goodwill.

Single Variable Pay Award (SVPA)

The tables below show the 2019 performance measures and level of achievement:

Measure	Performance target range Threshold - Maximum	Outcome	Maximum opportunity (% of salary)	Actual average performance pay achieved (% of salary)
Financials				
2019 Group PBT (adjusted) (£m) [1]	128.4 - 181.2	155.3	5%	3.3%
Mortgages and Savings division PBT (adjusted) (£m) [1]	77.4 - 109.2	101.9	15%	12.6%
Mortgages and Savings Cost Income Ration (%)	65.1% - 61.1%	60.2%	5%	5%
Team KPIs			10%	6.9%
Net Member Growth	38,700 - 54,600	35,868		
Net Customer Satisfaction (%)	81% - 88%	86%		
Employee Engagement (%)	80% - 89%	89%		
Risk and Governance:				
Number of medium overdue audit actions	12 - 5	3		
Number of medium overdue compliance actions	10 - 4	-		
Strategic Team Objectives - a set of objectives aligned to the Society’s Corporate Plan focusing the Executive Team on the achievement of certain key strategic aims for the Society. Examples included Mortgage Strategy, costs and the Society’s Financial Advice Proposition.			7.5%	5.7%
Personal Objectives - performance has been assessed against both the delivery of the Society performance scorecard as well as individuals’ goals, conduct and behaviours.			7.5%	5.6% - 6.0%
Out of a maximum opportunity (as a % of salary) of:			**50%**	**39.1% - 39.5%**

Notes

1. For bonus purposes, the Group profit and Mortgages and Savings division profit are adjusted for those items that are not considered part of the Group’s core strategy or for those items that are outside of the Directors’ control, as set out in the scheme rules. The adjusted profit is calculated prior to dividends receivable from subsidiary undertakings, fair value gains or losses on financial instruments, fair value gains or losses in relation to the equity release portfolio, Connells management incentive scheme costs, the FSCS levy, profits or losses on disposal of Group undertakings and impairment of Group undertakings or goodwill.

The table below summarises the total payments made to Executive Directors in respect of the 2019 financial year. The figures shown in the graph are included in the single figure table on page 82. Further details on the variable pay awards, the performance measures and the extent to which they are achieved are on pages 83 and 84.

Key highlights of 2019		Base salary	Benefits and Pension	SVPA	Total remuneration earned in 2019 £000	Deferred to future years £000
2.5% average salary increase for Executive Directors **39.2%** average SVPA award – minimum of 50% deferred for between 1 to 5 years or 60% deferred between 3 to 7 years No new MTI awards made since 2016 – deferred payments continue until 2020	Mr D J Cutter	521	119	205	**845**	123
	Mr R S D M Ndawula	332	45	132	**509**	79
	Mr I M Cornelius	306	43	120	**469**	60
	Mr A P Bottomley	301	57	119	**477**	60

Base salary Benefits and Pension SVPA

Directors' Remuneration Policy

Overview of Remuneration Policy for Executive Directors in the Society

The Board's policy is designed to ensure that Executive Directors' remuneration reflects performance and enables the Group to attract, retain and motivate a sufficient number of high calibre individuals to lead and direct the organisation and deliver sustainable business performance for our members. The policy received a majority vote from members at the AGM held on 29 April 2019.

How Executive Director Remuneration is determined

In establishing, implementing and maintaining the remuneration policy, the Committee applies a set of remuneration principles for the Group. The general principles set out the Committee's standards with regard to remuneration, governance, risk management and the link to performance. There are specific requirements for those firms captured by the PRA, which includes the Society. The general principles for these firms have been reviewed and updated for 2020 and are set out below. The full remuneration principles are available on request from the Secretary.

General principles of remuneration in 2020

a. We believe it is important to offer remuneration which is competitive and able to attract and retain talented people with the skills, knowledge and experience needed for our business while offering a positive work environment where people can develop and progress on a level playing field.

b. Our values underpin an inclusive culture where individuals are supported to achieve their personal and professional goals, while maintaining a good work/life balance.

c. We believe in strong corporate governance and expect leaders responsible for drafting remuneration schemes to adhere to these principles in our remuneration policies and scheme design. All schemes must comply with the relevant PRA, FCA and EBA remuneration regulations applicable to the business or type of employee. Remuneration must be paid in accordance with the principles and not by any other means intended to circumvent the regulatory requirements. Business leaders are also responsible for ensuring that remuneration practices meet national pay legislation requirements (e.g. minimum wage, salary sacrifice, equal pay requirements) and align to the living wage.

d. Remuneration structures should avoid complexity and the rationale and operation should be easy to understand.

e. It is important that remuneration policies, procedures and practices are consistent with and promote sound, effective risk management and do not encourage risk taking which falls outside the Board Risk Appetite, which is reviewed annually, or the scope of Board policies. Remuneration practices should be formally reviewed at least annually by the senior leaders in each business responsible for approving remuneration, in order to ensure they do not encourage inappropriate risk taking behaviour or present uncontrolled conflicts of interest which may result in poor outcomes for our customers.

f. It is important to us that our people are rewarded fairly regardless of race, colour, creed, ethnic or national origin, marital status, disability, age, gender, gender reassignment, sexual orientation, political opinion, religion, trade union or non-trade union membership.

g. We align our remuneration practices to our business strategy and the long term aims of the Society, taking account of the Board's risk appetite and the need to provide sustainable growth which will benefit our members/customers, colleagues and our communities.

h. Where remuneration is performance related, it is important that the assessment of the individual/team, the business unit and overall Group performance (if appropriate) is taken into account. In assessing individual performance, it is important to take into account a balance of financial and non-financial criteria, including appropriate risk and quality measures.

i. We believe in a consistent and fair approach to remuneration which reflects individuals' responsibilities and performance. Basic pay will reflect the core role and responsibilities of the individual whereas variable pay will reflect the achievement of annually agreed targets or objectives.

j. Remuneration policies, practices and procedures should be transparent, cost effective and, as far as possible, free from conflicts of interest. Where some potential conflicts of interest are unavoidable, systems and controls should be in place to mitigate the risk. Remuneration policies, practices and procedures should be clearly documented and straightforward to understand, administer and communicated in a timely fashion.

k. Employees in control functions (such as Risk, Compliance and Internal Audit) should be rewarded competitively to attract and retain adequately experienced employees. Their variable reward will be based predominantly on personal and non-financial measures and objectives for the business units they oversee, wherever possible.

In addition to the general principles, the Committee sets out requirements for the operation of variable pay, setting appropriate rules and limits around incentive related payments, including approving executive salaries in excess of £200,000 and being informed of individuals earning in excess of £275,000 (including base salary, annual and any long term bonus pay out) in any one calendar year. Additional rules apply to the calculation of termination payments to ensure they are fair to both the employee and the Skipton Group and do not reward failure or misconduct. Further requirements on deferral and performance adjustment apply specifically to Material Risk Takers (as defined on page 91). The principles are reviewed annually and are supported by key policies.

The Executive Directors' SVPA scheme is designed to link the performance of the participants to sustainable business performance. Any payments reflect both individual and business performance outcomes against corporate plan targets, whilst ensuring effective risk management of financial, operational and conduct risks. Targets are set in the context of the corporate plan and are discussed at the Board and approved by the Remuneration Committee.

Participation in the SVPA scheme relating to any financial year is at the discretion of the Remuneration Committee. The total incentive opportunity is apportioned across financial measures, team key performance indicators, personal and strategic objectives. A threshold level of Group and Mortgages and Savings division profit is set based on the corporate plan. If the threshold level is not met then no incentive is payable. To ensure transparency this information is communicated to the participants of the SVPA scheme.

The Committee is responsible for setting remuneration of the Executive Directors and approves the policy for senior managers who have a material impact on the Society's risk profile (Material Risk Takers). In addition, the Committee reviews recommendations from the Group Chief Executive on the remuneration for other key executives.

An update was given to the Committee in the first quarter of 2019 detailing the challenges in relation to the economic and political landscape and the competitive external environment that influenced the final total awards for the All Employee Scheme. This information was taken into consideration, along with other criteria, when setting the executive pay to ensure the levels of award made were fair, consistent and align to those being awarded to the broader workforce.

Policy on remuneration of Executive Directors

The table below shows the key elements of remuneration for Executive Directors and the reasons for their inclusion.

Element **How element supports our strategy**	**Operation**	**Maximum potential value**	**Performance conditions and assessment**
Base salary • Supports the recruitment and retention of Executive Directors, reflecting their individual roles, skills and contribution.	Base salary reflects the size of the role and responsibilities, individual performance (assessed annually) and the skills and experience of the individual. In setting appropriate salary levels, the Committee takes into account data for similar positions in comparable organisations. The data is independently commissioned and the Society aims to position Executive Directors competitively within this reference group.	Increases to base salary are determined annually by the Committee taking into account: • Individual performance; • The scope of the role; • Pay levels in comparable organisations; and • Pay increases elsewhere within the Group.	None applicable, although we do take account of individual performance when considering base pay increases.
Pension • Supports recruitment and retention of Executive Directors at a cost that can be controlled by the Society.	Generally, the Society contributes to a defined contribution pension scheme for the Executive Directors. The contribution can instead be paid in cash (which is excluded from incentive calculations) if the Executive Director is likely to be affected by the limits for tax-approved pension saving.	The maximum is 20% of base salary. Mr Cutter receives 20% of base salary and the other Executive Directors between 10% and 15% of base salary.	None applicable.
Benefits • To attract, retain and provide security for Executive Directors; and • Provide a competitive level of benefits to assist Executive Directors to carry out their roles effectively.	A number of benefits are provided to Executive Directors, including a car or car allowance, private medical insurance, life insurance and disability benefits. The Committee reviews benefits from time to time and may make changes, for example, to reflect market practice or the needs of the business.	The Society bears the cost of providing benefits, which may vary from year to year.	None applicable.

Directors' Remuneration Report *(continued)*

Element How element supports our strategy	Operation	Maximum potential value	Performance conditions and assessment
Single Variable Pay Arrangement (SVPA) • Supports the attraction and retention of Executive Directors; • Supports the development of a high performance culture; • Rewards performance within the context of achieving corporate goals and objectives as set out in the corporate plan; and • Encourages the right behaviours in respect of sustainable performance that supports the achievement of strategic goals.	A combination of financial and non-financial measures and targets are set with a weighting which will not exceed 50% of the total incentive opportunity for financial measures and which will not exceed 60% for non-financial measures. The latter includes personal objectives (normally up to 20%). Targets are set and assessed against these criteria each year relative to the Society's strategic aims. 50% of earned incentive is normally paid in cash shortly after performance has been assessed. The remaining 50% of earned incentive is deferred over a period of one to five years, or three to seven years if required by regulation, and is normally paid in cash subject to performance adjustment. Current regulations also require that for those whose total remuneration exceeds £500,000 or whose variable pay (for the relevant performance year) exceeds 33% of total remuneration (de minimis threshold), 60% of the SVPA will be deferred and 50% of the initial up-front award will be delivered in the form of an 'instrument' which will be subject to a further holding period (currently 12 months). The instrument will be subject to a write down if the CET 1 ratio falls below a prescribed level. An element of the performance assessment will be made over a period of more than one financial year to meet regulatory requirements and to maintain a longer term perspective in the scheme. This will be achieved by the Remuneration Committee making a sustainability assessment one year after the award of the incentive. Up to 25% of the incentive originally awarded can be reduced or cancelled as a result of this assessment. The percentage of deferred incentive, the deferral period (one to five years or three to seven years) and the payment instrument may be amended in response to changes in regulation. The Committee may reduce or withdraw the payment of a deferred amount in certain circumstances and has the power to reduce, cancel or recover payments under the SVPA if it believes there are circumstances where the payments are not appropriate, for example due to failure to maintain certain capital levels, evidence of systemic conduct risk, or evidence of significant control failures or weaknesses.	The maximum incentive which may be earned for any year by the SVPA is 50% of base salary. For each performance measure, the Committee determines a threshold, target and maximum level of performance. No incentive is payable for performance below the threshold level, with varying levels of pay-out for performance between threshold and maximum. On-target performance generally attracts an incentive of 60% of the maximum.	The performance measures attached to the SVPA will be determined by the Committee from year to year, but might typically include (but are not limited to) any of the following: • Group profit (adjusted); • Mortgages and Savings division profit (adjusted); • Efficiency measures; • Customers (growth and satisfaction); • Risk and governance; • People; • Personal objectives (includes an element for strategy development and implementation). Performance against the measures is reviewed and approved by the Remuneration Committee. The weightings attached to the types of measure and the individual weightings attached to each individual measure may vary from year to year as determined by the Committee.

Notes to the table

Performance measures

The performance conditions attached to the SVPA scheme have been selected as they support the sustainable success of the Society. The Committee believes that the use of a range of financial and non-financial measures provides a balanced assessment of the overall performance of the Society.

The Committee considers the targets attached to the SVPA to be commercially sensitive and will not therefore disclose these at the beginning of the financial years to which they relate. The Committee will, however, disclose the weightings that will be attached to each SVPA performance measure at the beginning of the relevant financial year.

A summary of performance against the targets will be disclosed following the end of the relevant financial year. In setting the target and maximum payments, the Committee considers both the market position and the risk appetite of the Society and sets these levels accordingly. The weightings for 2020 are outlined in the 'Statement of implementation of Remuneration Policy in 2020' section of this report.

MTI scheme

The Society has a legacy MTI scheme which was discontinued from 2016. The final three year performance cycle ended in December 2017 and payments were phased 50% in 2018 with the remaining 50% to be paid pro-rata in 2019 and 2020.

Remuneration for other employees

All employees of the Society receive a base salary and benefits consistent with market practice and are eligible to participate in the Society's pension plan and in the incentive arrangements relevant to their role.

Members of the Executive Committee and other selected senior managers may be eligible to participate in the SVPA on the same terms as the Executive Directors, subject to the discretion of the Group Chief Executive and the Committee. The award size for these individuals may be lower than for the Executive Directors.

A variable pay arrangement for all employees (excluding the Executive Committee and certain senior managers) is in place, so that everyone employed by the Society will have the opportunity to share in the Society's success. The key measures for the scheme are aligned with those that apply for senior management.

Committee's discretion in relation to the SVPA and MTI schemes

As noted above, the Committee has the discretion to reduce, defer or recover payments under the SVPA in accordance with the Society's Policy on Malus and Clawback. Malus refers to the reduction or withdrawal of deferred awards and clawback is the repayment of amounts already paid. The Committee also has the discretion to cease or amend the operation of either arrangement where this is necessary to ensure the arrangements continue to meet the Committee's overriding remuneration principles and risk criteria. This might include, for example, amending the deferral arrangements to comply with changing regulation.

Pensions

All new appointments to Executive roles will fully align to the pension arrangements available to all other colleagues. There are a small number of historical arrangements in place for our current Executive Team which are closed for future accrual.

Directors' service contracts and notice periods

The Executive Directors are employed on rolling service contracts which can be terminated by either the Society or the Director giving one year's notice. Unless notice to terminate is given by either party, the contracts continue automatically. Non-Executive Directors do not have service contracts.

Policy on remuneration of Non-Executive Directors

The table below sets out the elements of Non-Executive Directors' remuneration and the policy on how each element is determined.

Element	Approach to determination
Base fees	Reviewed annually based on time commitment and responsibility required for Board and Board committee meetings. Review takes into account fees paid by comparable financial services organisations.
Additional fees	Additional fees are payable for additional responsibilities such as committee chair or other duties.
Other items	Non-Executive Directors are not eligible to participate in any form of performance pay plans and do not receive pensions or other benefits. Travel and subsistence expenses, including between home and Skipton offices, are reimbursed.

The Remuneration Committee determines the Chair's fee while the fees of the other Non-Executive Directors are determined by the Non-Executive Remuneration Committee and approved by the Board.

Annual Report on Remuneration in 2019

Executive Directors' Remuneration

The total remuneration for Executive Directors in 2019 and 2018 is set out in the tables below:

2019 Audited	Mr D J Cutter £000	Mr A P Bottomley £000	Mr I M Cornelius £000	Mr R S D M Ndawula £000	Total £000
Salary	521	301	306	332	1,460
Benefits[1]	15	12	12	12	51
Pension[2]	104	45	31	33	213
Total fixed remuneration	**640**	**358**	**349**	**377**	**1,724**
2019 annual performance award (SVPA)[3]	205	119	120	132	576
Total remuneration in respect of performance periods ending in 2019	**845**	**477**	**469**	**509**	**2,300**
Total 2019 performance pay deferred[4]	(123)	(60)	(60)	(79)	(322)
Prior years' deferred performance pay now released[5]	107	60	60	65	292
Total paid in 2019 or payable in 2020[6]	**829**	**477**	**469**	**495**	**2,270**

2018 Audited	Mr D J Cutter £000	Mr A P Bottomley £000	Mr I M Cornelius £000	Mr R S D M Ndawula £000	Total £000
Salary	510	294	299	322	1,425
Benefits	15	12	12	12	51
Pension	102	44	30	30	206
Total fixed remuneration	627	350	341	364	1,682
2018 annual performance award (SVPA)	234	135	136	148	653
Total remuneration in respect of performance periods ending in 2018	861	485	477	512	2,335
Total 2018 performance pay deferred	(140)	(67)	(68)	(89)	(364)
Prior years' deferred performance pay now released	147	71	69	85	372
Total paid in 2018 or payable in 2019	868	489	478	508	2,343

Notes
1. Benefits comprise the provision of a car or car allowance and private medical insurance contributions.
2. Mr Cutter's 2019 pension figure includes the additional value earned in the defined benefit scheme during 2019 which was £nil (2018: £nil) and a non-consolidated allowance paid in lieu of contributions. For the other Executive Directors, the figure relates to contributions to the defined contribution pension scheme and/or a non-consolidated cash allowance.
3. £122,782 (60%) of the 2019 SVPA award for Mr Cutter (2018: £140,130) will be deferred in equal amounts for between three to seven years. Half of the initial up-front award (i.e. 20% of the total) will be paid in March 2020 and the remaining half will be retained for a further 12 month period and paid subject to CET 1 capital remaining at or above the agreed level in March 2021. £79,024 (60%) of Mr Ndawula's 2019 SVPA award will also be deferred on the same basis as Mr Cutter's (2018: £88,805). 50% of the 2019 awards for Mr Bottomley and Mr Cornelius will be deferred for between one and five years in line with the SVPA scheme rules. The 2019 annual performance award is the total variable remuneration for 2019.
4. These are amounts which have vested in respect of the performance period ending in December 2019 (from the 2019 SVPA scheme) which are due to be paid in future years in line with the scheme rules.
5. These are deferred amounts from STI schemes from 2016 onwards plus deferred payments from the 2015/2017 MTI schemes which are payable in 2020.
6. Total payable is salary, benefits, pension and other payments which have been paid in 2019 and variable pay from 2019 (and from prior years) which is payable in 2020.

In 2019, no payments were made to past Directors or for loss of office.

Base salary

Our annual salary review process takes place in April each year and the following adjustments were made to the Executive Directors' base salaries taking into account data from PwC as our remuneration advisers and the average pay review award in the wider Society, which was 2.8% for employees below Executive Committee level. The increases were effective from 1 April 2019.

Director	% increase	April 2019	April 2018
Mr D J Cutter	2.25%	£523,700	£512,170
Mr A P Bottomley	2.25%	£302,310	£295,650
Mr I M Cornelius	2.25%	£308,190	£301,400
Mr R S D M Ndawula[1]	3.25%	£335,130	£324,580

Note
1. Mr Ndawula was awarded a 3.25% increase, based on market review and alignment.

Variable Pay

Single Variable Pay Arrangement (SVPA)

The SVPA is designed as a discretionary variable incentive scheme and supports the attraction and retention of high quality employees and the development of a high performance culture. The scheme is designed to link the performance of participants to sustainable business performance. Participation in the scheme relating to any financial year shall be at the discretion of the Remuneration Committee.

The measures, weightings and the final payments from the 2019 SVPA scheme are set out below:

Director	Target bonus opportunity (% of salary)	Maximum bonus opportunity (% of salary)	Weighting					SVPA award	
			Group profit (adjusted)	Mortgages and Savings division profit (adjusted)	Efficiency measure	Team KPIs[1]	Personal and team strategic objectives	% of salary	£000
Mr D J Cutter	30%	50%	10%	30%	10%	20%	30%	39.1%	205
Mr A P Bottomley	30%	50%	10%	30%	10%	20%	30%	39.5%	119
Mr I M Cornelius	30%	50%	10%	30%	10%	20%	30%	39.1%	120
Mr R S D M Ndawula	30%	50%	10%	30%	10%	20%	30%	39.3%	132

Note
1. Team KPIs include the measures for growth in Society members, net customer satisfaction, risk, governance and people as set out in the policy table on page 77.

In 2018, four key strategic team objectives were introduced into the SVPA scheme, which were focused on the growth of our financial advice business, achieving our digital strategy, optimising our cost base and optimising the risk adjusted return on capital (RAROC). The four key strategic team objectives are still relevant in 2019 with an adjustment being made to equalise strategic and personal objectives to 15% each. The weighting for team KPIs remains at 20%.

Directors' Remuneration Report *(continued)*

The table below summarises the outcome against the various measures underlying the SVPA:

Measure	Performance target range Threshold - Maximum	Outcome	Maximum opportunity (% of salary)	Actual average performance pay achieved (% of salary)
Financials				
2019 Group PBT (adjusted) (£m) [1]	128.4 - 181.2	155.3	5%	3.3%
Mortgages and Savings division PBT (adjusted) (£m) [1]	77.4 - 109.2	101.9	15%	12.6%
Mortgages and Savings Cost Income Ratio (%)	65.1% - 61.1%	60.2%	5%	5%
Team KPIs				
Net Member Growth	38,700 - 54,600	35,868	10%	6.9%
Net Customer Satisfaction (%)	81% - 88%	86%		
Employee Engagement (%)	80% - 89%	89%		
Risk and Governance:				
Number of medium overdue audit actions	12 - 5	3		
Number of medium overdue compliance actions	10 - 4	-		
Strategic Team Objectives - a set of objectives aligned to the Society's Corporate Plan focusing the Executive Team on the achievement of certain key strategic aims for the Society. Examples included Mortgage Strategy, costs and the Society's Financial Advice Proposition.			7.5%	5.7%
Personal Objectives - performance has been assessed against both the delivery of the Society performance scorecard as well as individuals' goals, conduct and behaviours.			7.5%	5.6% - 6.0%
Out of a maximum opportunity (as a % of salary) of:			**50%**	**39.1% - 39.5%**

Notes

1. For bonus purposes, the Group profit and Mortgages and Savings division profit are adjusted for those items that are not considered part of the Group's core strategy or for those items that are outside of the Directors' control, as set out in the scheme rules. The adjusted profit is calculated prior to dividends receivable from subsidiary undertakings, fair value gains or losses on financial instruments, fair value gains or losses in relation to the equity release portfolio, Connells management incentive scheme costs, the FSCS levy, profits or losses on disposal of Group undertakings and impairment of Group undertakings or goodwill.

Risk considerations

In order to ensure that rewards are based on sustainable performance, set in a multi-year period, the Remuneration Committee conducts a 'sustainable performance assessment' for senior schemes (SVPA and SLT), one year after the original performance year. The review also takes into account feedback from the Board Risk and Board Audit Committees provided as part of the annual risk assessment process. The sustainability review conducted in February 2020 for the 2018 SVPA and SLT schemes demonstrated that 2018 performance levels had been either maintained, or for the majority of measures, exceeded, in 2019. The Committee concluded, therefore, that no adjustment to the 2018 award was required.

The Society has a Risk Adjustment Policy which sets out its approach to ex-ante and post risk adjustment, malus and clawback. Where the Remuneration Committee determines that risk adjustment is required, payments due from the scheme and deferred payments (if applicable) may be postponed, reduced or cancelled for some, or all, participants. In certain circumstances, the business may need to apply clawback arrangements and require repayment of an appropriate amount of variable pay relating to the event which has occurred.

The Remuneration Committee, after consultation with the Board Audit and Risk Committees and consideration of performance against risk appetites, decided that no risk adjustment was deemed necessary for 2019.

Deferral arrangements for 2019

SVPA

The SVPA scheme requires a minimum deferral of 50% of the award over a period of five years for all participants but this increases to 60% for Executive Directors if remuneration for the current performance year exceeds de minimis limits, i.e. the total remuneration awarded for the current performance year is greater than £500,000 or the variable amount awarded for the current year is more than 33% of total remuneration. Where remuneration exceeds these limits, then 50% of the SVPA award will need to be paid in 'instruments'. In a listed company, this would be a form of share instrument, but for ourselves as a mutual organisation this means that 50% of the award payable in each year will be retained for a further 12 months and will only be paid subject to meeting agreed capital levels. The retained amount cannot increase or attract interest payments during the deferral and retention periods.

Deferred awards are released on a pro-rated basis between three and seven years if the Director is classified as a 'Senior Manager' under the PRA Senior Managers Regime and remuneration exceeds the de minimis level.

In 2019, the total remuneration awarded to Mr Cutter and Mr Ndawula exceeded the de minimis level and therefore 60% of the SVPA will be deferred and released during a period of three to seven years as per the schedule below:

	Total award (£000)	Non-deferred element	Mar-20	Mar-21	Deferred element	Mar-23	Mar-24	Mar-25	Mar-26	Mar-27	Mar-28
Mr Cutter	205	40%	20%	20%	60%	6%	12%	12%	12%	12%	6%
Mr Ndawula	132	40%	20%	20%	60%	6%	12%	12%	12%	12%	6%

Notes

1. The table reflects the percentage of the total award and how the payments are phased over time.
2. The 20% due in March 2021 is the retained element of the non-deferred portion of the award.

Mr Bottomley and Mr Cornelius' awards were below the de minimis threshold. 50% of the award will be deferred over a period of five years in line with the SVPA scheme rules.

Current and deferred awards can be reduced or clawed back at the discretion of the Remuneration Committee. This could be in the event of a significant loss, a material error, material failure of risk management or failure to meet appropriate standards of fitness and propriety or some other substantial reason.

Medium Term Incentive (MTI)

The three year performance cycle for the 2015 – 2017 MTI ended in December 2017. Payments resulting from this performance cycle, which were phased 50% in 2018, 25% in 2019 and 25% in 2020, are subject to malus and clawback in the usual way. The MTI scheme was discontinued from 2016 and no new awards are due to be made.

Directors' pension benefits

Mr Cutter is a deferred member of the Skipton Building Society (2015) Group Pension Scheme which is a defined benefit fund registered with HM Revenue and Customs under the Finance Act 2004. The scheme is closed to the future accrual of benefits and no member contributions were made during the year. The value of his benefits in the scheme is set out below.

Audited 2019	Normal retirement date	Member's contribution for the year ended 31 December 2019 £000	Accrued pension entitlement at 31 December 2018 £000 pa	Accrued pension entitlement at 31 December 2019 £000 pa	Value of remuneration for the year ended 31 December 2019 £000
Mr D J Cutter	**1 January 2027**	**-**	**93**	**95**	**-**

Governance

Directors' Remuneration Report *(continued)*

Normal retirement date for members of the scheme is when they reach the age of 65. The scheme rules specify that this is the earliest date at which members are entitled to benefits from the scheme:

- without consent (from the employer or the Trustee of the scheme); and
- without actuarial reduction in the benefits;
- but disregarding any special provisions in the scheme rules relating to a member's entitlement to early payment of their benefits on the grounds of ill health, redundancy or dismissal.

Audited 2018	Normal retirement date	Member's contribution for the year ended 31 December 2018 £000	Accrued pension entitlement at 31 December 2017 £000 pa	Accrued pension entitlement at 31 December 2018 £000 pa	Value of remuneration for the year ended 31 December 2018 £000
Mr D J Cutter	1 January 2027	-	90	93	-

During the year Mr Cutter's accrued pension entitlement was revalued in line with the scheme rules. The value of remuneration shown above is calculated using a modified version of HM Revenue and Customs' tax rules for pension savings, as laid out in the regulations. The additional value earned by Mr Cutter during the year due to his membership of the scheme is included in his total remuneration.

Non-Executive Directors' remuneration

Non-Executive Directors' fees (excluding those of the Chair) are reviewed annually by the Non-Executive Directors' Remuneration Committee, in line with the policy outlined earlier in the report. The Non-Executive Directors' Remuneration Committee makes recommendations concerning Non-Executive Directors' remuneration to the Board and in 2019 recommended that the basic Non-Executive Director fee should be increased by 2.25% (rounded down to the nearest £100) effective from 1 August 2019. The following changes were approved.

	2019 £	2018 £
Non-Executive Directors	52,100	51,000
Audit Committee and Risk Committee Chairs	14,600	14,300
Remuneration Committee Chair	14,600	12,200
Deputy Chair	6,200	6,100
Connells Non-Executive Director	34,700	26,500

The disparity between the fees for the Chairs of the Audit and Risk Committees and the Chair of the Remuneration Committee were reviewed and it was agreed to increase the Remuneration Committee Chair fee to align with Audit and Risk.

The Chair's fee is reviewed and approved by the Remuneration Committee. Mr East's fee was increased by 7.8% to £165,000 (2018: £153,000) which reflects his performance in the role, the time commitment he provides to Skipton and also takes into account external benchmarking.

Miss Burton is a non-executive director of Connells Limited and now chairs their remuneration committee, in recognition of which her annual fee was increased from £26,500 to £34,700 from 1 August 2019.

Audited		2019				2018			
	Note	Fees £000	Committee chair fees £000	Taxable benefits(1) £000	Total £000	Fees £000	Committee chair fees £000	Taxable benefits(1) £000	Total £000
Mr R D East (Chair)		158	-	6	164	152	-	6	158
Mr M J Lund (Deputy Chair)	2	58	-	5	63	54	-	4	58
Miss A J Burton	3	81	-	3	84	68	-	3	71
Ms M Cassoni	4	17	5	2	24	50	14	6	70
Mr J R Coates	5	51	10	1	62	50	-	2	52
Mrs D P Cockrem	6	51	-	3	54	50	-	6	56
Mr D A Hall	7	51	14	4	69	50	14	3	67
Ms H L Jackson	8	51	-	2	53	10	-	-	10
Mr G E Picken	9	-	-	-	-	25	-	2	27
Ms H C Stevenson	10	51	13	3	67	50	12	4	66
		569	42	29	640	559	40	36	635

Notes

1. The taxable benefits shown in the table above relate to the reimbursement of travel and subsistence expenses between home and Skipton head office (and for Miss Burton, who is also a Non-Executive Directors of Connells, Connells' head office), including for attendance at Board and Committee meetings.
2. Mr Lund was appointed as Deputy Chair on 24 April 2018.
3. Miss Burton was appointed as a Non–Executive Director of Connells Limited on 1 May 2018 for which she receives an annual fee of £34,700 (increased from £26,500 with effect from 1 August 2019 to reflect the fact that she now chairs Connells' remuneration committee), included pro-rata in the table above.
4. Ms Cassoni was the Chair of the Board Audit Committee until 29 April 2019 when she retired from the Board.
5. Mr Coates was appointed Chair of the Board Audit Committee on 30 April 2019.
6. With effect from 1 July 2019, Mrs Cockrem waived her basic fee and it is now paid to her employer organisation, which is wholly owned by a charitable trust, and compensates them for the time she spends as a Skipton Non-Executive Director.
7. Mr Hall is Chair of the Board Risk Committee.
8. Ms Jackson was appointed to the Board on 24 October 2018.
9. Mr Picken (former Deputy Chair) retired from the Society Board on 23 April 2018. He was a Non-Executive Director of Connells Limited between January 2018 and April 2018, for which he received an annual fee of £26,000, included pro-rata in the table above.
10. Ms Stevenson is the Chair of the Remuneration Committee.

History of Group Chief Executive's remuneration

The table below shows a breakdown of the total remuneration of the Group Chief Executive over the last ten years, together with the SVPA/STI and MTI awarded to the Group Chief Executive as a percentage of his maximum possible award.

Year	Base pay(1) £000	Benefits and pension £000	Variable pay (SVPA)(2) £000	Variable pay (MTI)(3) £000	Total remuneration £000	SVPA/STI as % of maximum	MTI as % of maximum
2019	521	119	205	N/A	845	78	N/A
2018	510	117	234	N/A	861	91	N/A
2017	500	115	234	163	1,012	93	79
2016	490	113	161	157	921	66	79
2015	418	99	149	N/A	666	71	N/A
2014	408	96	195	N/A	699	95	N/A
2013	366	89	296	N/A	751	94	N/A
2012	352	84	181	N/A	617	60	N/A
2011	344	85	53	N/A	482	18	N/A
2010	320	75	68	N/A	463	25	N/A

Notes

1. The Group Chief Executive's base pay was increased by 15.4% in 2016 to compensate for the reduction in his variable pay opportunity (from 100% to 50%).
2. From 2018, the SVPA (maximum 50% of salary) is the only variable pay awarded.
3. A proportion of the SVPA and MTI is deferred and paid in future years as set out on page 77.

Directors' Remuneration Report *(continued)*

Remuneration in the Society

The Committee does not currently consult employees on remuneration policy for Directors but it does take into consideration remuneration arrangements for the wider population in the Society when determining executive remuneration.

As part of adopting, on a voluntary basis, the new FRC Corporate Governance Code for listed companies, the Society has designated, with effect from January 2019, a Non-Executive Director with a particular focus on engagement with employees as a further step to ensure that their views are reflected in Board discussions and decision making.

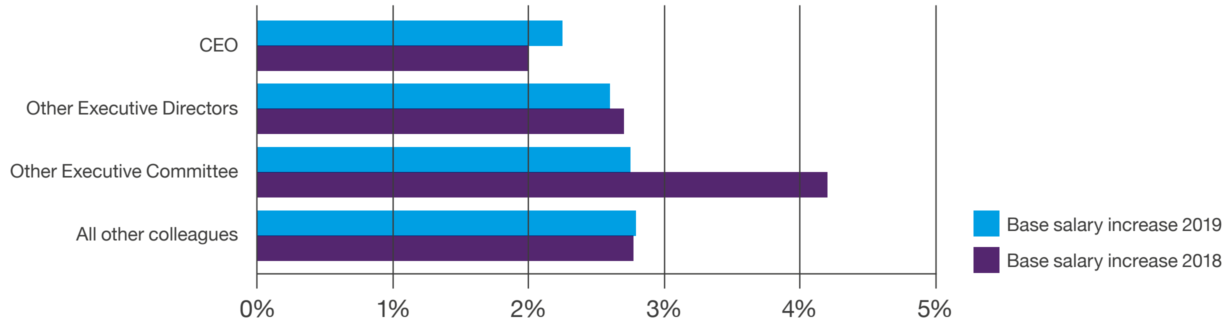
As our culture evolves and changes, we must continue to reward and provide our people with the things that they value most. During 2019, the Society reviewed the approach to reward and have listened to the views of our people about what is important to them. This has been done through a combination of our engagement survey, feedback from colleagues and specific focus groups and listening sessions.

A set of fair pay principles have been developed taking into consideration the many views of colleagues across the Society and these underpin the Society's current and future reward strategies.

Comparison of average base salary increases awarded in the annual pay review

The table below illustrates the average annual base salary increases, expressed as a percentage of salary, made as part of the annual pay review.

Base salary increase



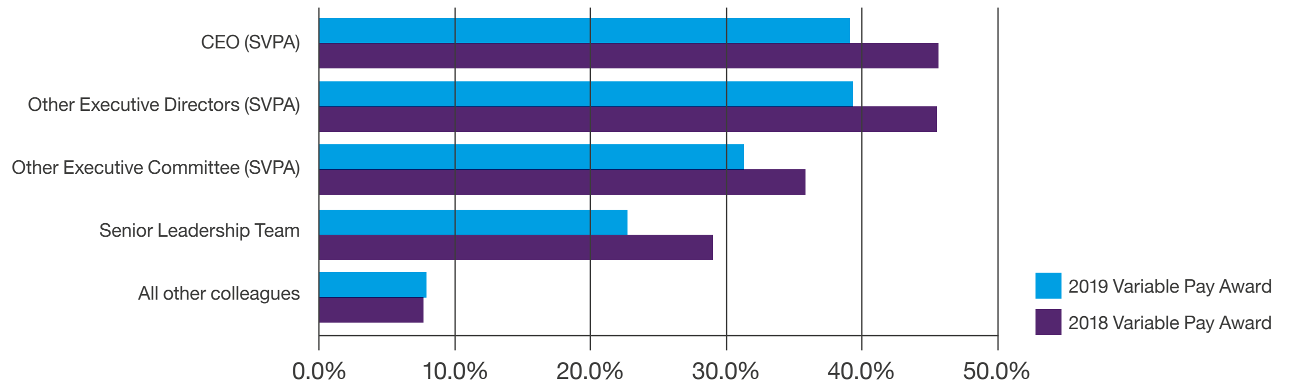
The 'all other colleagues' remuneration comparator relates to Society employees only as this is considered to be the most appropriate comparator to use due to the varying remuneration policies across the Group's subsidiaries. The salary increase figure for other Executive Committee members includes an element to address market position for a number of Executive Committee members.

Comparison of annual variable pay awarded in respect of 2019

Bonus payments are determined based on the achievement of a mixture of Group profit and customer satisfaction and growth targets taken directly from the corporate plan.

Variable Pay Award as a % of salary

The table below illustrates the average annual variable pay awards, expressed as a percentage of salary, made in 2020.



Note
1. The calculations for average bonus awards are based on full year participation.

The Group Chief Executive's award under the Society's SVPA scheme in respect of 2019 represented 39.1% of his base salary (2018: 45.6%). This compares to the average amount awarded to the other Executive Directors of 39.3% (2018: 45.4%) and other Executive Committee members of 31.5% (2018: 35.8%). The average amount awarded to the Senior Leadership Team was 22.7% (2018: 29.0%) and to the remainder of our people in the Society was 7.9% (2018: 7.7%).

The table below shows a breakdown of the benefits offered and the cascade within the Society:

Cascade of Remuneration through the Society

	Executive	Senior Leaders	Leaders	Colleagues
Base Salary	✓	✓	✓	✓
Annual Bonus - cash	✓	✓	✓	✓
Pension	✓	✓	✓	✓
Life Cover	✓	✓	✓	✓
Group Income Protection (GIP) Private Medical Insurance (PMI)	✓	✓	✓	✗
Company Sick Pay	✓	✓	✓	✓
Annual Health Check	✓	✗	✗	✗
Other Benefits	✓	✓	✓	✓

CEO pay ratio

In line with the requirements for listed companies, the Board has agreed to voluntarily publish the CEO pay ratio for the Society only. Given the diversity of the wider Skipton Group, the Society measure was thought to be more appropriate as it would provide a more meaningful comparison with our peers in financial services.

For the purposes of this year's disclosure, the April 2019 gender pay gap data has been used to identify the three appropriate employees for comparison with the CEO (Option B). The latest available gender pay gap data is used to identify the best equivalent for three colleagues whose hourly rates of pay are at the 25th, 50th and 75th percentiles for the Society and their total pay and benefits figure for 2019 is then calculated. A sample of colleagues with hourly pay rates either side of the initially identified individuals are also reviewed to ensure that the appropriate representative colleagues are selected.

The table below compares the total remuneration of the Chief Executive against the total remuneration of the median employee and those who sit at the 25th, 50th and 75th percentiles for the Society.

Year	Method	25th percentile pay ratio	50th percentile pay ratio	75th percentile pay ratio
2019	Option B	35:1	30:1	18:1

The total remuneration and salary values for the 25th, median and 75th percentile employees in 2019 are:

	25th percentile	50th percentile	75th percentile
Base salary (£)	20,586	25,000	39,391
Total remuneration (£)	24,476	27,882	47,190

Note
1. As recognised by the BEIS, those companies with multiple subsidiaries and payrolls can opt to use Option B.
2. Employee data includes full time equivalent total remuneration for Society employees as at 31 December 2019.

Base salaries of all employees, including our Executive Directors, are set with reference to a range of factors including market practice, experience and performance in role. The CEO's remuneration package is weighted more heavily towards variable pay than the wider workforce due to the nature of the role, and this means the ratio is likely to fluctuate depending on the performance of the business and associated outcomes of incentive plans each year.

Directors' Remuneration Report *(continued)*

Statement of implementation of Remuneration Policy in 2020

The base salaries of our Executive Directors were reviewed in April 2019 and adjusted accordingly. Details are included in this report.

The SVPA for 2020 will continue to be based on a balanced scorecard of financial and non-financial measures, as outlined in our policy section. 2020 sees the addition of members' savings and mortgage balances to the financial measures, reflecting the importance of the Society's strategy of achieving growth in a market environment of low interest rates and narrow margins.

The 30% weighting for personal and strategic team objectives is designed to give a continued focus on the achievement of longer term strategic objectives. The team objectives for the Executive Directors cover four key areas:

- Change
- Organisational design and capability
- Financial advice
- Cost efficiency

The measures and weightings in 2020 are set out in the table below:

Financial measures	Weighting	Team KPIs (non-financial measures)	Weighting	Objectives	Weighting
Group profit	8%	Net member / customer growth	5%	Personal objectives	15%
Mortgages and Savings division profit	24%	Net customer satisfaction	5%	Team objectives	15%
Mortgages and Savings division cost income ratio	8%	Employee opinion survey overall score	5%		
Year-end mortgage balances	4%	Audit actions	2%		
Year-end savings balances	4%	Compliance actions	2%		
		Women in Finance Charter – gender mix	3%		
Total weighting	48%		22%		30%

The maximum opportunity will remain as 50% of base salary and will be 30% of base salary at target.

The deferral arrangements operating in 2019 will continue to apply in 2020 and Directors' salaries will be reviewed on 1 April 2020 as they are for all colleagues in the Society.

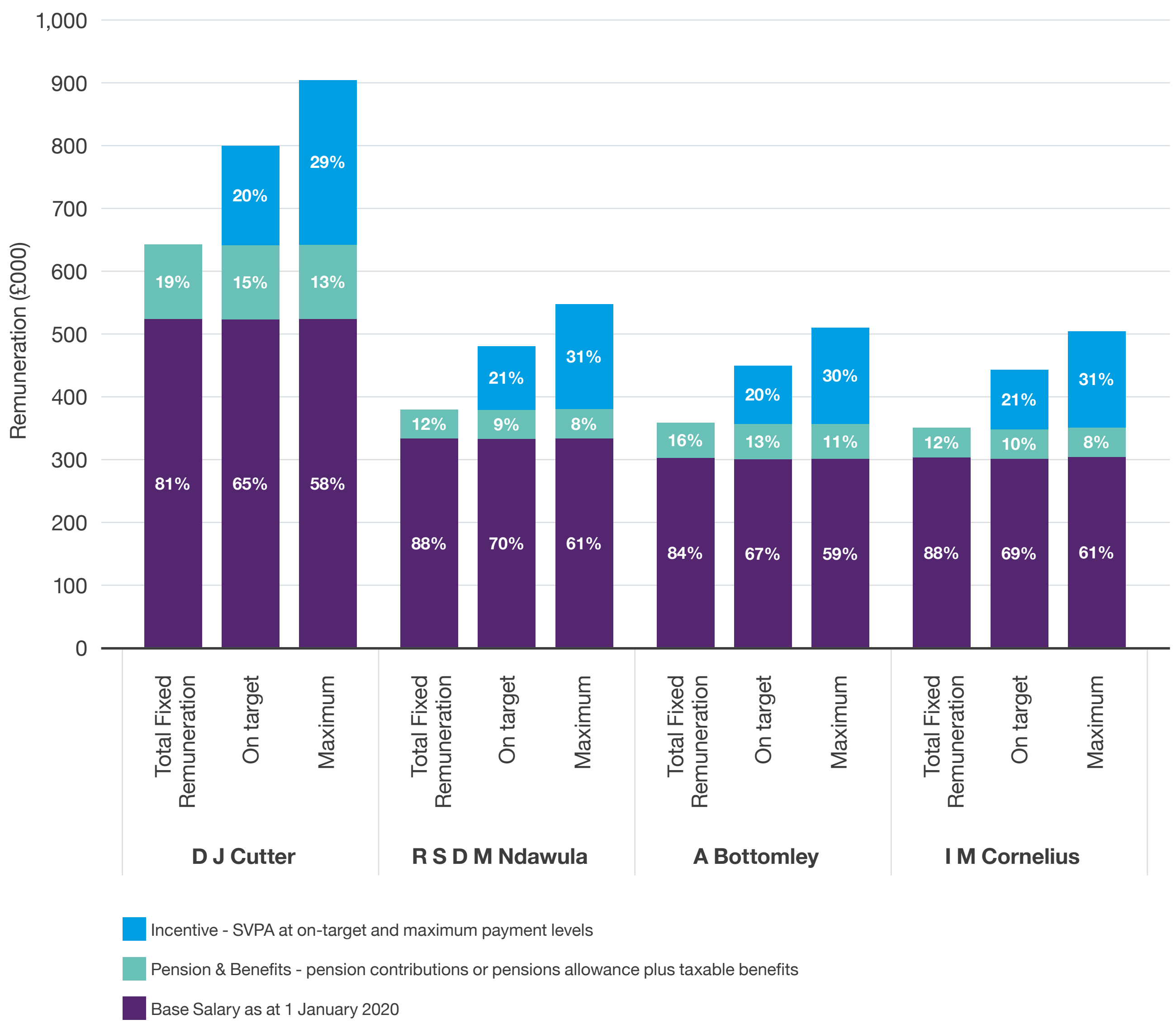
Governance

Illustration of application of remuneration policy

The chart below illustrates the 2020 remuneration that would be paid to each of the Executive Directors under three different performance scenarios: (i) Minimum; (ii) On-target; and (iii) Maximum. The minimum scenario assumes that no pay-out is achieved from any variable elements of remuneration and on-target and maximum scenarios are as defined in the policy table on pages 79 and 80.

The chart illustrates that the application of the policy evidences predictability of outcomes at threshold, target and maximum.

The elements of remuneration have been categorised into three components: (i) Base salary; (ii) Pensions and benefits; and (iii) Incentive (Single Variable Pay Arrangement).



On a broader level in 2020, the Committee will begin work on CRD V and the broader remit this will bring. As part of this, we will continue to review our overarching approach to remuneration, setting out principles of fairness for the Society and reviewing how our current remuneration practices align with these and cascade through the Society.

Material Risk Takers

Material Risk Takers (MRTs) are those 'whose professional activities have a material impact on an institution's risk profile' and, in accordance with CRD IV and the criteria set out by the European Banking Authority (EBA), we have identified MRTs in the Society and in the Group subsidiary companies who are in scope of the regulations.

Directors' Remuneration Report *(continued)*

The Remuneration Committee is responsible for approving remuneration policies, maintaining oversight of the remuneration of MRTs and for ensuring that remuneration is paid to them in accordance with regulatory requirements.

Details of the MRTs' remuneration arrangements for 2019 are included in the Pillar 3 document which is available at skipton.co.uk/about-us/pillar-3-disclosure.

The Committee and its advisers

The purpose of the Remuneration Committee is

- To determine, on behalf of the Board, the Remuneration Policy
- Ensure that remuneration arrangements support and encourage desired behaviours and culture
- Maintain policies that are compliant with governing laws and regulations
- Ensure appropriate governance of remuneration practices across the Society and its subsidiary companies and exercise effective oversight of these
- Ensure that remuneration policies, principles and practices are appropriate to enable the business to attract, retain and reward people with the right skills, experience, knowledge and behaviours to support achievement of business goals and objectives

Amongst its other duties, the Committee specifically:

- Determines and agrees, on behalf of the Board, the Society's Remuneration Principles and Policy, ensuring alignment to the business strategy, risk profile, corporate values, regulatory requirements and the long term interests of the Society and its members;
- Provides adequate oversight arrangements to ensure policies are operating as intended;
- Works closely with the Board Audit and Board Risk Committees to ensure that Remuneration Policy promotes sound and effective risk management;
- Maintains an effective risk adjustment policy and process which takes into account the Board Risk Appetite, capital and liquidity levels and ensures remuneration levels reflect overall performance;
- Assesses with regard to variable pay the achievement of performance targets and the need for ex-ante or ex-post risk adjustments, including the application of malus and clawback arrangements;
- Determines and agrees remuneration for the Chair of the Society Board and Society Executive Directors which shall be subject to the Remuneration Principles;
- Oversees the remuneration of the senior officers in the Risk and Compliance functions;
- Receives recommendations from the Group Chief Executive for approval of the remuneration for Senior Executives which shall be subject to the Remuneration Principles;
- Determines the policy, term, objectives and content of Society Executive Directors' and Society Senior Executives' service contracts to ensure they remain aligned to the Committee's overarching Remuneration Policy, regulatory requirements and good practice guidance; and
- Reviews any proposed remuneration structures or pay proposals which fall outside the parameters of the agreed Remuneration Principles.

The Committee ensures that clear remuneration principles for the Society and its subsidiaries are set and agreed annually. For the PRA and FCA regulated businesses, the principles set out appropriate standards for remuneration design, governance, risk management, and, where applicable, remuneration for MRTs. The Committee receives reports from the Group Remuneration Oversight Committee on the implications of the remuneration policies within the Group and compliance with the principles. The Chief Risk Officers update the Committee on risk related matters and provide information and insight as part of the risk adjustment process.

The full terms of reference of the Remuneration Committee and the Remuneration Principles are available on request from the Secretary. The terms of reference are also available online at skipton.co.uk/about-us/governance/board-committees.

The Remuneration Committee held five scheduled meetings during 2019. In discharging its duties, the Committee reviews and takes into account independently produced data in relation to similar financial services organisations. Remuneration consultants advising the Committee are independent from the Group.

Helen Stevenson, the Remuneration Committee Chair, has been in tenure since May 2016.

The Non-Executive Directors' Remuneration Committee, which currently comprises Messrs East (Chair), Bottomley, Cutter, Cornelius and Ndawula, determines the level of the other Non-Executive Directors' fees.

The Chair, Group Chief Executive, Chief Conduct Risk Officer and Secretary and Chief Human Resources Officer have regularly attended meetings by invitation and external advisers are invited to attend meetings as and when appropriate.

PwC were appointed by the Committee in 2015 following a review of potential advisers. PwC is a signatory to the voluntary Code of Conduct in relation to remuneration in the UK. Their remuneration team have continued to support the Committee in 2019 and have received £40,000 (net of VAT) in fees in respect of remuneration services provided. The Committee maintains oversight of remuneration policy and practice through an annual internal audit which is supported by other independent remuneration experts.

In addition to remuneration, PwC provide other services to the Society such as accounting, internal audit and tax advice.

Consideration of member views

The Committee has, for a number of years, invited members to vote (on an advisory basis) on the Remuneration Policy and annual Remuneration Report and takes member feedback into account when determining policy and outcomes.

Statement of voting at the 2019 AGM

At the 2019 AGM the Directors' Remuneration Report was subject to an advisory vote of members, the results of which were as follows:

	Votes		
	For	**Against**	**Withheld**
2019 remuneration policy	59,252 (90.2%)	6,444 (9.8%)	1,495
2018 remuneration report	59,633 (90.8%)	6,072 (9.2%)	1,482

Helen Stevenson
Chair of the Remuneration Committee

25 February 2020

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Financial Statements

Independent Auditor's Report

Independent auditor's report to the members of Skipton Building Society

Opinion

In our opinion, the financial statements:

- Give a true and fair view, in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2019 and of the Group's and the Society's income and expenditure for the year then ended; and
- Have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Skipton Building Society which comprise:

Group	Society
Consolidated Statement of Financial Position as at 31 December 2019	Statement of Financial Position as at 31 December 2019
Consolidated Income Statement for the year ended 31 December 2019	Income Statement for the year ended 31 December 2019
Consolidated Statement of Comprehensive Income for the year ended 31 December 2019	Statement of Comprehensive Income for the year ended 31 December 2019
Consolidated Statement of Changes in Members' Interests for the year ended 31 December 2019	Statement of Changes in Members' Interests for the year ended 31 December 2019
Consolidated Statement of Cash Flows for the year ended 31 December 2019	Statement of Cash Flows for the year ended 31 December 2019
Related notes 1 to 43 to the financial statements, including a summary of significant accounting policies	Related notes 1 to 43 to the financial statements, including a summary of significant accounting policies
Information on Country by Country Reporting	

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the 'Auditor's responsibilities for the audit of the financial statements' section of our report below. We are independent of the Group and Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (FRC)'s Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Performing a first year audit

In preparation for our first year audit of the 31 December 2019 financial statements, we performed a number of transitional procedures.

Following our selection, we undertook procedures to establish our independence of the Group. This involved considering previous commercial relationships and personal financial arrangements, and confirming that all staff who work on the audit are independent of the Group.

We held discussions with the Group's predecessor auditor and reviewed their 2018 financial statement audit work papers, where available, to obtain evidence regarding the opening balances. We performed alternative procedures where required. We gained an understanding of the Group's processes, including the risk assessment and key judgements made by the predecessor auditors.

At the outset of our audit we gained an understanding of the business issues and met with executive and key management of the Group.

We used the understanding the audit team had formed to establish our audit base and assist in the formalisation of our audit strategy for the 2019 Group audit.

Conclusions relating to principal risks, going concern and viability statement

The directors have voluntarily complied with the UK Corporate Governance Code (the "Code") and Listing Rule 9.8.6(R)(3)(a) of the Financial Conduct Authority (FCA) and provided a statement in relation to going concern, required for companies with a premium listing on the London Stock Exchange.

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs (UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 67 to 73 that describe the principal risks and explain how they are being managed or mitigated;
- the Directors' confirmation set out on page 50 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the Directors' statement set out on page 50 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the Directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the Directors' explanation set out on page 50 in the Annual Report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach	
Key audit matters	• Risk of fraud in revenue recognition relating to effective interest rate (EIR) accounting • Measurement of loan impairments relating to retail and commercial mortgages • Fair value of the equity release portfolio • Risk of management override in Connells revenue streams
Audit scope	• We performed an audit of the complete financial information of three components and audit procedures on specific balances for a further seven components. • The components where we performed full or specific audit procedures accounted for 99.6% of adjusted profit before tax, 99.7% of total income and 100% of total assets.
Materiality	• Overall Group materiality of £7.8m, which represents 5% of profit before tax, adjusted for fair value losses in relation to the equity release portfolio.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit, and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Independent Auditor's Report *(continued)*

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Risk of fraud in revenue recognition relating to effective interest rate (EIR) accounting **(Group - 31 December 2019: £510.0m;** **Society - 31 December 2019: £452.8m)** The EIR method of revenue recognition involves significant management judgement and complex calculations in both determining the initial EIR and recording the present value of adjustments arising in subsequent periods when cash flows are reforecast. As such, it represents a risk of fraud in revenue recognition and through management override of internal controls. The Group's EIR models are most sensitive to changes in the behavioural life and future interest rate assumptions. Modelled forecast cash flows may be measured incorrectly due to the use of inaccurate or incomplete data, erroneous formulae or inappropriate assumptions. Due to the degree of judgement that needs to be exercised by the Directors around forecast future cash flows, the number of different products the Group has across its loan portfolio and the complexity of calculation, this was considered a key audit matter.	We understood and evaluated the design effectiveness of key controls over the EIR process, and adopted a substantive audit approach. We validated and challenged assumptions used in the EIR models, including the behavioural lives of assets and the approach to estimating future interest rates. We compared customer redemption assumptions with recent customer behaviours observable in the Group's portfolios, and compared the forecast interest rate methodology with market derived base rate forecasts and the Society's expectations of future interest margins. We tested the accuracy of the EIR calculations by engaging valuations specialists to independently recalculate the EIR for a sample of mortgages. We performed data integrity testing on the key data fields used within the EIR calculations by corroborating data back to the Society's systems. We tested the accuracy of the disclosures made in the financial statements regarding the key estimates used in the EIR models, and their sensitivity to reasonable alternative assumptions.	We communicated to the Audit Committee that the model, assumptions and calculations informing the EIR calculation as at 31 December 2019 were reasonable and that these resulted in EIR adjustments to interest income which were appropriately derived. We also communicated our observations on the key assumptions. We highlighted the subjectivity in the behavioural life and future assumptions. We were satisfied that the assumptions deployed in the EIR model were reasonable in the context of the Society's mortgage portfolio and current market conditions.
Measurement of loan impairments relating to retail and commercial mortgages **(Group - 31 December 2019: £16.1m;** **Society - 31 December 2019: £10.8m)** The measurement of the loan impairment provision under IFRS 9 is subjective and requires the Directors to exercise judgement with regards to estimating future losses that the Group may occur within the retail and commercial mortgage books. This includes the application of multiple economic scenarios and key assumptions when calculating expected credit losses. There is also judgement involved in identifying assets that have experienced a significant increase in credit risk (SICR) since origination (stage 2) and those that are credit impaired (stage 3). Furthermore, there is a risk that financial disclosures do not comply with the requirements of the International Financial Reporting Standards.	We understood and evaluated the design effectiveness of key controls over the impairment process, and adopted a substantive audit approach. For a sample of stage 3 provisions we independently challenged the provision adequacy by assessing the valuation of collateral at the balance sheet date and considered assumptions about future recoverability. Our substantive audit procedures over the residential and commercial IFRS 9 provision models included assessing, challenging and substantiating key assumptions to historical data, such as: definition of default, probability of default ("PD"), loss given default, significant increases in credit risk and the staging applied, forward looking assumptions and the determination of lifetime PDs. In order to assess the Group's modelled provisions, we engaged credit modelling specialists to perform substantive procedures over the model design, perform sensitivity analysis, and determine whether any indications of material model weaknesses exist which could reasonably give rise to a material misstatement. We also recalculated the ECL provision for a sample of individually assessed mortgages. We critically assessed the Group's methodology for determining the SICR criteria and independently tested staging allocation by selecting a sample of loans in stages 1, 2 and 3 to verify whether they were allocated appropriately, with reference to the Group's SICR criteria. We independently challenged the economic scenario base case and alternative economic scenarios adopted with support from economics specialists. We challenged the probability weightings ascribed to the scenarios and compared them to other scenarios from a variety of external sources, as well as EY internally developed forecasts. With the assistance of economics specialists, we assessed whether forecast macroeconomic variables, such as unemployment, interest rates and the house price index were appropriate loan loss provision drivers. We assessed the completeness of post model adjustments using our knowledge and experience across the UK lending sector and tested material overlays for reasonableness of estimation with reference to observable market data. To validate data quality, we tested data used in the ECL calculation by reconciling and performing sample tests for accuracy of key data fields to source systems. We corroborated the adequacy and appropriateness of the disclosures made within the financial statements for compliance with both IFRS 9 and IFRS 7.	We communicated that we were satisfied that loan impairment provisions were reasonable and in compliance with the requirements of IFRS 9. We communicated to the Audit Committee that our independent testing of models and underlying modelling assumptions resulted in minor differences that were considered to be immaterial in aggregate. We considered the multiple economic scenarios incorporated in the IFRS 9 models and post model overlays to be reasonable. We also concluded that disclosures relating to mortgage loan impairments are in compliance with the requirements of International Financial Reporting Standards.

Independent Auditor's Report *(continued)*

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Fair value of equity release portfolio **(Group - 31 December 2019: £410.0m;** **Society - 31 December 2019: £410.0m)** The Society holds three equity release mortgage portfolios that carry a no negative equity guarantee ("NNEG"). This guarantee limits the Society's maximum return to the value of the relevant customer's property on redemption. The Society is therefore exposed to potential losses on the portfolio, albeit any loss is limited in part by a further guarantee provided to the Society by a third party. The Society uses equity release swaps to manage the interest rate risk and reduce income statement volatility that would otherwise result from changes in the fair value of the equity release mortgage portfolio. The fair value of the equity release portfolio is determined using a complex model which uses a Monte Carlo simulation and a number of different judgemental assumptions to derive an estimated value. The equity release swaps are also valued using a Monte Carlo based model. The key assumptions used in the models include: • Discount rate, including illiquidity premia • Mortality rates • Future increases in house prices ('HPI') • Prepayment rates Due to the degree of judgement that needs to be exercised by the Directors around the key assumptions into the valuation model, and the complexity of the calculation, this was considered a key audit matter.	We understood and evaluated the design effectiveness of key controls over the fair value of the equity release portfolio and corresponding swaps, and adopted a substantive audit approach. With support from our valuation specialists, we assessed the appropriateness of the valuation techniques and independently calculated a range of fair values for the equity release portfolio and associated swaps. We compared the Directors' modelled fair values against this range. We challenged assumptions used in the fair value models, including the discount rate, mortality rates, future changes in house prices and prepayment rates. We compared assumptions applied in the fair value model to the Society's historical experience and benchmarked assumptions to observable market data where applicable. We performed sensitivity analysis on judgemental assumptions to assess the significance of each assumption and the impact of alternative assumptions. We tested the completeness and accuracy of data used within the fair value models by agreeing the model data to source systems and underlying evidence. We validated the accuracy and sufficiency of the disclosures made within the financial statements regarding the key estimates made within the fair value models, and their sensitivity to reasonable alternative assumptions.	We communicated to the Audit Committee that the models and assumptions informing the fair value of the equity release portfolio and associated swaps as at 31 December 2019 were reasonable. We also communicated our observations on the key assumptions. We highlighted the subjectivity in the HPI assumption and the discount rate, including illiquidity premia. We were satisfied that the assumptions deployed in the fair value of the equity release portfolio and corresponding swap models are reasonable in the context of the equity release mortgage portfolio and current market conditions.
Risk of management override in Connells revenue streams **(Connells - 31 December 2019: £428.2m)** There is a risk that management may override controls and post manual journals in order to overstate revenue in the estate agency business in order to achieve targets set within respective management incentive schemes. This risk is specific to manual revenue journals posted during the financial year within the Connells revenue streams which are material to the Group. Given the manual nature and volume of revenue transactions in Connells, this was considered a key audit matter.	We understood and evaluated the design effectiveness of key controls over the revenue recognition process; we adopted a substantive audit approach. We performed cut off testing on a sample of transactions falling either side of the 31 December 2019 year end date. We performed data analysis procedures to assess the recognition of revenue throughout the year. We performed testing over full populations of transactions using data analysis tools to analyse all of the revenue transactions for the significant revenue streams. We tested the correlation of revenue to cash receipts to verify the occurrence of revenue. For some of the Connells subsidiaries where we did not use data analysis tools, we performed alternative substantive procedures including tracing from origination of revenue through to the general ledger to confirm that the revenue was appropriately recorded in the correct period and at the correct value. We performed testing over a sample of manual journal entries recorded for each significant revenue stream. We substantiated these journals to supporting documentation and validated that revenue recognition criteria had been fulfilled and that values were materially correct.	We communicated to the Audit Committee that through our data analysis procedures we identified a correlation of transactions between revenue and trade receivables. We concluded that we did not identify any evidence of material misstatements in the revenue recognised or any instances of management override.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of Group-wide controls, changes in the business environment and other factors such as recent Internal Audit results when assessing the level of work to be performed at each entity.

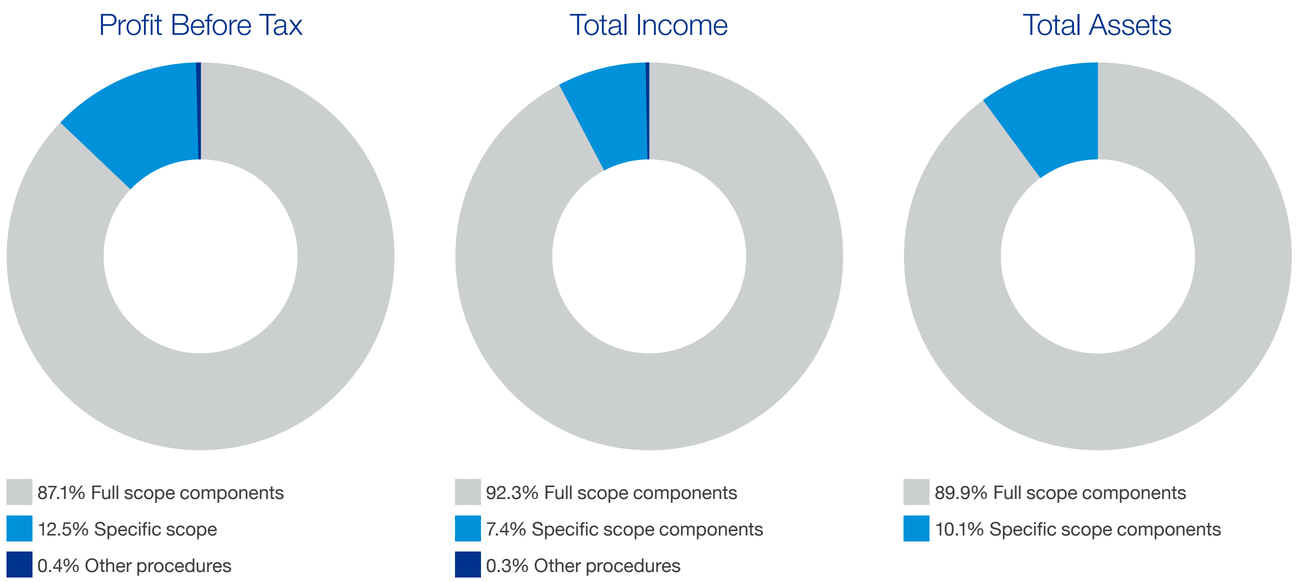
In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements, of the 15 reporting components of the Group we selected 10 components covering entities within the United Kingdom, New Zealand and Guernsey, which represent the principal business units within the Group.

Of the 10 components selected, we performed an audit of the complete financial information of three components ("full scope components") which were selected based on their size or risk characteristics. For the remaining seven components ("specific scope components"), we performed audit procedures on specific accounts within that component that we considered had the potential for the greatest impact on the significant accounts in the financial statements either because of the size of these accounts or their risk profile.

The reporting components where we performed audit procedures accounted for 99.6% of the Group's adjusted profit before tax, 99.7% of the Group's total income and 100% of the Group's total assets. For the current year, the full scope components contributed 87.1% of the Group's adjusted profit before tax, 92.3% of the Group's total income and 89.9% of the Group's total assets. The specific scope component contributed 12.5% of the Group's adjusted profit before tax, 7.4% of the Group's total income and 10.1% of the Group's total assets. The audit scope of these components may not have included testing of all significant accounts of the component but will have contributed to the coverage tested for the Group.

Of the remaining five components that together represent less than 1% of the Group's adjusted profit before tax, none are individually greater than 1% of the Group's adjusted profit before tax. For these components, we performed other procedures, including detailed analytical reviews to respond to any potential risks of material misstatement to the Group financial statements.

The charts below illustrate the coverage obtained from the work performed by our audit teams.



Involvement with component teams

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken at each of the components by us, as the primary audit engagement team, or by component auditors from other EY global network firms operating under our instruction. Of the three full scope components, audit procedures were performed on one of these directly by the primary audit team and audit procedures on two of these were performed by component audit teams. For the seven specific scope components, audit procedures were performed by the primary audit team except for one specific scope component. Where the work was performed by component auditors, we determined the appropriate level of involvement to enable us to determine that sufficient audit evidence had been obtained as a basis for our opinion on the Group as a whole.

The Group audit team undertook a programme of planned visits designed to ensure that the Senior Statutory Auditor visits the principal locations of the Group. During the current year's audit cycle, visits were undertaken by the primary audit team to the following locations:

Component	Location	Scope	Number of visits
Connells Limited	Leighton Buzzard, United Kingdom	Full	2
Skipton International Limited	Guernsey	Full	2

These visits involved discussing the audit approach with the component team and any issues arising from their work, as well as meeting with local management, and reviewing key audit working papers on risk areas. The primary team interacted regularly with the component teams where appropriate during various stages of the audit, reviewed key working papers and were responsible for the scope and direction of the audit process. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £7.8 million, which is 5% of profit before tax adjusted for fair value losses in relation to the equity release portfolio.

We determined materiality for the Society to be £3.8 million, which is 5% of profit before tax adjusted for income from shares in subsidiary undertakings and fair value losses in relation to the equity release portfolio.

We assessed profit before tax an appropriate basis for materiality given the users of the financial statements, including the Society's members and regulators, focus on pre-tax profit in assessing the Society's performance. Pre-tax profit is a consistent basis for calculating materiality across the industry and is considered to be the most appropriate basis for profit-making banks and building societies. We adjusted pre-tax profit for losses during the year on the Group's equity release portfolio, as these are unpredictable in nature and not part of the Group's core operating performance.

In the prior year audit, the predecessor auditor adopted materiality of £9.0m for the Group, determined with reference to a benchmark of Group profit before tax, normalised to exclude profit on disposal of subsidiary undertakings, profit on disposal of other Group undertakings, loss on disposal of mortgage assets and impairment of goodwill and fair value movements in equity share investments, as well as the 2018 fair value gains in relation to the equity release portfolio. Materiality for the Society financial statements as a whole was set at £3.9m by the predecessor auditor, determined with reference to a benchmark of Society profit before tax, normalised to exclude dividend income and impairment of investment in subsidiaries.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was £3.9m, being 50% of our planning materiality. We have set performance materiality at this percentage since this is a first year audit.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £0.8m to £2.0m.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.4m, which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report set out on pages 6 to 93, including 2019 Group Highlights, Chairman's Statement, Group Chief Executive's Report, Strategic Report, Sustainability Report, The Board of Directors, Directors' Report, Directors' Report on Corporate Governance, Audit Committee Report, Risk Management Report and Directors' Remuneration Report, other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

The directors have voluntarily complied with the UK Corporate Governance Code (the "Code") and prepare a Corporate Governance Statement in accordance with the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority ("FCA").

The directors have requested that we review the parts of the Corporate Governance Statement relating to the Society's compliance with the Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) as if the Society were a premium listed company.

Independent Auditor's Report *(continued)*

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- Fair, balanced and understandable set out on page 55 – the statement given by the Directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Audit committee reporting set out on pages 59 and 60 – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- Directors' statement of compliance with the Code set out on page 52 – the parts of the Directors' statement required under the Listing Rules relating to the Society's compliance with the Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the Code.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

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

- Proper accounting records have not been kept by the Society; or
- The Group or Society's financial statements are not in agreement with the accounting records; or
- We have not received all the information and explanations and access to documents we require for our audit.

Other voluntary reporting matters

Directors' Remuneration Report

The Society voluntarily prepares a Report of the Directors on remuneration in accordance with the provisions of the Companies Act 2006. The directors have requested that we audit the part of the Report of the Directors on remuneration specified by the Companies Act 2006 to be audited as if the Society were a quoted company.

In our opinion, the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement set out on page 49, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are: to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and determined that the most significant were the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
- We understood how the Group complies with these legal and regulatory frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also: reviewed correspondence between the Group and UK regulatory bodies; reviewed minutes of the Board and Board Risk Committee; and gained an understanding of the Group's approach to governance, demonstrated by the Board's approval of the Group's governance framework and the Board's review of the Group's Operational Risk Framework and internal control processes.
- We assessed the susceptibility of the Group's financial statements to material misstatement, including how fraud might occur by considering the controls that the Group has established to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings or influence the perceptions of investors and stakeholders.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraphs above. Our procedures involved inquiries of legal counsel, executive management, internal audit, and focused testing, as referred to in the 'Key audit matters' section above.
- The Group operates in the banking industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters we are required to address

- We were appointed by the Society on 10 May 2019 to audit the financial statements for the year ending 31 December 2019 and subsequent financial periods.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society and we remain independent of the Group and the Society in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

Use of our report

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

Steven Robb (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Leeds

25 February 2020

Notes

1. *The maintenance and integrity of the Skipton Building Society's web-site is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web-site.*
2. *Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.*

Income Statements

For the year ended 31 December 2019

	Notes	Group 2019 £m	Group 2018[1] Restated[2,3] £m	Society 2019 £m	Society 2018[1] Restated[2] £m
Interest receivable and similar income:					
Accounted for using the effective interest rate method	2	510.0	470.1	452.8	406.8
On financial instruments held at fair value through profit or loss (FVTPL)	2	4.9	3.7	5.4	4.6
Total interest receivable and similar income		514.9	473.8	458.2	411.4
Interest payable and similar charges	3	(276.8)	(232.6)	(277.0)	(225.5)
Net interest receivable		238.1	241.2	181.2	185.9
Fees and commissions receivable	4a)	492.4	496.4	31.9	33.6
Fees and commissions payable		(8.2)	(7.6)	(2.8)	(2.4)
Fair value gains / (losses) on financial instruments mandatorily held at FTVPL:					
Hedging instruments and hedged items		1.2	2.0	2.8	0.4
Other derivatives	15	2.6	18.1	2.6	18.1
Equity release portfolio	15	(6.0)	(17.1)	(6.0)	(17.1)
Other financial instruments		-	(0.3)	1.0	1.0
Fair value (losses) / gains on deemed loans from subsidiary undertakings designated at FVTPL		-	-	(1.0)	1.4
Realised profits on treasury assets held at fair value through other comprehensive income (FVOCI)		2.4	-	2.4	-
Income from shares in subsidiary undertakings		-	-	38.5	82.9
Profit on disposal of subsidiary undertakings	17c)	1.1	3.3	-	-
Share of profits from joint ventures		1.7	0.8	-	-
Other income		0.8	3.7	6.1	3.9
Total income		726.1	740.5	256.7	307.7
Administrative expenses	5	(554.0)	(536.5)	(146.3)	(138.7)
Operating profit before impairment and provisions		172.1	204.0	110.4	169.0
Impairment (losses) / credit on loans and advances to customers	14	(0.5)	(2.5)	0.3	(1.1)
Impairment credit / (losses) on liquid assets	10, 11	0.2	(0.1)	0.1	(0.2)
Realised losses on equity release portfolio	15	(0.5)	(0.7)	(0.5)	(0.7)
Provisions for liabilities	29	(18.1)	(12.0)	1.1	0.4
Profit before tax		153.2	188.7	111.4	167.4
Tax expense	9	(30.8)	(40.7)	(17.3)	(22.6)
Profit for the financial year attributable to members of Skipton Building Society		122.4	148.0	94.1	144.8

[1] The Group has adopted IFRS 16 with effect from 1 January 2019; comparative information for prior periods is not restated (see note 1b)).
[2] The Group and Society comparative amounts are restated for adjustments relating to hedge amortisation (see note 1b)).
[3] The Group comparative amounts for 'Fees and commissions receivable' and 'Administrative expenses' are restated. There is no impact on profits and no impact on reserves (see note 4a)).

Segmental performance of the Group is shown in note 40.

The accompanying notes form part of these financial statements.

Statements of Comprehensive Income

For the year ended 31 December 2019

	Notes	Group 2019 £m	Group 2018[1] Restated[2] £m	Society 2019 £m	Society 2018[1] Restated[2] £m
Profit for the financial year		122.4	148.0	94.1	144.8
Other comprehensive income:					
Items that will not be reclassified to profit or loss:					
Remeasurement gains / (losses) on defined benefit obligations	31	0.5	(3.1)	0.3	(1.4)
Income tax on items that will not be reclassified to profit or loss	33	0.3	1.0	0.2	0.5
		0.8	(2.1)	0.5	(0.9)
Items that may be reclassified subsequently to profit or loss:					
Movement in cash flow hedging reserve:					
Gains taken to equity		3.1	1.2	3.2	0.3
Realised gains transferred to Income Statement		(6.9)	-	(6.9)	-
Movement in fair value reserve (debt securities):					
Losses taken to equity		(0.3)	(2.3)	(0.3)	(2.5)
Impairment loss allowance on debt securities held at FVOCI	11	(0.1)	0.1	(0.1)	0.2
Movement in cost of hedging reserve:					
Losses taken to equity		(5.2)	(0.5)	-	-
Exchange differences on translation of foreign operations		(0.7)	-	-	-
Income tax on items that may be reclassified to profit or loss	33	2.5	0.3	2.4	0.5
		(7.6)	(1.2)	(1.7)	(1.5)
Other comprehensive expense for the year, net of tax		(6.8)	(3.3)	(1.2)	(2.4)
Total comprehensive income for the year attributable to members of Skipton Building Society		115.6	144.7	92.9	142.4

[1] The Group has adopted IFRS 16 with effect from 1 January 2019; comparative information for prior periods is not restated (see note 1b)).
[2] The Group and Society comparative amounts are restated for adjustments relating to hedge amortisation (see note 1b)).

The accompanying notes form part of these financial statements.

Financial Statements

Statements of Financial Position

As at 31 December 2019

	Notes	Group 2019 £m	Group 2018[1] Restated[2,3] £m	Society 2019 £m	Society 2018[1] Restated[2] £m
Assets					
Cash in hand and balances with the Bank of England		**1,793.1**	2,395.7	**1,793.1**	2,395.7
Loans and advances to credit institutions	10	**546.6**	422.7	**465.8**	349.5
Debt securities	11	**2,182.9**	1,383.1	**2,032.5**	1,344.9
Derivative financial instruments		**38.5**	72.3	**46.6**	68.2
Loans and advances to customers held at amortised cost	12	**20,065.6**	18,119.0	**17,891.6**	15,991.2
Loans and advances to customers held at FVTPL	16	**1.5**	1.9	**1.5**	1.9
Equity release portfolio held at FVTPL	15	**410.0**	410.9	**410.0**	410.9
Current tax asset		**1.0**	-	**-**	-
Deferred tax asset	30	**38.6**	37.1	**26.6**	26.1
Investments in Group undertakings	17a)	**-**	-	**898.5**	975.0
Investments in joint ventures		**12.5**	12.2	**-**	-
Equity share investments	17e)	**1.5**	0.8	**-**	-
Property, plant and equipment	18	**75.7**	77.9	**39.2**	36.5
Right-of-use assets	19	**67.4**	-	**12.7**	-
Investment property	20	**9.4**	12.0	**9.4**	12.0
Intangible assets	21	**162.6**	161.4	**3.4**	2.5
Other assets	22	**82.5**	84.9	**16.9**	15.0
Total assets		**25,489.4**	23,191.9	**23,647.8**	21,629.4
Liabilities					
Shares	23	**17,364.1**	16,113.5	**17,362.3**	16,112.1
Amounts owed to credit institutions	24	**1,678.3**	1,878.0	**1,743.6**	1,999.9
Amounts owed to other customers	25	**1,816.9**	1,690.5	**415.4**	529.2
Debt securities in issue	26	**2,302.6**	1,420.3	**2,194.9**	1,194.4
Derivative financial instruments		**361.1**	279.4	**321.7**	282.3
Current tax liability		**16.0**	18.5	**10.6**	10.0
Lease liabilities	27	**66.6**	-	**12.5**	-
Other liabilities	28	**52.6**	56.9	**11.9**	10.5
Accruals		**42.3**	48.9	**14.8**	16.9
Deferred income		**2.7**	2.7	**-**	-
Provisions for liabilities	29	**23.7**	24.3	**1.0**	4.4
Deferred tax liability	30	**1.7**	1.2	**0.3**	0.4
Retirement benefit obligations	31	**87.0**	99.5	**48.8**	52.2
Subscribed capital	32	**41.6**	41.6	**41.6**	41.6
Total liabilities		**23,857.2**	21,675.3	**22,179.4**	20,253.9
Members' interests					
General reserve		**1,633.9**	1,510.7	**1,468.2**	1,373.6
Fair value reserve		**1.4**	1.6	**1.5**	1.7
Cash flow hedging reserve		**(3.3)**	(0.4)	**(2.7)**	0.2
Cost of hedging reserve		**(4.3)**	(0.5)	**1.4**	-
Translation reserve		**4.5**	5.2	**-**	-
Attributable to members of Skipton Building Society		**1,632.2**	1,516.6	**1,468.4**	1,375.5
Total members' interests and liabilities		**25,489.4**	23,191.9	**23,647.8**	21,629.4

[1] The Group has adopted IFRS 16 with effect from 1 January 2019; comparative information for prior periods is not restated (see note 1b)).
[2] The Group and Society comparative amounts are restated for adjustments relating to hedge amortisation (see note 1b))
[3] The Group comparative amounts are restated for adjustments relating to deferred taxation (see note 30).

The accompanying notes form part of these financial statements.

These Accounts were approved by the Board of Directors on 25 February 2020 and were signed on its behalf by:

Robert East — **Chair**
David Cutter — **Group Chief Executive**
Bobby Ndawula — **Group Finance Director**

Statements of Changes in Members' Interests

For the year ended 31 December 2019

Group	General reserve £m	Fair value reserve £m	Cash flow hedging reserve £m	Cost of hedging reserve £m	Translation reserve £m	Total £m
Balance at 1 January 2019	**1,510.7**	**1.6**	**(0.4)**	**(0.5)**	**5.2**	**1,516.6**
Profit for the financial year	122.4	-	-	-	-	**122.4**
Other comprehensive income						
Remeasurement gains on defined benefit obligations	0.8	-	-	-	-	**0.8**
Net (losses) / gains from changes in fair value	-	(0.1)	2.7	(3.8)	-	**(1.2)**
Debt securities at FVOCI: impairment loss allowance	-	(0.1)	-	-	-	**(0.1)**
Cash flow hedges: realised gains transferred to the Income Statement	-	-	(5.6)	-	-	**(5.6)**
Exchange differences on translation of foreign operations	-	-	-	-	(0.7)	**(0.7)**
Total other comprehensive income (note 33)	**0.8**	**(0.2)**	**(2.9)**	**(3.8)**	**(0.7)**	**(6.8)**
Total comprehensive income for the year	**123.2**	**(0.2)**	**(2.9)**	**(3.8)**	**(0.7)**	**115.6**
Balance at 31 December 2019	**1,633.9**	**1.4**	**(3.3)**	**(4.3)**	**4.5**	**1,632.2**

For the year ended 31 December 2018[1]

Group	General reserve £m	Available-for-sale reserve £m	Fair value reserve £m	Cash flow hedging reserve £m	Cost of hedging reserve £m	Translation reserve £m	Total £m
Balance at 31 December 2017	1,396.4	3.1	-	0.1	-	5.2	1,404.8
Adjustment on initial adoption of IFRS 9 (net of tax)	(38.7)	(3.1)	3.2	-	-	-	(38.6)
Other adjustments[2]	(8.4)	-	-	(1.4)	-	-	(9.8)
Adjusted balance at 1 January 2018 (restated)[2]	1,349.3	-	3.2	(1.3)	-	5.2	1,356.4
Profit for the financial year (restated)[2]	148.0	-	-	-	-	-	148.0
Other comprehensive income							
Remeasurement losses on defined benefit obligations	(2.1)	-	-	-	-	-	(2.1)
Net (losses) / gains from changes in fair value (restated)[2]	-	-	(1.7)	0.9	(0.5)	-	(1.3)
Debt securities at FVOCI: impairment loss allowance	-	-	0.1	-	-	-	0.1
Total other comprehensive income (restated)[2] (note 33)	(2.1)	-	(1.6)	0.9	(0.5)	-	(3.3)
Total comprehensive income for the year (restated)[2]	145.9	-	(1.6)	0.9	(0.5)	-	144.7
Transfer of engagements	15.5	-	-	-	-	-	15.5
Balance at 31 December 2018 (restated)[2]	1,510.7	-	1.6	(0.4)	(0.5)	5.2	1,516.6

[1] The Group has adopted IFRS 16 with effect from 1 January 2019; comparative information for prior periods is not restated (see note 1b)).
[2] Amounts are restated for adjustments relating to hedge amortisation (see note 1b)).

Statements of Changes in Members' Interests *(continued)*

For the year ended 31 December 2019

Society	General reserve	Fair value reserve	Cash flow hedging reserve	Cost of hedging reserve	Total
	£m	£m	£m	£m	£m
Balance at 1 January 2019	**1,373.6**	**1.7**	**0.2**	**-**	**1,375.5**
Profit for the financial year	94.1	-	-	-	**94.1**
Other comprehensive income					
Remeasurement gains on defined benefit obligations	0.5	-	-	-	**0.5**
Net (losses) / gains from changes in fair value	-	(0.1)	2.7	1.4	**4.0**
Debt securities at FVOCI: impairment loss allowance	-	(0.1)	-	-	**(0.1)**
Cash flow hedges: realised gains transferred to the Income Statement	-	-	(5.6)	-	**(5.6)**
Total other comprehensive income (note 33)	**0.5**	**(0.2)**	**(2.9)**	**1.4**	**(1.2)**
Total comprehensive income for the year	**94.6**	**(0.2)**	**(2.9)**	**1.4**	**92.9**
Balance at 31 December 2019	**1,468.2**	**1.5**	**(2.7)**	**1.4**	**1,468.4**

For the year ended 31 December 2018[1]

Society	General reserve	Available-for-sale reserve	Fair value reserve	Cash flow hedging reserve	Total
	£m	£m	£m	£m	£m
Balance at 31 December 2017	1,260.8	3.1	-	0.1	1,264.0
Adjustment on initial adoption of IFRS 9 (net of tax)	(38.7)	(3.1)	3.5	-	(38.3)
Other adjustments[2]	(7.9)	-	-	(0.2)	(8.1)
Adjusted balance at 1 January 2018 (restated)[2]	1,214.2	-	3.5	(0.1)	1,217.6
Profit for the financial year (restated)[2]	144.8	-	-	-	144.8
Other comprehensive income					
Remeasurement losses on defined benefit obligations	(0.9)	-	-	-	(0.9)
Net (losses) / gains from changes in fair value (restated)[2]	-	-	(2.0)	0.3	(1.7)
Debt securities at FVOCI: impairment loss allowance	-	-	0.2	-	0.2
Total other comprehensive income (restated)[2] (note 33)	(0.9)	-	(1.8)	0.3	(2.4)
Total comprehensive income for the year (restated)[2]	143.9	-	(1.8)	0.3	142.4
Transfer of engagements	15.5	-	-	-	15.5
Balance at 31 December 2018 (restated)[2]	1,373.6	-	1.7	0.2	1,375.5

[1] The Group has adopted IFRS 16 with effect from 1 January 2019; comparative information for prior periods is not restated (see note 1b)).
[2] Amounts are restated for adjustments relating to hedge amortisation (see note 1b)).

The accompanying notes form part of these financial statements.

Statements of Cash Flows

For the year ended 31 December 2019

	Notes	Group 2019	Group 2018[1] Restated[2]	Society 2019	Society 2018[1] Restated[2]
		£m	£m	£m	£m
Cash flows from operating activities					
Profit before tax		**153.2**	188.7	**111.4**	167.4
Adjustments for:					
Impairment charge / (credit) on loans and advances to customers	14	**0.5**	2.5	**(0.3)**	1.1
Loans and advances written off, net of recoveries	14	**(2.2)**	(1.7)	**(1.2)**	(0.5)
Impairment (credit) / losses on liquid assets	10, 11	**(0.2)**	0.1	**(0.1)**	0.2
Impairment (credit) / losses on trade receivables	38c)	**(0.1)**	0.8	**-**	-
Impairment of goodwill	21	**-**	2.5	**-**	-
Depreciation and amortisation	18, 19, 20, 21	**37.7**	21.1	**8.2**	5.5
Impairment of property, plant and equipment and investment property	18, 20	**0.5**	2.3	**0.5**	2.3
Income from shares in subsidiary undertakings		**-**	-	**(38.5)**	(82.9)
Income Statement charge / (credit) for fair value of subsidiary management incentive scheme liability	5	**1.8**	(4.2)	**-**	-
Fair value losses on equity share investments	17e)	**-**	0.3	**-**	-
Interest on subscribed capital	3	**4.5**	4.5	**4.5**	4.5
Interest on lease liabilities	3	**1.4**	-	**0.3**	-
Profit on disposal of property, plant and equipment, investment property and intangible assets		**(0.6)**	(0.3)	**(0.6)**	(0.2)
Profit on disposal of treasury assets		**(2.4)**	-	**(2.4)**	-
Share of profits from joint ventures		**(1.7)**	(0.8)	**-**	-
Profit on disposal of subsidiary undertakings	17c)	**(1.1)**	(3.3)	**-**	-
Fair value losses on equity release portfolio	15	**6.0**	17.1	**6.0**	17.1
Realised losses on equity release portfolio	15	**0.5**	0.7	**0.5**	0.7
Other non-cash movements		**(17.7)**	(12.3)	**(12.4)**	(11.4)
		180.1	218.0	**75.9**	103.8
Changes in operating assets and liabilities:					
Movement in prepayments and accrued income		**(4.4)**	(2.4)	**(4.7)**	(1.4)
Movement in accruals and deferred income		**(4.0)**	15.7	**0.2**	17.7
Movement in provisions for liabilities		**-**	(1.8)	**(3.1)**	(2.7)
Movement in fair value of derivatives		**115.5**	(17.2)	**61.0**	(6.6)
Movement in fair value adjustments for hedged risk		**(93.6)**	(10.1)	**(46.9)**	(18.5)
Fair value movements in debt securities	11	**0.7**	4.3	**(0.3)**	3.5
Movement in loans and advances to customers		**(1,866.4)**	(1,501.4)	**(1,826.8)**	(1,454.7)
Movement in shares		**1,231.5**	1,018.0	**1,231.5**	1,018.0
Net movement in amounts owed to credit institutions and other customers		**(74.1)**	260.3	**(369.7)**	5.7
Net movement in debt securities in issue		**919.1**	746.8	**995.4**	833.6
Net movement in loans and advances to credit institutions		**(98.1)**	(107.1)	**(98.4)**	(107.1)
Remeasurement gains / (losses) on defined benefit obligations		**0.5**	(3.1)	**0.3**	(1.4)
Net movement in other assets		**(2.1)**	36.9	**2.5**	(0.5)
Net movement in other liabilities		**(9.2)**	(37.3)	**(1.9)**	3.0
Income taxes paid		**(32.7)**	(40.4)	**(16.0)**	(18.9)
Net cash flows from operating activities		**262.8**	579.2	**(1.0)**	373.5

Statements of Cash Flows *(continued)*

For the year ended 31 December 2019

	Notes	Group 2019 £m	Group 2018[1] Restated[2] £m	Society 2019 £m	Society 2018[1] Restated[2] £m
Net cash flows from operating activities		**262.8**	579.2	**(1.0)**	373.5
Cash flows from investing activities					
Purchase of debt securities	11	**(2,611.5)**	(1,763.2)	**(2,035.1)**	(1,313.9)
Proceeds from disposal of debt securities		**1,813.4**	1,166.9	**1,350.2**	723.1
Purchase of property, plant and equipment	18	**(12.7)**	(14.5)	**(7.0)**	(6.0)
Purchase of intangible assets	21	**(7.7)**	(4.9)	**(1.8)**	(0.8)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		**3.7**	1.5	**2.8**	0.2
Dividends received from subsidiary undertakings		**-**	-	**38.5**	82.9
Decrease in loans to subsidiary undertakings	17a)	**-**	-	**76.5**	111.0
Dividends received from joint ventures		**1.4**	1.4	**-**	-
Cash acquired on transfer of engagements		**-**	12.9	**-**	12.9
Contingent consideration received following disposal of subsidiary (net of costs)		**6.2**	5.4	**-**	-
Investment in equity share investments	17e)	**(0.7)**	(0.7)	**-**	-
Purchase of other business units	17b)	**(0.3)**	(0.6)	**-**	-
Deferred consideration paid in respect of prior year acquisitions of subsidiary undertakings and business assets		**(0.1)**	(1.6)	**-**	-
Net cash flows from investing activities		**(808.3)**	(597.4)	**(575.9)**	(390.6)
Cash flows from financing activities					
Exercise of share options in subsidiary management incentive scheme	28	**(9.3)**	(9.8)	**-**	-
Share options issued in subsidiary management incentive scheme	28	**0.7**	-	**-**	-
Exercise of put options held by non-controlling shareholders	28	**(0.6)**	(0.3)	**-**	-
Interest paid on subscribed capital	32	**(4.5)**	(4.5)	**(4.5)**	(4.5)
Interest paid on lease liabilities		**(1.4)**	-	**(0.3)**	-
Payment of lease liabilities	27	**(16.3)**	-	**(2.8)**	-
Net cash flows from financing activities		**(31.4)**	(14.6)	**(7.6)**	(4.5)
Net decrease in cash and cash equivalents		**(576.9)**	(32.8)	**(584.5)**	(21.6)
Cash and cash equivalents at 1 January		**2,421.9**	2,455.0	**2,348.8**	2,370.6
Adjustment on initial adoption of IFRS 9		**-**	(0.3)	**-**	(0.2)
Decrease in impairment loss allowance on cash and cash equivalents	10	**0.1**	-	**-**	-
Cash and cash equivalents at 31 December		**1,845.1**	2,421.9	**1,764.3**	2,348.8

Analysis of the cash balances as shown within the Statement of Financial Position:

	Notes	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Cash in hand and balances with the Bank of England		**1,793.1**	2,395.7	**1,793.1**	2,395.7
Mandatory reserve deposit with the Bank of England		**(57.8)**	(46.9)	**(57.8)**	(46.9)
		1,735.3	2,348.8	**1,735.3**	2,348.8
Loans and advances to credit institutions	10	**109.8**	73.1	**29.0**	-
Cash and cash equivalents at 31 December		**1,845.1**	2,421.9	**1,764.3**	2,348.8

[1] The Group has adopted IFRS 16 with effect from 1 January 2019; comparative information for prior periods is not restated (see note 1b)).
[2] Group and Society comparative amounts are restated for adjustments relating to hedge amortisation (see note 1b)).

The accompanying notes form part of these financial statements.

Notes to the Accounts

1. Accounting policies

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

a) Basis of preparation

The Annual Accounts of the Group and the Society are prepared on a going concern basis (see page 50 of the Directors' Report) and in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and effective at 31 December 2019 and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 and the Building Societies Act 1986 applicable to building societies reporting under IFRS.

The Annual Accounts have been prepared under the historical cost convention as modified by the application of fair value measurements required or allowed by relevant accounting standards.

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

b) Changes to significant accounting policies and other prior period adjustments

The Group has adopted IFRS 16 *Leases* with effect from 1 January 2019; the impacts of initially adopting this new accounting standard are set out at i) below. In addition, the Group has early adopted *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)*, which is effective for accounting periods commencing on or after 1 January 2020 with earlier adoption permitted; the impacts of adopting these amendments are set out at ii) below. Details of other prior period adjustments are set out at iii) below.

i) IFRS 16

IFRS 16 *Leases* supersedes IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases (subject to certain limited exemptions) under a single on-balance sheet model. Lessor accounting under IFRS 16 is substantially unchanged from IAS 17; lessors will continue to classify leases as either operating or finance leases, using principles similar to those in IAS 17.

Impact of initial adoption

The Group has a significant number of lease contracts, primarily relating to leases of branch premises operated by the Society and by Connells. The Group adopted IFRS 16 with an initial application date of 1 January 2019, using the modified retrospective method. Under this method, the cumulative effect of initial application is recognised in retained earnings at 1 January 2019 and comparative information for prior periods is not restated.

On adoption of IFRS 16, the Group elected to apply in its accounting policies the following exemptions and practical expedients permitted by the standard:

- The Group elected to take the recognition exemption for short-term leases, except for property leases that are short-term by virtue of being under renegotiation. Short-term leases are those which, at the commencement date, have a lease term of not more than twelve months and do not contain a purchase option;
- Except for leases of motor vehicles, the Group elected to take the recognition exemption for leases for which the underlying asset is of low value when new;
- Certain of the Group's lease contracts contain non-lease components (e.g. service charges). Except for property leases, the Group elected not to separate out the non-lease components and therefore to account for these as part of the lease component.

For the purposes of transition to IFRS 16, the Group elected to apply the following transition expedients permitted by the standard:

- For the purposes of identifying leases held by the Group at 1 January 2019, the Group elected to retain the assessments previously made by the Group under IAS 17 and IFRIC 4; IFRS 16 was therefore initially applied at 1 January 2019 only to those contracts that were previously identified as leases under IAS 17 and IFRIC 4;
- For portfolios of leases with similar characteristics, the Group elected to apply a single discount rate;
- For the purposes of assessing any impairment of right-of-use assets as at 1 January 2019, the Group relied on its assessment as at 31 December 2018 of any onerous leases under IAS 37;
- Except for property leases under renegotiation, the Group elected to account for leases that ended by 31 December 2019 in the same way as short-term leases as described above;
- The Group elected to use hindsight, such as in determining the lease term where contracts contained termination options or extension options.

Financial Statements

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

Prior to IFRS 16, the Group's leases were classified as operating leases under IAS 17 and lease rentals were expensed to the Income Statement on a straight-line basis over the period of the lease agreement (presented within 'Administrative expenses').

On adoption of IFRS 16, the Group's leases (other than where exemptions taken for short-term leases and leases of low value assets) are brought onto the balance sheet; lease liabilities are recognised in respect of the Group's obligations to make future lease payments and 'right-of-use' assets are recognised that represent the Group's right to use the underlying assets. Following adoption of IFRS 16, lease rentals are no longer expensed directly to the Income Statement (other than for exempt leases); instead, amounts expensed to the Income Statement represent the interest costs on lease liabilities (presented within 'Interest payable and similar charges') and the depreciation charge on right-of-use assets (presented within 'Administrative expenses'). For exempt leases, the Group continues to expense lease rentals to the Income Statement on a straight-line basis over the lease term (presented within 'Administrative expenses').

The table below summarises the post-tax impact of transition to IFRS 16 on the general reserve at 1 January 2019.

	Increase / (decrease) in general reserve on adoption of IFRS 16 at 1 January 2019	
	Group (restated[1]) **£m**	**Society £m**
Recognition of lease liabilities (note 2)	(64.7)	(13.0)
Recognition of right-of-use assets (note 3)	68.1	13.8
Impairment of right-of-use assets (note 4)	(0.6)	(0.3)
Decrease in prepayments (note 3)	(3.4)	(0.8)
Decrease in provisions for liabilities (note 4)	0.6	0.3
Total	-	-

Notes
1. The amounts presented above for the Group are restated from the amounts which were presented in the Group's 2019 half-yearly financial report; this is to reflect the results of the Group's final assessments based on up-to-date information.
2. In accordance with IFRS 16, lease liabilities recognised on transition were measured as the present value of the remaining lease payments, discounted using the Group's incremental borrowing rate at 1 January 2019. The incremental borrowing rates applied at 1 January 2019 ranged from 1.4% to 8.6%, depending on the lease term and country.
3. As permitted by IFRS 16, the Group chose to measure the transition right-of-use assets at an amount equal to the transition lease liabilities, adjusted by the amount of any prepaid or accrued lease payments recognised in the Statement of Financial Position immediately prior to the transition date (Group: £3.4m, Society: £0.8m prepaid as at 31 December 2018).
4. As required by IFRS 16, the Group has applied IAS 36 *Impairment of Assets* to right-of-use assets at 1 January 2019 resulting in impairment on transition (Group: £0.6m; Society: £0.3m); these amounts had already been recognised in previous periods (held within provisions for liabilities as at 31 December 2018), hence no impact on reserves at transition.

As disclosed in note 32b) to the 2018 Annual Report and Accounts, the Group and Society had commitments at 31 December 2018 under non-cancellable operating leases. The table below explains the key differences between the total commitments at 31 December 2018 (as previously disclosed under IAS 17 and on an undiscounted basis) and the total amount of lease liabilities recognised on adoption of IFRS 16 at 1 January 2019.

	Group £m	**Society £m**
Operating lease commitments at 31 December 2018 as disclosed under IAS 17 in the Group's 2018 Annual Report and Accounts	69.5	16.3
VAT amounts included in IAS 17 operating lease commitments	(1.3)	(1.3)
Prepaid rents included in IAS 17 operating lease commitments	(0.8)	(0.8)
Transition exemption for leases with less than 12 months remaining	(1.4)	(0.2)
Extension options assumed to be exercised	6.5	-
Impact of discounting using incremental borrowing rates at 1 January 2019	(7.7)	(1.0)
Translation difference	(0.1)	-
Lease liabilities recognised at 1 January 2019	**64.7**	**13.0**

Impact for the year

The Income Statements for the year ended 31 December 2019 include the following income / (expense) in respect of leases:

	Group 2019 £m	**Society 2019 £m**
Interest expense on lease liabilities	(1.4)	(0.3)
Depreciation and impairment charges on right-of-use assets	(17.0)	(3.1)
Lease rental expense - exempt leases:		
Short-term leases	(2.1)	(0.8)
Lease rental expense – variable lease payments	(0.1)	-
Income from subleasing of right-of-use assets	0.5	0.1

The Statements of Financial Position as at 31 December 2019 include the following amounts in respect of leases:

Group 2019	Right-of-use assets			Lease liabilities
	Land and buildings £m	Equipment, fixtures and fittings £m	**Total £m**	**Total £m**
At 31 December 2018	**-**	**-**	**-**	**-**
Adjustment on initial adoption of IFRS 16^	66.4	1.1	67.5	64.7
At 1 January 2019	**66.4**	**1.1**	**67.5**	**64.7**
Additions	11.2	5.7	16.9	17.0
Disposals	(1.4)	-	(1.4)	(1.4)
Depreciation and impairment	(16.3)	(0.7)	(17.0)	-
Interest expense	-	-	-	1.4
Payments	-	-	-	(17.7)
Transfers from provision for the costs of surplus properties	-	-	-	1.2
Modifications and remeasurements	1.5	(0.1)	1.4	1.4
At 31 December 2019	**61.4**	**6.0**	**67.4**	**66.6**

^ As noted above, these amounts are restated from the amounts which were presented in the Group's 2019 half-yearly financial report; this is to reflect the results of the Group's final assessments based on up-to-date information.

Society 2019	Right-of-use assets			Lease liabilities
	Land and buildings £m	Equipment, fixtures and fittings £m	**Total £m**	**Total £m**
At 31 December 2018	**-**	**-**	**-**	**-**
Adjustment on initial adoption of IFRS 16	13.4	0.1	13.5	13.0
At 1 January 2019	**13.4**	**0.1**	**13.5**	**13.0**
Additions	3.0	0.1	3.1	3.0
Disposals	(0.8)	-	(0.8)	(0.7)
Depreciation and impairment	(3.0)	(0.1)	(3.1)	-
Interest expense	-	-	-	0.3
Payments	-	-	-	(3.1)
At 31 December 2019	**12.6**	**0.1**	**12.7**	**12.5**

Impact on regulatory capital

The impact on the Group's regulatory capital of transition to IFRS 16 at 1 January 2019 is to reduce the CET 1 ratio by 0.2%, from 32.8% (which reflects the restatement for the hedge amortisation adjustment as described on pages 116 to 118) at 31 December 2018 to 32.6%, as a result of the increase to risk weighted assets arising from the recognition of right-of-use assets on the balance sheet. The leverage ratio was unchanged at 6.1% (which also reflects the above restatement).

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

Significant accounting policies

Further details on the Group's significant accounting policies as a result of adopting IFRS 16 can be found in note 1k) Leases.

ii) Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)

In September 2019 the IASB issued *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)*, which the Group has early adopted in these consolidated financial statements. The amendments include a number of reliefs, which apply to all hedging relationships that are directly affected by interest rate benchmark reform. A hedging relationship is affected if the reform gives rise to uncertainties about the timing or amount of benchmark-based cash flows of the hedged item or the hedging instrument; the new reliefs allow hedge accounting to continue during the period of uncertainty arising from interest rate benchmark reform.

The Group hedges and applies hedge accounting to its benchmark interest rate exposures. Application of the amendments impacts the Group's accounting in the following ways:

- The Group has fixed rate advances in the form of retail mortgage lending to customers and has fixed rate funding in the form of retail deposits from customers, which it includes in a portfolio fair value hedge of the GBP LIBOR risk component of those advances. This benchmark interest rate component was separately identifiable at the time of the initial designation; the amendments permit continuation of hedge accounting even though in the future the hedged benchmark interest rate, GBP LIBOR, may no longer be separately identifiable;
- The Group uses cross-currency interest rate swaps to hedge the foreign currency risk and interest rate risk in its Euro-denominated covered bond issuances. The amendments permit continuation of hedge accounting despite there being uncertainty about the replacement of the GBP LIBOR floating interest rates included in one of the cross-currency interest rate swaps;
- The Group will retain the cumulative gain or loss in the cash flow hedging reserve for designated cash flow hedges that are subject to benchmark interest rate reforms, despite there being uncertainty arising from the interest rate benchmark reform with respect to the timing and amount of the cash flows of the hedged items. Should the Group consider the hedged future cash flows are no longer expected to occur due to reasons other than interest rate benchmark reforms, the cumulative gain or loss will be reclassified immediately to profit or loss.

Further details of how the Group is managing its transition to replacement benchmark interest rates, and the extent to which the Group's hedging relationships are affected by this reform, are set out in note 35. Further details on the Group's significant accounting policies as a result of adopting *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)* can be found in note 1e).

iii) Other prior period adjustments

Hedge amortisation

The Group has reviewed its application of hedge accounting in accordance with the requirements of IFRS 9 and IAS 39. This review identified a material misstatement where the Group had not appropriately amortised certain fair value adjustments over the life of the hedge. In accordance with IAS 8 *Accounting policies, Changes in Accounting Estimates and Errors*, Group and Society comparative amounts are restated as set out in the tables below. Any tax credit in respect of this adjustment will be subject to the error or mistake provisions in schedule 18 of the Finance Act 1998 and, on the basis that there is significant uncertainty as to whether a claim will be possible, no tax credit has been recognised.

Other prior period adjustments

As described in note 4a), the Group's 2018 comparative amounts for 'Fees and commissions receivable' and 'Administrative expenses' have been restated to present certain items on a gross basis; this revised presentation more fairly reflects the substance of the arrangements. This restatement is presentational only; there is no impact on profits and no impact on reserves.

As described in note 30, Group and Society comparative amounts for deferred tax assets and deferred tax liabilities have been restated to, where appropriate, present deferred tax on a net basis; this revised presentation more fairly reflects the nature of these items as the tax in question will ultimately be settled on a net basis. This restatement is presentational only; there is no impact on profits and no impact on reserves.

As described in note 3, Group and Society comparative amounts for interest payable and similar charges have been restated to reclassify interest payable on certain borrowings between line items; this revised presentation more fairly reflects the nature of the relevant interest costs. This restatement is presentational only; there is no impact on profits and no impact on reserves.

Income Statement For the year ended 31.12.18	Group				Society		
	Previously reported £m	Hedge amortisation adjustments £m	Other adjustments £m	Restated £m	Previously reported £m	Hedge amortisation adjustments £m	Restated £m
Fees and commissions receivable	480.9	-	15.5	496.4	33.6	-	33.6
Fair value gains / (losses) on hedging instruments and hedged items	1.5	0.5	-	2.0	0.1	0.3	0.4
Total income	724.5	0.5	15.5	740.5	307.4	0.3	307.7
Administrative expenses	(521.0)	-	(15.5)	(536.5)	(138.7)	-	(138.7)
Operating profit before impairment and provisions	203.5	0.5	-	204.0	168.7	0.3	169.0
Profit before tax	188.2	0.5	-	188.7	167.1	0.3	167.4
Tax expense	(40.6)	(0.1)	-	(40.7)	(22.6)	-	(22.6)
Profit for the financial year attributable to members of Skipton Building Society	147.6	0.4	-	148.0	144.5	0.3	144.8

Statement of Comprehensive Income For the year ended 31.12.18	Group			Society		
	Previously reported £m	Hedge amortisation adjustments £m	Restated £m	Previously reported £m	Hedge amortisation adjustments £m	Restated £m
Profit for the financial year	147.6	0.4	148.0	144.5	0.3	144.8
Movement in cash flow hedging reserve: gains taken to equity	(0.3)	1.5	1.2	(1.0)	1.3	0.3
Income tax on items that may be reclassified to profit or loss	0.6	(0.3)	0.3	0.8	(0.3)	0.5
Other comprehensive expense for the year (net of tax)	(4.5)	1.2	(3.3)	(3.4)	1.0	(2.4)
Total comprehensive income for the year attributable to members of Skipton Building Society	143.1	1.6	144.7	141.1	1.3	142.4

Statement of Financial Position As at 31.12.18	Group				Society		
	Previously reported £m	Hedge amortisation adjustments £m	Other adjustments £m	Restated £m	Previously reported £m	Hedge amortisation adjustments £m	Restated £m
Loans and advances to customers held at amortised cost	18,127.0	(8.0)	-	18,119.0	15,999.2	(8.0)	15,991.2
Deferred tax asset	41.6	(0.2)	(4.3)	37.1	26.3	(0.2)	26.1
Total assets	23,204.4	(8.2)	(4.3)	23,191.9	21,637.6	(8.2)	21,629.4
Shares	16.113.5	-	-	16,113.5	16,113.5	(1.4)	16,112.1
Amounts owed to other customers	1,690.4	0.1	-	1,690.5	529.2	-	529.2
Current tax liability	18.6	(0.1)	-	18.5	10.0	-	10.0
Deferred tax liability	5.5	-	(4.3)	1.2	0.4	-	0.4
Total liabilities	21,679.6	-	(4.3)	21,675.3	20,255.3	(1.4)	20,253.9
General reserve	1,518.7	(8.0)	-	1,510.7	1,381.2	(7.6)	1,373.6
Cash flow hedging reserve	(0.2)	(0.2)	-	(0.4)	(0.6)	0.8	0.2
Members' interests attributable to members of Skipton Building Society	1,524.8	(8.2)	-	1,516.6	1,382.3	(6.8)	1,375.5
Total members' interests and liabilities	23,204.4	(8.2)	(4.3)	23,191.9	21,637.6	(8.2)	21,629.4

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

Statement of Changes in Members' Interests For the year ended 31.12.18	Group Previously reported £m	Group Hedge amortisation adjustments £m	Group Restated £m	Society Previously reported £m	Society Hedge amortisation adjustments £m	Society Restated £m
General reserve						
Adjusted balance at 1 January 2018	1,357.7	(8.4)	1,349.3	1,222.1	(7.9)	1,214.2
Profit for the financial year	147.6	0.4	148.0	144.5	0.3	144.8
Total comprehensive income for the year	145.5	0.4	145.9	143.6	0.3	143.9
Balance at 31 December 2018	1,518.7	(8.0)	1,510.7	1,381.2	(7.6)	1,373.6
Cash flow hedging reserve						
Adjusted balance at 1 January 2018	0.1	(1.4)	(1.3)	0.1	(0.2)	(0.1)
Net gains from changes in fair value	(0.3)	1.2	0.9	(0.7)	1.0	0.3
Total other comprehensive income	(0.3)	1.2	0.9	(0.7)	1.0	0.3
Total comprehensive income for the year	(0.3)	1.2	0.9	(0.7)	1.0	0.3
Balance at 31 December 2018	(0.2)	(0.2)	(0.4)	(0.6)	0.8	0.2

Statement of Cash Flows For the year ended 31.12.18	Group Previously reported £m	Group Hedge amortisation adjustments £m	Group Reclass-ifications	Group Restated £m	Society Previously reported £m	Society Hedge amortisation adjustments £m	Society Reclass-ifications	Society Restated £m
Profit before tax	188.2	0.5	-	188.7	167.1	0.3	-	167.4
Other non-cash movements	(16.4)	1.0	3.1	(12.3)	(13.8)	1.0	1.4	(11.4)
Movement in fair value adjustments for hedged risk	(8.2)	(1.9)	-	(10.1)	(16.9)	(1.6)	-	(18.5)
Remeasurement gains / (losses) on defined benefit obligations	-	-	(3.1)	(3.1)	-	-	(1.4)	(1.4)
Net movement in other assets	36.5	0.4	-	36.9	(0.8)	0.3	-	(0.5)

c) Basis of consolidation

Subsidiary undertakings

Subsidiary undertakings are entities controlled by the Society. Control exists when the Society is exposed, or has rights, to variable returns from its involvement with an entity and has the ability to affect those returns through its power over the entity. In assessing control, only substantive rights (i.e. rights that can be practically exercised) are taken into account.

Investments in subsidiary undertakings

Investments in subsidiary undertakings are recorded in the Society's Statement of Financial Position at cost, less any provision for impairment. The Group Accounts consolidate the financial statements of the Society and all its subsidiary undertakings, eliminating intra-Group transactions and balances.

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is measured at fair value, as are the separately identifiable net assets acquired. Any goodwill arising is accounted for in accordance with the Group's accounting policy for goodwill (see note 1d)). Any gain on a bargain purchase is recognised in profit or loss immediately. All transaction or acquisition costs are written off to the Income Statement as incurred.

In accordance with IFRS 3 *Business Combinations (2008)*, goodwill is accounted for only upon the acquisition of a subsidiary undertaking or as a result of a business combination. Subsequent changes in the Group's interest in a subsidiary undertaking, where control is retained, are recognised in equity. In accordance with IFRS 10 *Consolidated Financial Statements (2011)*, for business combinations which have taken place from 1 January 2010 onwards, all transactions relating to ownership interests with non-controlling interests are recorded in equity if there has been no change in control.

When the Group loses control over a subsidiary, through disposal or other changes in circumstances, it derecognises the assets and liabilities of the subsidiary and any associated goodwill, as well as any related non-controlling interest and other components of equity. Any resulting gain or loss is recognised in the Income Statement.

Put options

Within a number of subsidiary undertakings where the Group has less than 100% ownership, there is an option for the non-controlling shareholders to require the Group to purchase their shares at some point in the future. In accordance with IAS 32 *Financial Instruments: Presentation*, the Group recognises the present value of these options as a financial obligation, along with recognition of further goodwill on the future purchase of remaining non-controlling interests. Under this accounting policy the Group consolidates 100% of the results of such subsidiary undertakings to reflect the 100% implicit ownership in the recording of the future purchase of the non-controlling interests' shareholdings (i.e. the put option liability).

Any changes in the valuation of a put option obligation in respect of an entity acquired after 1 January 2010 are credited or charged through the Income Statement. Put options issued prior to 1 January 2010 are accounted for in accordance with IAS 27 *Consolidated and Separate Financial Statements (2003)* and IFRS 3 *Business Combinations (2004)* and any adjustment to the Group's estimation of the present value of the put option liability results in an adjustment to goodwill. Dividends paid to the non-controlling interests are charged to the Income Statement. The change in fair value of the liability due to the accretion of the discount of the liability is expensed in the Income Statement.

Business combinations between mutual organisations

Where trading operations, assets and liabilities of another mutual organisation are merged into the business of the Society, the Society applies acquisition accounting under IFRS 3. All assets and liabilities are incorporated into the Society's Statement of Financial Position at fair value on the date of the merger.

No consideration is transferred for business combinations between mutual organisations. The amount of goodwill recognised on merger with the mutual organisation is determined by reference to the excess of the fair value of the Society's interest in the acquiree over the fair value of the acquiree's separately identifiable net assets on the date of acquisition.

All transaction costs are written off to the Society's Income Statement as incurred.

Joint ventures

A joint venture is an undertaking in which the Group has joint control and has rights to the net assets of the arrangement.

The results and assets and liabilities of joint ventures are accounted for in these consolidated financial statements using the equity method of accounting. Investments in joint ventures are carried within the Statement of Financial Position at cost, as adjusted by post-acquisition changes in the Group's share of the net assets of the joint venture, less any impairment in the value of individual investments.

Equity share investments

An equity share investment is an investment in the share capital of a company where the Group does not have significant influence.

Unconsolidated structured entities

The Group invests in structured entities where the principal purpose of the structured entity is to provide investors with access to specific portfolios of assets and also provide the investor liquidity through the securitising of financial assets. A structured entity is one that has been set up so that any voting rights or similar rights are not the determining factor in deciding which party controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

A structured entity often has some or all of the following characteristics:

- Restricted activities;
- A narrow and well defined objective;
- Insufficient equity to permit the structured entity to finance its activities without subordinated financial support.

Third party funding entities

The Group invests in structured entities through the purchase of issued mortgage backed securities, as disclosed in note 11. These structured funding entities are not consolidated into the Group Accounts because the Group does not have the ability to direct the activities of the entities in question and does not control these entities through voting rights, contractual rights, funding agreements or any other means. The Group's involvement is in relation to investment activity only.

Interests in unconsolidated structured entities

The Group's interests in unconsolidated structured entities refer to involvement that exposes the Group to variability of returns from the performance of the structured entities.

Income derived from involvement with unconsolidated structured entities

Interest income on funding provided to unconsolidated structured entities is recognised within interest receivable in the Income Statement.

1. Accounting policies *(continued)*

Special purpose funding vehicles

The Society has transferred the beneficial interest in certain portfolios of loans and advances to customers to special purpose funding vehicles (SPVs). These SPVs enable the subsequent raising of debt, either by the SPVs or the Society, to investors who gain the security of the underlying assets as collateral. The SPVs are fully consolidated into the Group Accounts in accordance with IFRS 10.

The transfers of the beneficial interest in these loans to the SPVs are not treated as sales by the Society and are not derecognised. The Society continues to recognise these assets within its own Statement of Financial Position after the transfer because it retains substantially all the risks and rewards of these mortgage portfolios through the receipt of interest income and deferred consideration from the SPVs for the transfer of the beneficial interest in the mortgage loans. For securitisations, in the accounts of the Society, the proceeds received from the transfer of mortgage loans are accounted for as a deemed loan repayable to the SPV and are included in 'Amounts owed to other customers' within the Society's Statement of Financial Position.

Where the Society issues the debt, as is the case for the covered bonds (see note 17a)), it then lends the proceeds on back-to-back terms to Skipton Covered Bonds Limited Liability Partnership (LLP); the proceeds lent to the LLP are known as the 'term advance'. Some or all of the proceeds from the term advance are then paid to the Society from the LLP as consideration for the beneficial interest in the mortgage pool and is accounted for as a deemed loan repayable to the LLP. In the accounts of the Society, the term advance and the deemed loan are not recognised separately as additional assets and liabilities; the difference between the term advance and the deemed loan are shown net within the Society's Statement of Financial Position as an amount owed from subsidiary undertakings. This is to avoid the 'grossing up' of the Statement of Financial Position.

To manage interest rate risk, the Society enters into interest rate swap arrangements with the LLP; the Society receives interest payments from the LLP relating to receipts on the mortgages in the pool and pays a floating rate of interest to the LLP. In accordance with IFRS 9 these swap arrangements are treated as part of the deemed loan and not separately fair valued because the relevant mortgage loans to which the interest swaps relate are not derecognised. All other derivatives relating to securitisations are treated as explained in note 1e).

To manage currency risk arising from the Euro-denominated covered bond issuances, the LLP has entered into a cross-currency swap transaction. These derivatives are designated in hedge accounting relationships against the term advance, which mirrors the conditions of the debt issued, effectively hedging the debt issued by the Society. In accordance with IFRS 9, any cost for currency basis spread priced within the cross-currency swap is permitted to be excluded from the hedge relationship and is recognised directly in reserves (the cost of hedging reserve). The Group has elected to apply this treatment for these hedge relationships. See note 1e) for further details.

Further details on the nature and amount of the beneficial interest transferred to the SPVs can be found in note 13 to these financial statements.

d) Intangible assets

Goodwill

Goodwill arising on the acquisition of Group undertakings or other businesses represents the excess of the fair value of the consideration paid over the fair value of separately identifiable net assets acquired at the date of acquisition. Goodwill arising on the acquisition of subsidiary undertakings is included in the 'Intangible assets' line within the Statement of Financial Position. Goodwill arising on the acquisition of joint ventures, associates or other businesses is included within the carrying value of the underlying investment within the Statement of Financial Position.

Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses, and is reviewed for impairment, at least, at each reporting date. Any impairment is recognised in the Income Statement.

For the purposes of impairment testing, goodwill is allocated to each of the Group's cash generating units expected to benefit from the synergies of combination. The impairment test compares the carrying value of the cash generating unit, being its net assets plus associated goodwill, to its associated value in use. The value in use calculations are carried out by discounting the forecast future cash flows of the cash generating unit to present value (see note 21). Future cash flows are ordinarily based upon the corporate plans of the cash generating units for the next five years and assumed growth thereafter for the subsequent 10 years, generally in line with long term growth rates. The cash flows are extrapolated for subsequent years indefinitely (or a specific number of years where circumstances dictate), to reflect the fact that cash generating units are held for the long term. The Group estimates discount rates based upon the weighted average cost of capital which is adjusted to take account of the market risks associated with each cash generating unit.

Goodwill arising on acquisitions before the transition to IFRS on 1 January 2005 has been retained at its previous UK GAAP amount and is reviewed for impairment, at least, at each reporting date, as above.

Impairment losses are recognised in profit or loss. They are allocated first to reduce the carrying amount of any goodwill allocated to the cash generating unit, and then to reduce the carrying amounts of the other assets in the cash generating unit on a pro-rata basis.

Computer software, databases, brands and customer contracts

In accordance with IAS 38 *Intangible Assets*, computer software, databases, brands and customer contracts are recognised as an intangible asset if, and only if, the cost incurred leads to the creation of an identifiable asset whose cost can be measured reliably and it is probable that the asset created will generate future economic benefits which will flow to the Group. Further, brands and customer contracts are only eligible to be recognised as an intangible asset when purchased externally or when acquired as part of a business combination; internally generated brands and customer contracts are not capitalised. Expenditure incurred to maintain existing levels of performance is recognised as an expense as incurred.

Intangible assets are initially recognised at cost, or at fair value when acquired as part of a business combination, and subsequently amortised from the date they are available for use using the straight line method over their estimated useful economic lives (unless deemed to have an indefinite economic life), which can be up to 10 years. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Intangible assets are tested for impairment at each reporting date or when there is an indication of impairment. The Group identifies impairment by comparing the future economic benefit to the Group against the carrying value of the asset. The assessment of future economic benefit includes value in use calculations to determine recoverable amounts for cash generating units.

e) Financial assets

In accordance with IFRS 9, the financial assets of the Group are each classified into one of three categories (amortised cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVTPL)), further details of which are provided below.

In classifying each financial asset, the Group assesses:

- The objective of the business model in which the financial asset is held; and
- Whether the contractual cash flows of the financial asset are 'solely payments of principal and interest' (SPPI).

Financial assets are reclassified when, and only when, the Group changes its business model for managing the assets.

Business model assessment

The Group's business model assessment is made at a portfolio level as this best reflects the way the business is managed and how information is provided to management. The information considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. These include whether management's strategy focuses on earning contractual interest income, matching the duration of the financial assets to the duration of any related liabilities or realising cash flows through the sale of the assets;
- How the performance of the portfolio is evaluated and reported to the Group's management;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- The frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and expectations about future sales activity. Transfers of financial assets to third parties in transactions that do not qualify for derecognition are not considered sales for this purpose, consistent with the Group's continuing recognition of the assets.

SPPI assessment

For the purposes of the Group's SPPI assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making this assessment, the Group considers:

- Terms that may adjust the contractual coupon rate, including variable-rate features;
- Contingent events that would change the amount or timing of cash flows;
- Prepayment and extension features; and
- Terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse features).

As a result of the assessments outlined above, the financial assets of the Group have been classified as follows:

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

At amortised cost

A financial asset is measured at amortised cost only if it meets both of the following conditions and is not designated as at fair value through profit or loss (FVTPL):

- It is held within a business model whose objective is to hold assets to collect contractual cash flows ('held to collect' business model); and
- Its contractual terms give rise on specified dates to cash flows that are 'solely payments of principal and interest' (SPPI) on the principal amount outstanding.

The following have been assessed by the Group to be in a 'held to collect' business model and to have cash flows that pass the SPPI test:

- Loans and advances to customers (except for a small number of loans held at FVTPL)
- Cash balances
- Loans and advances to credit institutions
- Trade receivables
- Certain debt securities (disposed of by the Group during 2018)
- Loans to subsidiary undertakings (in the Society's Statement of Financial Position)

The Group's financial assets measured at amortised cost are initially recognised at fair value less any directly attributable transaction costs. The assets are subsequently measured at amortised cost using the effective interest method, less impairment loss allowances. The effective interest method calculates an interest rate which exactly discounts the forecast cash flows of an asset over its expected life back to its carrying value. For financial assets that are not credit-impaired (see note 1g)), interest revenue is calculated by applying the effective interest rate to the gross carrying amount of the asset.

For financial assets that are credit-impaired, interest revenue is calculated by applying the effective interest rate to the amortised cost of the asset.

In accordance with the effective interest method, directly attributable upfront costs and fees such as cashbacks, mortgage premia paid or discounts received on acquisition of mortgage books, lending charges paid by customers, procuration fees and completion fees are deferred and recognised over the expected life of mortgage assets. Historical and forecast mortgage redemption data and management judgement of future performance are used to estimate the expected lives of mortgage assets.

A change to management's estimate of expected mortgage lives is accounted for on the basis that such a change is regarded as a change to the original assumptions used. This results in an immediate adjustment to the carrying amount of the mortgage asset (discounted at its effective interest rate) at the point this change is made, which recalculates the carrying value as if the revised assumptions had always been in place.

If a change is made to the rate that fixed rate mortgage customers will revert to at the end of the product's fixed term (i.e. the Society's Mortgage Variable Rate (MVR) or Standard Variable Rate (SVR)), and it can be demonstrated that this change is driven by changes in market rates, this is accounted for as a change to the effective interest rate which means that the impact of the change is spread over the remaining life of the mortgage asset. Otherwise, any change in MVR or SVR is accounted for as described in the paragraph above.

Included in loans and advances to customers of the Society are balances which have been used to secure funding issued by the Group's special purpose funding vehicles which are consolidated into the Group Accounts, further details of which are included in note 17a). The beneficial interest in the underlying loans has been transferred to these entities. The loans are retained within the Society's Statement of Financial Position however as the Society retains substantially all the risks and rewards relating to the loans.

In accordance with IFRS 9, an impairment loss allowance is determined for expected credit losses (ECLs; see note 1g) for details on measurement of ECLs). The movement in the impairment loss allowance recognised during the period is charged or credited to the Income Statement.

At fair value through other comprehensive income (FVOCI)

A financial asset is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- It is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets ('held to collect and sell' business model); and
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

The majority of the Group's debt securities, which are held to manage liquidity requirements, have been assessed by the Group to be in a 'held to collect and sell' business model and to have cash flows that pass the SPPI test.

Financial assets held at FVOCI are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in fair value recognised in equity. The fair values of financial assets held at FVOCI are based on quoted prices, which represent the bid price.

In accordance with IFRS 9, an impairment loss allowance is determined for ECLs. For financial assets measured at FVOCI, the impairment loss allowance is not deducted from the carrying amount of the asset; instead the loss allowance is recognised through other comprehensive income. The movement in the impairment loss allowance recognised during the period is charged or credited to the Income Statement.

Interest income is recognised in the Income Statement on an effective interest basis. When the assets are derecognised, the accumulated gains or losses within equity are reclassified to the Income Statement.

The premia and discounts arising on the purchase of these assets are amortised over the period to the maturity date of the security on an effective interest basis. Any amounts amortised are charged or credited to the Income Statement in the relevant financial periods.

At fair value through profit or loss (FVTPL)

All financial assets which are not classified as either amortised cost or FVOCI, as described above, are measured at FVTPL. This includes all derivative financial assets. On initial recognition the Group may irrevocably designate as FVTPL a financial asset that otherwise meets the requirements to be measured at either amortised cost or FVOCI, if so doing eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Loans and advances to customers

A small number of loans are held at FVTPL because they contain contractual cash flows which do not pass the SPPI test. These loans consist mainly of certain lifetime mortgages. The fair value of these loans is determined by discounting future expected cash flows. Where the portfolio is so small that a probabilistic methodology to estimate future cash flows is not appropriate, management assumes that voluntary prepayments will be 100% in year one.

Equity release portfolio

The Group holds an equity release portfolio. The mortgage products within this portfolio provide the customer with a 'no negative equity guarantee' (NNEG), which is an embedded derivative. Under IFRS 9, the equity release portfolio and the NNEG are assessed together as a hybrid financial instrument. The Group assessed the characteristics of the equity release cash flows and concluded that the contractual terms do not give rise on specified dates to cash flows that are solely payments of principal and interest. As a result, the equity release portfolio is classified as FVTPL.

The existence of the NNEG means that the Group's maximum return on redemption of these loans is limited to the value of the customer's property at that time. The Group's exposure to potential losses as a result of the NNEG is limited in part by a guarantee provided to the Group by a third party for the longevity element of this risk. Due to the structured nature of the portfolio there is no single industry pricing methodology and assumptions for valuing these products differ by institution. Further complexity arises on a portion of the portfolio due to the customer rate being linked to the Retail Price Index (RPI).

A stochastic model was chosen and devised internally for the purpose of valuing this portfolio. The model uses inputs including mortality rates, voluntary prepayment rates, estimates of future RPI and a House Price Index (HPI) to predict future cash flows on the portfolio. These are then discounted back to present value using a discount curve based on a Sterling Overnight Index Average (SONIA) curve plus an illiquidity spread. The illiquidity spread reflects the fact that no repayments are made by the customer until the product redeems which may be many years into the future.

Where possible the inputs are market-driven or, where no market-driven data is available, based on management judgement that is informed by observable data wherever possible. Due to the high level of variability within these inputs, the model also runs several thousand scenarios for both the RPI and HPI inputs. The Group has robust control procedures in place regarding all the inputs to the valuation model.

As this valuation technique uses one or more significant inputs that are not based on observable market data, it is classed as a Level 3 valuation technique. For further details on the different levels of the fair value hierarchy, see note 39b). The impact of applying reasonably possible alternative assumptions of certain inputs into the valuation of the portfolio is found in note 1t).

Interest income on the equity release portfolio is recognised in the Income Statement on an effective interest basis. Fair value gains or losses on the portfolio are recognised within the 'Fair value gains / (losses) on equity release portfolio' line in the Income Statement. Realised losses recognised on redemption of a loan within the portfolio are recognised in the 'Realised losses on equity release portfolio' line in the Income Statement.

Derivative financial instruments

The Group's derivative financial instruments, which are held solely for hedging purposes, are measured and held at fair value within the Statement of Financial Position. The Group elected to adopt from 1 January 2018 the new hedge accounting requirements of IFRS 9 for all hedge relationships covered by those requirements. As permitted under IFRS 9, the Group continues to apply the requirements of IAS 39 for derivatives designated in a portfolio fair value hedge. For all other derivatives designated in a hedging relationship, the Group applies the requirements of IFRS 9.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

The Group uses derivative financial instruments to hedge its exposure to market risks (for example, interest rate risk) arising from operational, financing and investment activities. In accordance with its treasury policy and the Building Societies Act 1986, the Group does not hold or issue derivative financial instruments for trading purposes. In line with accounting standards, the changes in fair value of derivatives used to hedge particular risks can either be offset in the Income Statement or deferred to equity.

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

- Fair value hedges - Where a derivative financial instrument hedges the changes in fair value of a recognised asset or liability (or portion of a recognised asset or liability), any gain or loss on the hedging instrument is recognised in the Income Statement. To the extent that there is an effective hedge relationship, the associated hedged items (for example, mortgage assets) are stated at fair value in respect of the hedged risk, with any gain or loss also recognised in the Income Statement. As a result, fair value movements in the hedging instrument and in the hedged items offset each other and reduce profit volatility. Any residual fair value hedge ineffectiveness is also recognised in the Income Statement. In order to calculate the fair value in respect of hedged risk in relation to mortgage assets and some retail savings, the Group applies estimated prepayment assumptions using historical analysis. For fair value hedge relationships where ineffectiveness would arise as a result of foreign currency basis spread, movements are recognised in other comprehensive income (OCI) through the cost of hedging reserve (see below) in accordance with IFRS 9.
- Cash flow hedges - Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability (or portion of a recognised asset or liability) or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised in OCI and deferred in a separate reserve. The effective portion recognised in OCI is limited to the cumulative change in fair value of the hedged item, determined on a present value basis, from inception of the hedge. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately.

In accordance with IFRS 9, where foreign currency basis spread arises in fair value hedge relationships, this is separated and excluded from the designation of a financial instrument as the hedging instrument; movements relating to the foreign currency basis spread are recognised in OCI through the cost of hedging reserve. The Group calculates the value of the foreign currency basis spread by comparing the change in value of the actual foreign currency hedging instrument (excluding fees not relating to the hedge relationship) and the value of a hypothetical instrument derived and valued using market data excluding foreign currency basis spread.

Hedge accounting relationships within the scope of IFRS 9 require hedge accounting to only be discontinued when the qualifying criteria are no longer met. Additionally, if the hedge no longer meets the qualifying criteria due to a mismatch in the hedge ratio, the relationship must be rebalanced if possible rather than discontinuing hedge accounting.

Fair values are determined by the three tier valuation hierarchy as defined in IFRS 13 *Fair Value Measurement* and Amendments to IFRS 7 *Financial Instruments: Disclosures* and as described in note 39b). All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

In valuing derivatives used to hedge our mortgage and savings portfolios, the Group has not valued them as one net pool for market risk and credit risk management purposes as permitted under IFRS 13, but has valued each derivative individually.

Interest on derivatives is included within interest receivable where the derivative economically hedges an asset and within interest expense where the derivative economically hedges a liability, to align the recognition with its economic purpose.

Fair value gains and losses on derivatives and hedged items that are posted to the Income Statement are recognised in the 'Fair value gains / (losses) on hedging instruments and hedged items' line in the Income Statement, with the exception of the derivatives hedging the Group's equity release portfolio, whose changes in fair value are recognised in the 'Fair value gains / (losses) on other derivatives' line in the Income Statement.

Unrealised fair value gains and losses on cash flow hedging derivatives are recognised in the cash flow hedging reserve.

Where the Group enters into a cross-currency swap, as is the case for the issuance of Euro-denominated covered bonds (see page 120), the Group recognises the movement in the fair value of the derivative as follows:

- Foreign exchange movements are recognised in the 'Interest payable and similar charges' line in the Income Statement;
- Movements due to interest rate risk are recognised in the 'Fair value gains / (losses) on hedging instruments and hedged items' line in the Income Statement; and
- Movements due to foreign currency basis spread are recognised directly in the cost of hedging reserve as permitted by IFRS 9.

As outlined in note 1b), the Group has early adopted *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)*. The amendments include a number of reliefs, which apply to all hedging relationships that are directly affected by interest rate benchmark reform. A hedging relationship is affected if the reform gives rise to uncertainties about the timing or amount of benchmark-based cash flows of the hedged item or the hedging instrument; the new reliefs allow hedge accounting to continue during the period of uncertainty arising from interest rate benchmark reform. The reliefs cease to apply once certain conditions are met; these include when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and amount of the benchmark-based cash flows of the hedged item, if the hedging relationship is discontinued or once amounts in the cash flow hedging reserve have been released.

Contingent consideration

The Group holds a contingent consideration asset in relation to the disposal of a previous subsidiary undertaking. The Group assessed the characteristics of the contingent consideration cash flows based on the facts and circumstances that existed at initial recognition of the asset. As the contractual cash flows were dependent on the future performance of the counterparty, the Group concluded that the contractual terms did not give rise to cash flows on specified dates that are solely payments of principal and interest. The contingent consideration asset is therefore classified as FVTPL. The fair value of this asset is determined by calculating the present value of the expected future cash flows, discounted at an appropriate rate.

Equity share investments

Under IFRS 9 equity share investments are measured at FVTPL, except where an election is made at initial recognition to irrevocably designate an equity share investment that is not held for trading as FVOCI. The FVOCI election can be made on an instrument-by-instrument basis; the Group has made no such elections in respect of its existing equity share investments. The Group's equity share investments are therefore held at FVTPL. They are initially recognised at fair value, with subsequent changes in fair value being recognised in the Income Statement. Transaction costs are expensed to the Income Statement.

Share warrants

Within other assets of the Group are share warrants held in an unlisted entity. Other assets also includes amounts recognised, where appropriate, for additional share warrants yet to be received. The Group assessed the characteristics of the related cash flows and concluded that the contractual terms fail the SPPI test; these assets are therefore classified by the Group as FVTPL. The fair value is determined by reference to information included in an independent third party valuation.

Debt securities

The Society holds in its Statement of Financial Position residential mortgage backed securities that were issued in previous periods by the Group's securitisation vehicle. Certain tranches of these securities are held at FVTPL because they fail the SPPI test due to an elevated level of credit risk relative to other tranches.

f) Financial liabilities

In accordance with IFRS 9, the financial liabilities of the Group are classified as measured at either amortised cost or FVTPL. A financial liability is classified as at FVTPL if it meets the definition of 'held for trading', which includes derivatives (except for derivatives that are financial guarantee contracts or which are designated and effective hedging instruments). On initial recognition the Group may irrevocably designate as FVTPL a financial liability that otherwise meets the requirements to be measured at amortised cost, if so doing results in more relevant information; this can be either because it eliminates or significantly reduces an accounting mismatch that would otherwise arise, or because a group of financial liabilities is managed and evaluated on a fair value basis.

Financial liabilities at FVTPL are measured at fair value. Gains and losses, including any interest expense, are recognised in profit or loss unless the financial liability is one that was designated as FVTPL, in which case fair value changes are presented as follows:

- The amount of fair value change that is attributable to changes in the credit risk of the liability is presented in other comprehensive income (except where this would create or enlarge an accounting mismatch in profit or loss); and
- The remaining amount of fair value change is presented in profit or loss.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with any interest expense being recognised in profit or loss. Any gain or loss on derecognition is also recognised in profit or loss.

The financial liabilities of the Group have been classified as set out below.

Borrowings, comprising shares, deposits and debt securities in issue are recognised initially at fair value, being the amounts deposited or proceeds issued, net of premia, discounts and transaction costs incurred. Borrowings are subsequently measured at amortised cost using the effective interest method. Derivative liabilities and the fair value of the put option obligation are measured at fair value through profit or loss.

Permanent Interest Bearing Shares (PIBS) with no fixed maturity are classified as financial liabilities as opposed to equity instruments since their terms do not permit the Directors discretion to avoid the payment of interest, as the only instance where interest could not be paid on these instruments would be where capital levels are insufficient to allow such a payment to be made. PIBS are carried at amortised cost.

Where financial liabilities are hedged, the Group elects to use fair value hedging for those hedged financial liabilities. This treatment has been adopted to reduce the volatility that would otherwise exist given that the interest rate risk element of the underlying liabilities is economically hedged by derivatives which are held at fair value through profit or loss.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

The deemed loans to the Society from the special purpose vehicles Darrowby No. 3 plc and Darrowby No. 4 plc, as described in note 1c), were voluntarily designated as FVTPL on adoption of IFRS 9 on 1 January 2018. This designation, which is irrevocable, was on the grounds that doing so significantly reduces an accounting mismatch that would otherwise arise had they been held at amortised cost, given that the associated derivatives held to hedge fair value movements in the deemed loans are also held at FVTPL. Where applicable, changes in fair value of the deemed loans that are due to changes in credit risk of the Society are recognised in other comprehensive income. At 31 December 2019 the Society has considered the effect of its own credit risk and considers this to be not material.

g) Impairment of financial assets

Under IFRS 9, impairment of financial assets is assessed using a forward-looking expected credit loss (ECL) model. This model applies to financial assets measured at either amortised cost or FVOCI (except equity share investments). The Group recognises impairment loss allowances for ECLs on the following financial assets that are not measured at FVTPL:

- Loans and advances to customers;
- Trade receivables;
- Treasury assets, which comprise debt securities held at FVOCI, cash in hand and balances with the Bank of England and loans and advances to credit institutions; and
- Loans to subsidiary undertakings (within the Society's Statement of Financial Position).

The Group also recognises an impairment loss allowance for loan commitments where a firm offer has been made to the customer.

Measurement of ECLs

ECLs are an unbiased probability-weighted estimate of the present value of credit losses, taking account of forward-looking information that includes a range of possible economic outcomes. ECLs are measured as the difference between contractual cash flows and expected cash flows, discounted at the asset's effective interest rate.

When measuring ECLs, the Group assesses the probability of default, the expected exposure at the time of default, and the loss that is expected to arise on default. The maximum period considered is the maximum contractual period over which the Group is exposed to credit risk. The probabilities of default are adjusted to take account of expected customer redemptions. The Group typically assesses ECLs on an individual asset basis.

IFRS 9 requires an impairment loss allowance to be recognised at an amount equal to either 12-month ECLs ('stage 1' ECLs) or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument. 12-month ECLs are the ECLs that result from default events that are possible within the 12 months after the reporting date. 'Stage 2' ECLs are lifetime ECLs that are recognised where there has been a 'significant increase in credit risk' of the financial instrument and 'stage 3' ECLs are lifetime ECLs that are recognised where the financial instrument is considered to be 'credit impaired'. The Group's definitions of 'significant increase in credit risk' and 'credit-impaired' are detailed below.

The Group measures impairment loss allowances at an amount equal to lifetime ECLs, except for the following which are measured as 12-month ECLs:

- treasury assets that are determined to have low credit risk at the reporting date. The Group considers a treasury asset to have low credit risk when its credit rating is equivalent to the globally understood definition of 'investment grade'; and
- other financial assets on which credit risk has not increased significantly since their initial recognition (except trade receivables, for which the Group will always recognise lifetime ECLs in accordance with the simplified approach in IFRS 9).

Lifetime ECLs are required where the credit risk on a financial asset has increased significantly since initial recognition (except for investment grade treasury assets, as noted above).

For loan commitments, 12-month ECLs are measured by the Group for the percentage of such commitments expected to convert from an outstanding customer offer into a completed customer loan. The conversion factors applied are based on actual trends observed for the Group and are aligned with the Group's existing internal ratings based (IRB) approach for regulatory capital purposes.

Financial assets that are subject to the impairment requirements of IFRS 9 are described according to their ECL 'stage' as follows:

- 'Stage 1' - Assets for which a 12-month ECL is recognised;
- 'Stage 2' - Assets for which a lifetime ECL is recognised but which are not credit-impaired;
- 'Stage 3' - Assets for which a lifetime ECL is recognised and which are credit-impaired.

IFRS 9 includes specific requirements for financial assets that are credit-impaired when initially purchased or originated (POCI assets). For POCI assets, an entity recognises only the cumulative change in lifetime ECLs since initial recognition, discounted by the credit-adjusted effective interest rate. For POCI assets, interest revenue is accounted for using the credit-adjusted effective interest rate. The Group had no POCI assets during the current or prior period.

The assessment of impairment requires a number of estimates and assumptions, details of which are included in note 1t).

Forward-looking information

The Group incorporates forward-looking information into both its assessment of whether the credit risk of a financial asset has increased significantly since initial recognition and its measurement of ECLs. The time period over which the Group assesses forward-looking information is the maximum period over which the Group is exposed to credit risk. The Group determines a range of representative scenarios for the possible future direction of key economic variables; this includes forecasts of quarterly movements in these variables for years one to five, followed by phased transition assumptions for years six to eleven, arriving at a view of long-run averages from year twelve onwards. The scenarios are derived by reference to external information where this is publicly available and appropriate, together with internally generated views. A probability-weighting, based on management judgement, is assigned to each scenario.

The Group's 'base case' scenario represents a view of the most likely outcome and is aligned with information used by the Group for other purposes such as strategic planning and budgeting. The selection of alternative scenarios is intended to model the non-linear impact of economic factors on ECLs for the Group's financial assets.

For UK mortgage impairment (including Skipton International's UK buy-to-let portfolio), the Group typically considers a minimum of three scenarios; this includes the base case scenario, together with an upside scenario (more optimistic than the base case) and a downside scenario (more pessimistic than the base case). For non-UK mortgage impairment and for treasury asset impairment, the Group typically considers the base case scenario and a downside scenario. Further details are included in note 1t).

Significant increase in credit risk

The Group monitors all financial assets and loan commitments that are subject to IFRS 9's impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition of the asset. IFRS 9 includes a rebuttable presumption that credit risk has significantly increased when contractual payments are more than 30 days past due.

The Group uses internal credit risk metrics that reflect its assessment of the probability of default (PD) of individual counterparties. The credit risk of each exposure is assessed at initial recognition, based on the available information about the counterparty. For loans and advances to customers, the credit risk at initial recognition is typically assessed by reference to information as at the loan drawdown date; this information is not always held by the Group for loans drawn down prior to 2007, in which case the Group uses the earliest available information as a proxy (which is typically January 2007 data for pre-2007 loans that were originated by the Society). All exposures are monitored and the credit risk assessment is updated to reflect current information on an ongoing basis.

For residential mortgages, the Group considers that credit risk has significantly increased if one or more of the following criteria is met:

- the remaining lifetime PD as at the reporting date, as compared to the remaining lifetime PD for this point in time that was estimated on initial recognition of the asset, exceeds pre-determined thresholds which are set by the Group and reviewed periodically. The thresholds applied will depend on the credit quality at initial recognition, with a lower percentage change in PD being required for higher risk accounts. Further details are included in note 1t);
- the account is in a current state of forbearance (see page 128);
- the account is in arrears (no minimum); or
- the account term has expired.

For commercial mortgages, the Group considers that credit risk has significantly increased when an account is placed on a watchlist or is in arrears of at least 50% of the contractual monthly payment.

For residential and commercial mortgages, the above criteria for assessing significant increase in credit risk ensures compliance with IFRS 9's backstop of more than 30 days past due.

For debt factoring advances, the Group considers that credit risk has significantly increased when an account is placed on a watchlist.

For treasury assets, the Group applies criteria that consider the relative increase in the asset's lifetime PD, by reference to external credit ratings where available. Notwithstanding these criteria, the Group considers that credit risk has not increased significantly for any treasury asset that is determined to have 'low' credit risk at the reporting date. The Group considers a treasury asset to have low credit risk when its credit rating is equivalent to the globally understood definition of 'investment grade'.

The Society's Statement of Financial Position includes loans to subsidiary undertakings that are repayable on demand. For these loans, the Society considers that credit risk has significantly increased when the subsidiary undertaking no longer has sufficient liquid assets to repay the loan if demanded at the reporting date.

1. Accounting policies *(continued)*

Definition of default

For residential mortgages, the Group's definition of default is aligned with its existing IRB definition of default for regulatory capital purposes. For IFRS 9 accounting purposes, stage 3 loans which no longer meet any of the default criteria are subject to a six month probation period before they become eligible for transfer out of stage 3. Default occurs when one or more of the following criteria are met:

- The borrower is 90 days or more past due on their contractual payments.
- The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. The instances are:
  - the loan is in repossession;
  - the borrower has filed for bankruptcy;
  - more than two payments are in arrears and forbearance activity has been applied; or
  - other evidence is available that the customer is not going to be able to meet their loan commitments.

For commercial mortgages, stage 3 loans which no longer meet any of the default criteria are subject to a three month probation period before they become eligible for transfer out of stage 3. Default occurs when one or more of the following criteria are met:

- The borrower is 90 days or more past due on their contractual payments;
- The loan is in repossession;
- A receiver has been appointed;
- The mortgage term has expired; or
- Other evidence is available that the customer is not going to be able to meet their loan commitments.

Credit-impaired financial assets

At each reporting date, the Group assesses whether financial assets (other than those held at FVTPL) are credit-impaired. For those assets that have become credit-impaired, interest revenue is subsequently calculated by applying the effective interest rate to the amortised cost of the asset.

A financial asset is 'credit-impaired' when one or more events have occurred that have a detrimental impact on the estimated future cash flows of the financial asset. Evidence that a financial asset is credit-impaired includes the following:

- a breach of contract such as a default; or
- the disappearance of an active market for a security because of financial difficulties.

For residential and commercial mortgages, the Group considers that a loan that meets the definition of default is credit-impaired. For loans to no longer be considered credit-impaired, consistently good repayments must be demonstrated over a period of time, being not less than six months for residential and three months for commercial.

For debt factoring advances, the Group considers that an account is credit-impaired when there is no reasonable expectation of recovery due, typically, to financial difficulties of the customer.

To assess whether sovereign and corporate debt instruments are credit impaired, the Group considers factors such as bond yields, credit ratings and the ability of the borrower to raise funding.

To assess whether trade receivables are credit impaired, the Group considers factors such as the ageing profile, historical default rates and specific case knowledge.

Forbearance

In certain circumstances, the Group renegotiates loans to customers in financial difficulties (referred to as forbearance activities) to maximise collection opportunities and minimise the risk of default whilst ensuring the best outcome for the customer. Under the Group's forbearance policy, loan forbearance is granted on a selective basis if the customer is currently in default on their debt or if there is a high risk of default, there is evidence that the customer made all reasonable efforts to pay under the original contractual terms and the customer is expected to be able to meet the revised terms.

The revised terms typically include extending the maturity of the loan, changing the timing of interest payments or amending the terms of loan covenants. Both retail and commercial loans are subject to the forbearance policy. The Retail Credit Committee regularly reviews reports on forbearance activities.

For the purposes of disclosures in these financial statements, loans with renegotiated terms are defined as loans that have been restructured due to a deterioration in the borrower's financial position, for which the Group has made concessions by agreeing to terms and conditions that are more favourable for the borrower than the Group had provided initially and that it would not otherwise consider.

Write-offs

A financial asset is written off (in full or in part) when the Group judges there to be no reasonable expectation that the asset can be recovered (in full or in part). This is typically the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is performed at the individual asset level. The related impairment loss allowance is also written off once all the necessary procedures have been completed and the loss amount has crystallised. Financial assets that are written off could still be subject to enforcement activities and subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the Income Statement.

h) Financial assets and liabilities – modification, derecognition and offsetting

Modification

The Group sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Group assesses whether or not the new cash flows are substantially different to the original cash flows.

If the cash flows are substantially different, then the contractual rights to cash flows from the original loan are deemed to have expired. In this case, the original loan is derecognised (as discussed below) and a new loan is recognised at fair value. Where impairment is held against the original loan (i.e. the loan is not held at FVTPL), the original loan is derecognised from its existing impairment stage (which may be stage 1, stage 2 or stage 3) and the new loan is initially recognised in stage 1 with its new origination date. Thereafter, the assessment of whether there has been a significant increase in credit risk is made by reference to changes in credit risk for the new loan starting from the new origination date. Examples of loan modification events for which the Group typically applies derecognition include an existing borrower switching to a new mortgage product and an existing borrower porting their loan to a new property.

If the cash flows of a modified loan carried at amortised cost are not substantially different, then the modification does not result in derecognition of the loan. In this case, the Group recalculates the gross carrying amount of the loan and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in the Income Statement. If such a modification is carried out because of financial difficulties of the borrower, the gain or loss is presented together with impairment losses. In other cases, it is presented within interest income. The Group assesses whether there has been a significant increase in credit risk by comparing the remaining lifetime PD as at the reporting date (based on the modified contractual terms) to the remaining lifetime PD for this point in time that was estimated at initial recognition (based on the original, unmodified contractual terms). An example of a loan modification event for which the Group typically does not apply derecognition is the application of forbearance strategies.

Derecognition

The Group derecognises a financial asset when the contractual rights to receive the asset's cash flows expire (including deemed expiry arising from a modification with substantially different terms as discussed above), or when the contractual rights have been transferred and either i) the Group transfers substantially all the risks and rewards of ownership, or ii) the Group neither transfers nor retains substantially all the risks and rewards of ownership and the Group has not retained control.

On derecognition of a financial asset, the difference between the carrying amount of the asset and the sum of i) the consideration received (including any new asset obtained less any new liability assumed) and ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

The Society has not derecognised the loans transferred to the Group's special purpose funding vehicles because substantially all the risks and rewards are retained by the Society as detailed in note 1c).

Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

Offsetting

Financial assets and financial liabilities are offset and the net amount presented within the Statement of Financial Position when, and only when, the Group has a legally enforceable right to offset the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously. There are no financial assets or liabilities which are offset within the Statement of Financial Position and all financial assets and liabilities are presented on a gross basis. Income and expenses are presented on a net basis only when permitted under IFRS.

i) Foreign currency transactions

Transactions in foreign currencies are translated into the respective functional currencies of Group entities using the exchange rates prevailing at the dates of the transactions. At the reporting date, monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the closing rate of exchange. Exchange differences are taken to the Income Statement as they arise.

On consolidation, the income statements of subsidiary undertakings with non-Sterling functional currencies are translated into Sterling (the Group's presentational currency) at the monthly average rates for the period and their assets and liabilities are translated into Sterling at the closing rate of exchange at the reporting date. Any exchange differences arising on the translation of net assets of overseas subsidiary undertakings are taken to reserves as a separate component of equity and disclosed in the Statement of Comprehensive Income, except to the extent that the translation difference is allocated to the non-controlling interests.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

Where a foreign operation is disposed of in its entirety, or partially disposed of such that control is lost, the cumulative amount of translation differences recognised as a separate component of equity is reclassified to the Income Statement as part of the gain or loss on disposal.

j) Taxation

The income tax expense or credit on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity and disclosed in the Statement of Comprehensive Income.

Current tax is the expected tax payable or receivable on the taxable income or expenditure for the year, using tax rates in force during the period, and any adjustments to tax payable in respect of previous years.

Deferred tax is provided using the statement of financial position asset and liability method, which recognises temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor income and expenditure, and differences relating to investments in subsidiary undertakings, associates and joint arrangements to the extent that it is probable they will not reverse in the foreseeable future. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which temporary differences reverse, based on tax rates and laws enacted or substantively enacted at the reporting date.

A deferred tax asset is only recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at least annually and are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Deferred tax assets and deferred tax liabilities are offset only where certain criteria are met.

k) Leases

Definition of a lease

Under IFRS 16 a contract is a lease, or contains a lease, if the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration.

On transition to IFRS 16, the Group elected to apply the following practical expedient permitted by the standard:

- For the purposes of identifying leases held by the Group at 1 January 2019, the Group elected to retain the assessments previously made by the Group under IAS 17 and IFRIC 4; IFRS 16 was therefore initially applied at 1 January 2019 only to those contracts that were previously identified as leases under IAS 17 and IFRIC 4. Contracts existing at 1 January 2019 that were not previously identified as leases under IAS 17 and IFRIC 4 were not reassessed. The new IFRS 16 definition of a lease is therefore applied by the Group only to contracts entered into, or changed, on or after 1 January 2019.

Right-of-use assets

The Group recognises right-of-use assets at the commencement date of the lease (i.e. the date the underlying asset becomes available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any re-measurement of lease liabilities.

The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred and lease payments made at or before the commencement date, less any lease incentives received. Where an obligation is incurred by the Group, the cost also includes an estimate of costs for dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease.

If the Group is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognised right-of-use asset is depreciated over the useful life of the underlying asset. Otherwise, the right-of-use asset is depreciated on a straight-line basis over the shorter of the estimated useful life of the right-of-use asset and the lease term. In accordance with IAS 36 *Impairment of Assets*, right-of-use assets are regularly reviewed, at least annually, for indications of impairment. Any impairment identified is charged to the Income Statement.

Lease liabilities

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments for this purpose include fixed payments (including in-substance fixed payments but deducting lease incentives receivable), variable lease payments that depend on an index or a rate and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option where reasonably certain to be exercised by the Group, and payments of penalties for terminating a lease (if the lease term reflects the Group exercising the option to terminate). Variable lease payments that do not depend on an index or a rate are recognised as an expense in the period in which the event or condition that triggers the payment occurs.

The present value of lease payments is determined using an appropriate discount rate. The Group uses the interest rate implicit in the lease where this can be readily determined; otherwise (and generally), the Group uses its incremental borrowing rate at the lease commencement date.

After the commencement date, the lease liability is increased to reflect the accretion of interest and is reduced for lease payments made. In addition, the lease liability is remeasured if there is a modification, a change in lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset.

Exempt leases

The Group has elected to take the recognition exemption for short-term leases, except for property leases that are short-term by virtue of being under renegotiation. Short-term leases are those which, at the commencement date, have a lease term of not more than twelve months and do not contain a purchase option.

Except for leases of motor vehicles, the Group has elected to take the recognition exemption for leases for which the underlying asset is of low value when new. The Group considers an underlying asset to be of low value where its value, when new, is not more than approximately £4,000.

For exempt leases, the Group expenses lease rentals to the Income Statement on a straight-line basis over the lease term.

Other practical expedients

Certain of the Group's lease contracts contain non-lease components (e.g. service charges). Except for property leases, the Group has elected not to separate out the non-lease components and therefore to account for these as part of the lease component. For property leases, the Group accounts separately for lease components and non-lease components.

Previous policy - applicable for the year ended 31 December 2018

Where the Group entered into a lease which entailed taking substantially all the risks and rewards of ownership of an asset, the lease was treated as a finance lease. The leased asset was recorded within the Statement of Financial Position as an item of property, plant and equipment and was stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses. Future instalments under such leases, inclusive of finance charges, were included within other liabilities. Rentals payable were apportioned between the finance element, which was charged to the Income Statement at a constant annual rate, and the amount which reduces the outstanding obligation for future instalments.

All other leases were classified as operating leases. Operating lease rentals were expensed to the Income Statement on a straight-line basis over the period of the lease agreement.

Where leasehold premises ceased to be occupied by the Group and current market conditions were expected to preclude sub-letting for a rental sufficient to cover the rental costs, a provision was made to cover the present value of the expected deficit.

l) Employee benefits

Defined contribution pension arrangements

Obligations for contributions to defined contribution pension arrangements are recognised as an expense in the Income Statement as incurred.

Defined benefit schemes

The Group operates three defined benefit pension schemes (one of which is a hybrid scheme). The schemes are administered by a corporate Trustee, the funds of which are separate from those of the Group.

Included within the Statement of Financial Position are the Group's net obligations in respect of the defined benefit pension schemes. The obligation of each scheme is calculated separately by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods.

That benefit is discounted to determine its present value, and the fair value of any scheme assets is deducted. The discount rate is based on the average yield available from AA-rated corporate bonds of appropriate duration. The calculation is performed by a qualified actuary using the projected unit credit method.

Net interest income on the defined benefit obligations comprises interest income on plan assets, less the interest cost on the scheme liabilities, and interest on the effect of the asset ceiling. Net interest income relating to the defined benefit pension schemes is recognised in 'Other income' in the Income Statement.

Remeasurements of the retirement benefit obligations, which comprise actuarial gains or losses (arising from the differences between previous actuarial assumptions and actual experience), the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest) are recognised in the Statement of Comprehensive Income.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

Service costs are recognised immediately in the Income Statement. When a plan is curtailed, the resulting gain or loss on settlement is also recognised immediately in the Income Statement. The Group recognises gains or losses on the settlement of a retirement benefit obligation when the settlement occurs.

Contributions are transferred to the schemes on a regular basis to secure the benefits provided under the rules of the schemes. Pension contributions are assessed in accordance with the advice of a professionally-qualified actuary.

m) Fees and commissions

The Group recognises fees and commissions in accordance with IFRS 15 *Revenue from Contracts with Customers*. Revenue is measured based on the consideration specified in a contract with a customer.

Financial advice fees and commissions

The recognition of fees and commissions receivable from financial advice is recognised either when the right to consideration has been obtained through fulfilment of performance obligations or when the provision of advice can be demonstrated by the signing of the initial suitability letter by the customer which demonstrates acceptance of the advice provided. A provision for future clawbacks is made for repayment in the event of early termination by the customer.

Estate agency services

Estate agency commissions earned on the sales of properties and land and auction income are recognised on the date contracts are exchanged unconditionally. Property management income is recognised when the cash is received, which reflects the point at which income is earned and contractual obligations have been fulfilled. Insurance commission is recognised upon fulfilment of contractual obligations with a provision for future clawback repayment in the event of early termination by the customer. Survey and valuation revenue is recognised on the date the survey or valuation report is completed, which reflects the point at which all contractual obligations have been fulfilled; revenue and costs are recognised gross of sub-contracted panel fees. Mortgage origination income is recognised on completion of the mortgage transaction. Asset management commission is recognised on exchange of contracts and additional services are recognised upon completion of work, both of which reflect the point at which all performance obligations are considered to have been fulfilled,

Software products and services

Revenue from software licence fees is recognised when access to the software has been made available to the customer to enable implementation. Revenue from implementation and consulting services is recognised in proportion to the stage of completion, typically in accordance with the achievement of contract milestones or days expended. Customer support revenue and systems management revenue are recognised on a straight-line basis over the period of the service rendered. The amount of revenue recognised is adjusted for expected returns.

Fees and commissions payable are generally recognised on an accruals basis as services are received.

n) Property, plant and equipment

Property, plant and equipment is measured at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of those items.

Depreciation is calculated to write down the cost of items of property, plant and equipment to their estimated residual values over their estimated useful lives as set out below on a straight line basis unless stated otherwise.

Freehold and long leasehold buildings	50 to 100 years
Special purpose freehold head office facilities	40 years
Refurbishment of freehold and long leasehold buildings	five to 10 years
Short leasehold buildings	period of lease
Equipment, fixtures and fittings	two to 10 years
Motor vehicles	25% reducing balance

Land is not depreciated. Major items of property, plant and equipment purchased are depreciated on a monthly basis from the date the asset is available for utilisation. Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted where appropriate. In accordance with IAS 36 *Impairment of Assets*, all items of property, plant and equipment are regularly reviewed, at least annually, for indications of impairment. Any impairment identified is charged to the Income Statement.

Subsequent expenditure on items of property, plant and equipment is capitalised only if the subsequent expenditure increases the item's revenue generating capabilities and it is probable that future economic benefits associated with the expenditure will flow to the Group.

Any gain or loss on disposal of an item of property, plant and equipment is recognised in 'Other income' in the Income Statement.

o) Segmental reporting

In accordance with IFRS 8 *Operating Segments*, each operating segment is determined according to distinguishable operating components of the Group for which discrete financial information is available. The chief operating decision maker, the Board, regularly reviews internal reporting for each segment to appropriately allocate resources and assess their performance. The Group does not aggregate any of its operating segments for the purposes of financial reporting.

Information regarding the results of each reportable segment is included in note 40.

p) Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash comprises cash in hand and unrestricted loans and advances to credit institutions repayable on demand, and excludes the mandatory deposit the Society is required to place with the Bank of England. Cash equivalents comprise highly liquid unrestricted investments, typically with original maturities of less than three months, that are readily convertible into known amounts of cash with an insignificant risk of changes in value.

The Statements of Cash Flows have been prepared using the indirect method.

q) Investment properties

Properties held by the Group for capital appreciation or which earn rentals are recognised as investment properties at cost less depreciation and impairment losses. The depreciation policy for investment properties is consistent with the policy for property, plant and equipment. Investment properties are regularly reviewed for indications of impairment and any impairment identified is charged to the Income Statement.

Rental income from investment property is recognised over the term of the lease and is included in 'Other income' in the Income Statement.

Any gain or loss on disposal of investment property is also recognised in 'Other income'.

r) Sale and repurchase agreements

Investments and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained within the Statement of Financial Position when substantially all the risks and rewards of ownership remain with the Group and the liability associated with the cash advanced is included separately within the Statement of Financial Position.

The difference between the sale and repurchase price is accrued over the life of the agreement and recognised within net interest income.

s) Provisions for liabilities

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that the Group will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation. The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date. Further details can be found in note 29.

t) Critical accounting judgements and estimates in applying accounting policies

Critical judgements

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the financial statements. The key judgements management has made in applying the Group's accounting policies are set out below.

Consolidation of SPVs

Whilst the Society does not have a legal shareholding in the Group's securitisation vehicles, management has judged that the test of control under IFRS 10 is passed. Consequently they are fully consolidated into the Group Accounts. Further details on the consolidation of the securitisation vehicles and the nature of the Society's control over them are found in note 17a).

Transfer of beneficial interest in mortgage loans

Management has judged that the transfer of the beneficial interest in the loans transferred from the Society to the SPVs does not result in a transfer of the risks and rewards in relation to these loans. Therefore the transfer of the beneficial interest is not recognised as a sale by the Society, and the loans continue to be recognised within the Society's Statement of Financial Position, with the proceeds received from the transfer accounted for as a deemed loan repayable to the SPVs.

The Group's accounting policy for its SPVs is outlined in note 1c).

Impairment of mortgage loans and advances

Assessing loan impairment in accordance with IFRS 9 requires the following key judgements:

- determining whether credit risk has significantly increased since the loan was initially recognised; and
- the definition of default.

1. Accounting policies *(continued)*

Residential mortgages

For residential mortgages, management judges that significant increase in credit risk is determined by reference to certain quantitative and qualitative criteria. The quantitative criteria involve measuring the relative increase in lifetime probability of default for the loan. The qualitative criteria include the loan being in forbearance, in arrears or term expired. Management has further judged that the definition of default should align with the Group's existing IRB definition for regulatory capital purposes. For IFRS 9 accounting purposes, stage 3 loans which no longer meet any of the default criteria are subject to a six month probation period before they become eligible for transfer out of stage 3. Further details are found in note 1g).

Commercial mortgages

For commercial mortgages, management judges that credit risk has significantly increased when an account is placed on a watchlist or is in arrears of at least 50% of the contractual monthly payment. Management has further judged that an account is regarded as in default by reference to certain quantitative and qualitative criteria; these criteria include an account being 90 days past due (the IFRS 9 'backstop'). Further details are found in note 1g).

IFRS 16

The changes to critical judgements used by the Group as a result of adopting IFRS 16, that have an effect on the reported amounts of assets and liabilities, are outlined below.

Lease term

The Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease where this is reasonably certain to be exercised, or any periods covered by an option to terminate the lease where this is reasonably certain not to be exercised.

Many of the Group's leases, particularly property leases, contain options for the Group to extend and / or terminate the lease term. The Group applies judgement in evaluating whether it is reasonably certain to exercise these options, taking account of all relevant factors that create an economic incentive for it to do so. After the lease commencement date, the Group reassesses the lease term if there has been a significant event or change in circumstances that is within its control and which affects its ability to exercise (or not to exercise) the option to renew and / or to terminate (e.g. a change in business strategy).

Interest rate benchmark reform (IBOR reform)

As outlined in note 1b), the Group has early adopted *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)*. The Group will continue to apply these amendments until the uncertainty arising from the interest rate benchmark reforms, with respect to the timing and amount of the underlying cash flows to which the Group is exposed, ends. The Group has assumed that this uncertainty will not end until the Group's contracts that reference IBORs are amended to specify the date on which the interest rate benchmark will be replaced, the cash flows of the alternative benchmark rate and the relevant spread adjustment. This will, in part, be dependent on the introduction of fall-back clauses which have yet to be added to the Group's contracts and the negotiation with lenders and bondholders.

Critical estimates

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

Estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The key estimates and assumptions are set out below.

Effective interest rate

The carrying value of assets measured at amortised cost is accounted for using the effective interest method. This method imputes an interest rate which discounts the forecast future cash flows of an asset over its expected life back to its carrying value. The most critical factor in calculating the amortised cost of assets held by the Group is the expected lives of these assets which are determined on the basis of historical data and management judgement. The impact of a one month increase / (decrease) in the anticipated life of loans and advances to customers would result in the following increase / (decrease) in interest income:

	Group		Society	
	2019 £m	2018 £m	2019 £m	2018 £m
One month increase / (decrease)	28.1 / (23.7)	26.5 / (26.0)	27.5 / (23.0)	26.5 / (26.0)

During the year a charge of £2.7m (2018: £5.8m) for the Group and Society was recognised through interest income, following a reassessment of the expected lives of loans and advances to customers.

Impairment of mortgage loans and advances

The estimation of credit exposures for risk management purposes is complex and requires the use of models, a number of inputs into which are sources of estimation and require the Group to apply judgement. Key sources of estimation the Group uses to measure ECLs include:

- Probability of Default (PD) – the probability at a point in time that a customer will default;
- Exposure at Default (EAD) – the expected outstanding loan amount at the time of default;
- Loss Given Default (LGD) – the loss that is expected to arise on default, taking account of expected recoveries from collateral held;
- Thresholds to determine whether credit risk has significantly increased; and
- Use of forward-looking information.

ECLs are measured by multiplying together the PD, EAD and LGD, and are discounted using the loan's original effective interest rate. EAD is derived by adjusting the current outstanding loan amount for expected cashflows to the date of default. LGD is estimated on a discounted cash flow basis using the effective interest rate. The Group's LGD models consider factors including historical recovery rates and possible future property price changes.

Credit risk information is collected by the Group, based on a range of qualitative and quantitative data considered to be predictive of the risk of default and applying experienced credit judgement. The nature of the exposure and type of borrower are taken into account in the analysis. The Group's PD models use the relevant information to generate estimates of the remaining lifetime PD of exposures and how these are expected to change over time. The PDs are adjusted to take account of expected customer redemptions and also for the impact of forward-looking information.

The following data is typically used to monitor the Group's exposure to credit risk:

- Payment record, including payment ageing analysis;
- Forbearance activity;
- Changes in business, financial and economic conditions;
- Credit reference information supplied by external agencies; and
- Internally generated data of customer behaviour, affordability metrics etc.

For residential mortgages, the assessment of whether credit risk has significantly increased includes assessing the degree by which the remaining lifetime PD at the reporting date has increased compared to initial estimates. The Group determines thresholds for this purpose, expressed as a multiple of the initial PD estimate. The thresholds vary according to the credit quality of the loan at initial recognition. They are set with the aim of identifying accounts with significantly increased credit risk before the borrower misses a payment. The Group periodically reviews the effectiveness of these thresholds in achieving this objective and, as a result of this review, has revised during the year the thresholds applied by the Group. Details of these changes are set out below; each of the new multiples is lower than that previously applied, reflecting changes in definition for each of the three risk bands. These revisions have contributed to the increases during 2019 in the level of residential loan balances being held in stage 2 by the Group and by the Society (see note 38a)(i) for further details).

Lifetime PD band at initial recognition	Multiple by which remaining lifetime PD has increased compared to initial estimate 2019	2018
Low risk	initial estimate x 5	initial estimate x 14
Medium risk	initial estimate x 2.6	initial estimate x 5
High risk	initial estimate x 1	initial estimate x 2.5

The Group incorporates forward-looking information into both its assessment of whether the credit risk of a financial asset has increased significantly since initial recognition and its measurement of ECLs. In accordance with IFRS 9, the Group's estimate of ECLs is an unbiased and probability-weighted amount that reflects a range of possible outcomes. As outlined in note 1g), the Group determines a range of representative scenarios for the possible future direction of key economic variables and a probability-weighting is assigned to each scenario. The Group's 'base case' scenario represents a view of the most likely outcome and is aligned with information used by the Group for other purposes such as strategic planning and budgeting. In addition, the Group incorporates an upside scenario (representing a more optimistic view than the base case) and a downside scenario (representing a more pessimistic view than the base case); the selection of these alternative scenarios is intended to model the non-linear impact of economic factors on ECLs for the Group's mortgage portfolios.

The scenarios applied by the Group as at 31 December 2019 were determined with due consideration to the economic uncertainty surrounding the UK's departure from the EU. The downside scenario is set in the context of worsening economic conditions, with above-target inflation, rising unemployment and a house price slump, followed by a slow recovery in the longer-term; the economic indicators used are stressed sufficiently to capture the non-linear impact on ECLs for the Group's mortgage portfolios. The upside scenario is set in the context of reduced uncertainty, whereby the economy returns smoothly towards a long-run equilibrium. The relative weightings assigned to each scenario have been revised during the year to reflect heightened levels of uncertainty over the economic outlook, both domestic and global.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

The Group's scenario weightings as at 31 December 2019 were 50% for the base case, 10% for the upside scenario and 40% for the downside scenario (2018: base case 60%; upside scenario 15%; downside scenario 25%).

The key economic variables considered by the Group when developing the forecast scenarios are set out below, together with the range of assumptions used (i.e. lowest % and highest %) for each of the Group's scenarios as at 31 December 2019.

		Range of assumptions (lowest % / highest %)		
	Scenario	Base case	Upside	Downside
Bank of England base rate (%)	Years 1 – 5	0.50 / 0.75	0.75 / 2.00	0.00 / 0.25
	Years 6 – 10	1.00	2.50	0.50
	Beyond	2.50	3.00	2.00
Unemployment (%)	Years 1 – 5	4.0 / 4.8	3.8 / 4.4	4.3 / 7.0
	Years 6 – 10	5.0	4.5	5.5
	Beyond	5.0	5.0	5.0
House price inflation (UK) (%)	Years 1 – 5	2.0 / 3.5	2.0 / 5.9	(7.0) / 2.8
	Years 6 – 10	4.0	4.5	3.5
	Beyond	4.0	4.0	4.0
Commercial property price growth (%)	Years 1 – 2	0.0	2.0	(14.6) / (1.5)

Whilst actual loan cash flows and the level of losses realised are unaffected by IFRS 9's expected credit loss approach, the level of loan impairment accounted for by the Group under IFRS 9 may be volatile; this is due to the inherent uncertainty when incorporating forward-looking information. IFRS 9 impairment is expected to vary as expectations of economic conditions become either more pessimistic (which is likely to increase ECLs) or more optimistic (which is likely to reduce ECLs).

Management assesses the performance of the Group's ECL estimation process by comparison of actual and expected credit losses over a twelve month outcome; as IFRS 9 has been effective only since 2018, there is currently limited experience available for the Group to back-test predicted lifetime ECLs against actual results. Additional assurance is gained from validation of the composite sub-models. The ECL calculation is subject to formal quarterly monitoring, with output reported to the Society's Model Governance Committee for review, challenge and approval. In addition, the ECL calculation and all sub-components are subject to regular first-line review and independent validation.

The following table outlines the impact on the impairment loss allowance for the residential loan portfolio of possible alternative assumptions of certain estimates used in calculating the ECLs. Each sensitivity shown considers one change in isolation and the combined impact on the impairment loss allowance of more than one sensitivity occurring would not necessarily be the sum of the impact of the individual sensitivities.

Assumption	**Change to current assumption**	Group 2019	Group 2018	Society 2019	Society 2018
		Increase / (decrease) in impairment allowance			
		£m	£m	£m	£m
Downside scenario weighting (note 1)	Absolute increase of 10%	0.4	0.5	0.1	0.1
Downside scenario weighting (note 2)	Increase to 100%	2.7	4.0	1.1	1.6
Base case scenario weighting (note 3)	Increase to 100%	(1.8)	(1.3)	(0.8)	(0.6)
Significant increase in credit risk criteria (note 4)	Relative reduction by 25%	0.2	0.1	0.2	-
Future house price inflation	+ / - 0.5% pa	(0.4) / 0.4	(0.4) / 0.4	(0.1) / 0.2	(0.1) / 0.1

Notes
1. This sensitivity shows the impact of an increase of 10% to the probability weighting assigned to the downside scenario, from 40% to 50% (2018: from 25% to 35%), with a relative decrease to the probability weighting assigned to each of the base case and upside scenarios.
2. This sensitivity shows the impact of increasing to 100% the probability weighting assigned to the downside scenario (and therefore zero probability weighting assigned to both the base case and upside scenarios).
3. This sensitivity shows the impact of increasing to 100% the probability weighting assigned to the base case scenario (and therefore zero probability weighting assigned to both the upside and downside scenarios).
4. As outlined above, the assessment of whether credit risk has significantly increased since initial recognition includes the degree by which the remaining lifetime PD at the reporting date has increased compared to initial estimates. This sensitivity shows the impact of simultaneously reducing each multiplier threshold by 25%.

The following table outlines the impact on the impairment loss allowance for the commercial loan portfolio of possible alternative assumptions of certain estimates used in calculating the ECLs. Each sensitivity shown considers one change in isolation and the combined impact on the impairment loss allowance of more than one sensitivity occurring would not necessarily be the sum of the impact of the individual sensitivities.

Assumption	**Change to current assumption**	Group and Society 2019	Group and Society 2018
		Increase / (decrease) in impairment allowance	
		£m	£m
Downside scenario weighting	Absolute increase of 10%	0.4	0.5
Downside scenario weighting	Increase to 100%	2.4	3.4
Base case scenario weighting	Increase to 100%	(1.2)	(0.8)
Significant increase in credit risk criteria (note 1)	Additional 5% of balances placed on watchlist	2.0	2.6
Future commercial property price growth	+ / - 0.5% pa	(0.1) / 0.1	(0.1) / 0.1

Note
1. As outlined in note 1g), the assessment of whether credit risk has significantly increased since initial recognition is based on accounts being placed on a watchlist or being in arrears of at least 50% of the contractual monthly payment. This sensitivity shows the impact of management identifying an additional 5% of gross loan balances to be placed on a watchlist. For each period presented, the impact has been estimated by reference to the average ECL coverage ratios by stage for the commercial loan portfolio as at the relevant period end.

Impairment of treasury assets

The Group incorporates forward-looking information into its ECL assessment for treasury assets. In addition to the base case view, the Group also considers the impact of an extreme economic downturn such as a two-notch downgrade on the entire portfolio. At 31 December 2019, the relative weightings assigned to each scenario were 95% for the base case and 5% for the downside scenario (2018: base case 95%; downside scenario 5%).

The following table outlines the impact on the impairment loss allowance for treasury assets of possible alternative assumptions of certain estimates used in calculating the ECLs. Each sensitivity shown considers one change in isolation and the combined impact on the impairment loss allowance of more than one sensitivity occurring would not necessarily be the sum of the impact of the individual sensitivities.

Assumption	**Change to current assumption**	Group 2019	Group 2018	Society 2019	Society 2018
		Increase / (decrease) in impairment allowance			
		£m	£m	£m	£m
Downside scenario weighting	Absolute increase of 10%	0.1	0.1	0.1	0.1
Downside scenario weighting	Increase to 100%	0.7	0.8	0.7	0.8
Base case scenario weighting	Increase to 100%	-	(0.1)	-	(0.1)

Valuation of equity release portfolio

The valuation of the equity release portfolio relies on the calculation of future cash flows. The size and timing of these can vary depending on a number of different factors. These factors include future expected house prices, future expected inflation, mortality rates, anticipated redemption profiles (arising due to voluntary redemption, decease or a move to long term care) and the level of dilapidation of individual properties on resale.

Some of the factors are based on market expectations (e.g. market-implied RPI swap prices are used to construct a forward-looking inflation curve in order to forecast future expected cash flows receivable from the portfolio), whilst others are derived from historical trends on the portfolio (e.g. anticipated future voluntary redemptions). However, where market prices are not available and historical trends are not deemed to be appropriate the Group uses management judgement; this is the case for future house price index (HPI) growth and volatility.

The Group uses an expectation of HPI growth that is aligned to that used for the central path of the ECL model and corporate planning. This is a slightly subdued growth assumption in the near term, reverting to a long run expectation of an average of 4%. This is considerably lower than long term historical levels and reflects management's view. A volatility assumption of 10% is used to allow for an expected range of realised growth around this central figure. This volatility represents solely index volatility. In recognition of the potential for deviation from this index in the case of individual properties, the equity release valuation model also makes an allowance for idiosyncratic factors such as dilapidation upon sale of the property. This is assumed to rise over time, reaching 15% over the lifetime of the portfolio and averaging 7% - 8% at the point of expected peak redemptions.

The following table outlines the impact of reasonably possible alternative assumptions of key inputs which rely on management judgement and are not market observable. Each sensitivity shown considers one change in isolation and the combined impact on the valuation of the portfolio of all sensitivities occurring would not necessarily be the sum of the impact of the individual sensitivities.

1. Accounting policies (continued)

Assumption	Change to current assumption	Group and Society 2019	Group and Society 2018
		(Decrease) / increase in fair value of portfolio	
		£m	£m
Redemption rates	+ / - 1% pa	(11.0) / 12.4	(12.3) / 13.7
Discount rate	+ / - 0.2%	(9.9) / 10.3	(10.8) / 11.2
HPI forecast	+ / - 0.5% pa	9.4 / (11.1)	10.2 / (11.9)
Impact of property dilapidations	+ / - 5%	(8.1) / 6.7	(7.8) / 6.6
HPI volatility	+ / - 3% pa	(4.8) / 3.9	(4.8) / 4.1

For each of the above sensitivities, there would be a corresponding charge / credit to the Income Statement within the 'Fair value gains / (losses) on equity release portfolio' line arising from the decrease / increase in the fair value of the portfolio.

The Group holds derivative financial instruments to hedge the movements in the equity release portfolio, which offsets to some extent the movements in the valuation of the portfolio, further details of which are found below.

Derivative financial instruments

The Group holds derivatives which are used to hedge the Group's interest rate risk and inflation risk arising from the equity release portfolio. These derivatives are valued using discounted cash flow models using market observable benchmark rates consistent with accepted market methodologies for pricing financial instruments, and, as the notional values of the derivatives are intended to match the balance of the underlying mortgage assets, also include estimated redemption profiles (arising where a customer voluntarily prepays, moves permanently into long term care or is deceased) that are based on historical data (reviewed periodically against actuals) and published mortality tables. These redemption profiles are not market observable, therefore an element of management judgement is applied based on historical performance of redemptions.

The effect on the fair value of these derivatives of reasonably possible alternative assumptions regarding the redemption profile of the portfolio is outlined below.

Assumption	Change to current assumption	Group and Society 2019	Group and Society 2018
		(Decrease) / increase in liability	
		£m	£m
Redemption rates	+ / - 1% pa	(15.1) / 17.1	(17.0) / 19.3

Some of these derivatives hedge not only the interest rate risk but also the inflation risk within the equity release portfolio. In order to value these derivatives, the Group uses market-implied RPI swap prices to construct a forward looking inflation curve to forecast future expected cash flows relating to these derivatives. The model used to value the derivatives incorporates multiple scenarios for RPI in order to take account of the uncertainty and volatility of future RPI rates. The range of multiple scenarios used is based on management judgement and so is not market observable. The Group has robust control procedures in place regarding the inputs to the valuation that are based on management judgement.

Any change in fair value of the derivative liabilities is offset to some extent by a corresponding but opposite change in the value of the equity release portfolio. The characteristics and the valuation requirements differ slightly between the derivatives and the equity release portfolio resulting in the changes in fair value not offsetting completely.

Subsidiary management incentive scheme

In 2012, 2014 and 2019, senior management of Connells Limited purchased equity shares in that company and at the same time the Group issued options to these shareholders which required the Group to purchase these shares at some future dates. The final options relating to those equity shares purchased in 2012 were exercised in 2019. In accordance with IFRS 2 *Share-based Payment*, the Group recognises the increase or decrease in the fair value of the liability through the Income Statement, spread over the vesting period, to the estimated dates of exercise. The fair value of this liability is dependent on the following assumptions: an estimate of when the options will be exercised by the non-controlling shareholders, as well as forecasts of EBITDA (i.e. earnings before interest, tax, depreciation and amortisation, and as adjusted under the specific scheme rules) and cash flows of Connells Limited over the period to exercise.

The following table outlines the impact of reasonably possible alternative assumptions of certain estimates used in calculating the liability:

Assumption	Change to current assumption	Group 2019	Group 2018
		Increase / (decrease) in liability*	
		£m	£m
Connells Limited EBITDA	10% increase / decrease (note 1)	1.3 / (1.3)	0.5 / (0.5)
Date of exercise of options	Latest possible opportunity (note 2)	0.1	(3.0)

* With a corresponding increase / decrease in the charge to the Income Statement.

Notes

1. As described above, the estimate of the liability is dependent on the assumptions of future EBITDA and cash flows of Connells Limited over the period to exercise. The above sensitivity outlines the increase / decrease to the liability that would result if it was assumed that Connells' forecast EBITDA was 10% higher / lower each year (from 2020 to the periods of exercise) than that included in its corporate plans.
2. The fair value of the liability at 31 December 2019 is currently based on the assumption that management will exercise their remaining options at the earliest available opportunity under the terms of the scheme.

Goodwill

The carrying value of goodwill is assessed against value in use calculations. The key assumptions for the value in use calculations are those regarding cash flows, discount rates and growth rates. These assumptions are reviewed on a regular basis, at least at every reporting date, by senior management.

The future cash flows of the cash generating units are based on the latest detailed five year corporate plans available and are sensitive to assumptions regarding the long term growth pattern thereafter. The cash flows reflect management's view of future business prospects at the time of the assessment.

The discount rate used to discount the future expected cash flows is based on the cost of capital assigned to each cash generating unit (see note 21) and can have a significant effect on the valuation of a cash generating unit. The cost of capital is derived from a weighted average cost of capital calculation which incorporates a number of inputs including the risk-free interest rate and a premium to reflect the inherent risk of the business being evaluated. These variables are subject to fluctuations in external markets and economic conditions which are out of management's control and therefore are established on the basis of management judgement.

At 31 December 2019, to the extent that discount rates were to increase by 25%, e.g. from 10% to 12.5%, there would be no increase to the goodwill impairment charge (2018: increase of £1.3m). A reduction in the long term growth rate assumption from 2.5% to 0% would result in no increase to the impairment charge (2018: increase of £0.5m).

Retirement benefit obligations

The defined benefit pension schemes expose the Group to actuarial risks such as investment risk, interest rate risk, inflation risk and longevity risk. In conjunction with its actuaries the Group makes key financial assumptions that are used in the actuarial valuation of the defined benefit pension obligation and, therefore, changes to these assumptions have an impact on the pension obligation shown within the Statement of Financial Position. These assumptions include inflation and discount rates, life expectancy, commutation allowances and the rate of salary growth; see note 31 for further details on these assumptions.

A decrease in gilt / corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to scheme liabilities. This would impact the Statement of Financial Position adversely and may give rise to increased charges in future years' Income Statements. This effect would be partially offset by an increase in the value of the schemes' gilt and bond holdings and caps on inflationary increases also exist to protect the schemes against high levels of inflation.

Approximate sensitivities of the principal assumptions are set out in the table below which shows the increase or reduction in the scheme liabilities that would result. The methods used for calculating the sensitivities are the same as those used to determine the valuation of the defined benefit obligation as set out in note 31. Each sensitivity shown considers one change in isolation.

Assumption	Change in assumption	Group 2019	Group 2018	Society 2019	Society 2018
		(Decrease) / increase in liabilities			
		£m	£m	£m	£m
Discount rate	+ / -0.25% pa	(11.2) / 11.9	(10.3) / 10.9	(6.1) / 6.5	(5.5) / 5.9
Rate of inflation	+ / -0.5% pa	10.6 / (9.5)	9.6 / (8.7)	5.2 / (4.6)	4.6 / (4.2)
Rate of salary growth	+ / -0.5% pa	-	-	-	-
Commutation allowance	+ / -10% pa	2.3 / (2.3)	2.1 / (2.1)	1.2 / (1.2)	1.1 / (1.1)
Life expectancy	+ / -1 year	8.7 / (8.5)	7.7 / (7.6)	4.8 / (4.8)	4.1 / (4.1)

The rate of salary growth has no impact on the pension liabilities as the schemes are closed to future accrual of benefit.

Notes to the Accounts *(continued)*

2. Interest receivable and similar income

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
On financial assets held at amortised cost:				
On loans fully secured on residential property	478.8	444.5	396.5	362.8
On other loans and advances:				
To subsidiary undertakings	-	-	34.1	25.3
Other	12.9	12.4	5.8	6.0
On debt securities	-	0.2	-	0.2
On other liquid assets	16.1	18.9	15.7	18.6
	507.8	476.0	452.1	412.9
On financial assets held at fair value through other comprehensive income:				
On debt securities	20.9	12.5	19.6	11.7
On financial instruments at FVTPL:				
Net expense on derivative financial instruments held to hedge assets in qualifying relationships	(18.7)	(18.4)	(18.9)	(17.8)
Interest receivable accounted for using the effective interest rate method	510.0	470.1	452.8	406.8
On financial instruments held at FVTPL:				
On equity release portfolio	16.8	18.5	16.8	18.5
On debt securities	-	-	0.4	0.9
Net expense on derivative financial instruments held to hedge assets in non-qualifying relationships	(11.9)	(14.8)	(11.8)	(14.8)
	4.9	3.7	5.4	4.6
	514.9	473.8	458.2	411.4

3. Interest payable and similar charges

	Group 2019 £m	Group 2018 Restated* £m	Society 2019 £m	Society 2018 Restated* £m
On financial liabilities held at amortised cost:				
On shares held by individuals	212.8	197.6	212.8	197.6
On shares held by others	1.5	1.3	1.5	1.3
On subscribed capital	4.5	4.5	4.5	4.5
On deposits and other borrowings:				
Subsidiary undertakings	-	-	0.7	0.8
Wholesale and other funding	56.6	44.3	35.7	23.5
Lease liabilities	1.4	-	0.3	-
	276.8	247.7	255.5	227.7
On financial instruments held at FVTPL:				
Net expense / (income) on derivative financial instruments held for hedging liabilities	0.2	(15.3)	(7.6)	(19.7)
Finance charge on unwind of put option liability	(0.2)	0.2	-	-
Deemed loans from Group undertakings	-	-	29.1	17.5
	276.8	232.6	277.0	225.5

* Following a review of the presentation of interest payable and similar charges, interest payable on certain borrowings is now presented within the line 'Wholesale and other funding' (previously presented within the line 'Net expense / (income) on derivative financial instruments held for hedging liabilities'). The Group considers that this revised presentation more fairly reflects the nature of this interest cost. As a result, the 2018 comparative amounts have been restated in the table above; interest payable on 'Wholesale and other funding' has increased by £11.4m (Group and Society), with a corresponding adjustment to 'Net expense / (income) on derivative financial instruments held for hedging liabilities'. Total interest payable and similar charges for 2018 remains as previously reported (Group and Society). There is no impact on profits and no impact on reserves.

4. Fees and commissions

a) Fees and commissions receivable

The tables below provide further information regarding the nature, amount and timing of fees and commissions receivable. IFRS 15 requires that revenue is recognised by the Group in a way that depicts the transfer of goods or services to customers; some revenue is therefore recognised at a point in time and some revenue is recognised over a period of time. Further details as to the revenue recognition policies applied to fees and commissions receivable by the Group are set out in note 1m).

Group	2019 Products and services transferred at a point in time £m	2019 Products and services transferred over time £m	2019 Total £m	2018 Restated* Products and services transferred at a point in time £m	2018 Restated* Products and services transferred over time £m	2018 Restated* Total £m
Mortgage origination fees	42.5	11.3	53.8	39.8	13.2	53.0
Other mortgage related fees	2.0	-	2.0	1.8	-	1.8
General insurance income	57.1	1.1	58.2	52.6	0.6	53.2
Commissions earned on property sales	154.2	-	154.2	158.2	0.4	158.6
Commissions earned on property lettings	61.6	-	61.6	63.5	-	63.5
Survey and valuation fees	55.4	-	55.4	54.6	-	54.6
Asset management commission	15.6	0.2	15.8	15.7	0.2	15.9
Conveyancing fees	31.0	-	31.0	29.1	-	29.1
Financial advice fees	29.3	-	29.3	31.2	-	31.2
Software and consultancy fees	0.1	16.1	16.2	0.3	19.3	19.6
Factoring and invoice discounting services	10.2	-	10.2	9.3	-	9.3
Other fees and commissions	3.7	1.0	4.7	4.9	1.7	6.6
	462.7	29.7	492.4	461.0	35.4	496.4

* Following a review of the presentation of certain revenue lines within the Connells group, certain fees and commissions receivable that were previously presented net of associated costs have been restated to be presented on a gross basis and the associated costs are included within administrative expenses. This is considered to more fairly reflect the substance of the arrangements and the comparative figures in the above tables have been restated accordingly. This results in a £10.1m increase in asset management commission and a £5.4m increase in commissions earned on property sales. There is a corresponding £15.5m increase in administrative expenses and therefore there is no impact on profits and no impact on reserves.

Society	2019 Products and services transferred at a point in time £m	2019 Products and services transferred over time £m	2019 Total £m	2018 Products and services transferred at a point in time £m	2018 Products and services transferred over time £m	2018 Total £m
Mortgage related fees	1.7	-	1.7	1.6	-	1.6
General insurance income	-	1.1	1.1	-	0.6	0.6
Financial advice fees	27.8	-	27.8	29.6	-	29.6
Other fees and commissions	1.3	-	1.3	1.8	-	1.8
	30.8	1.1	31.9	33.0	0.6	33.6

4. Fees and commissions *(continued)*

The table below provides a reconciliation of fees and commissions receivable by the Group to the amounts presented by reportable segment in note 40:

Group 2019	Mortgages and Savings £m	Estate Agency £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
Mortgage origination fees	-	54.9	-	(1.1)	53.8
Other mortgage related fees	2.0	-	-	-	2.0
General insurance income	1.1	57.1	-	-	58.2
Commissions earned on property sales	-	154.2	-	-	154.2
Commissions earned on property lettings	-	61.6	-	-	61.6
Survey and valuation fees	-	65.0	-	(9.6)	55.4
Asset management commission	-	15.8	-	-	15.8
Conveyancing fees	-	31.0	-	-	31.0
Financial advice fees	29.3	-	-	-	29.3
Software and consultancy fees	-	-	17.0	(0.8)	16.2
Factoring and invoice discounting services	-	-	10.2	-	10.2
Other fees and commissions	1.2	4.5	0.4	(1.4)	4.7
Fees and commissions receivable	33.6	444.1	27.6	(12.9)	492.4
Other	(3.9)	(3.0)	(0.7)	0.2	(7.4)
Net non-interest income	29.7	441.1	26.9	(12.7)	485.0

Group 2018 Restated*	Mortgages and Savings £m	Estate Agency £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
Mortgage origination fees	-	54.2	-	(1.2)	53.0
Other mortgage related fees	1.8	-	-	-	1.8
General insurance income	0.6	52.6	-	-	53.2
Commissions earned on property sales	-	158.6	-	-	158.6
Commissions earned on property lettings	-	63.5	-	-	63.5
Survey and valuation fees	-	64.7	-	(10.1)	54.6
Asset management commission	-	15.9	-	-	15.9
Conveyancing fees	-	29.1	-	-	29.1
Financial advice fees	31.2	-	-	-	31.2
Software and consultancy fees	-	-	20.4	(0.8)	19.6
Factoring and invoice discounting services	-	-	9.3	-	9.3
Other fees and commissions	1.8	5.4	1.2	(1.8)	6.6
Fees and commissions receivable	35.4	444.0	30.9	(13.9)	496.4
Other	(3.5)	-	(0.6)	0.2	(3.9)
Net non-interest income	31.9	444.0	30.3	(13.7)	492.5

* The comparative periods have been restated as outlined on pages 116 to 118.

b) Fees and commissions payable

The total shown in the Income Statement for fees and commissions payable includes £2.7m for the Group (2018: £2.6m) and £nil for the Society (2018: £nil) relating to financial assets not measured at FVTPL. These figures exclude amounts which are incorporated in determining the effective interest rate on such financial assets.

5. Administrative expenses

	Group 2019 £m	Group 2018 Restated* £m	Society 2019 £m	Society 2018 £m
Employee costs:				
Wages and salaries	319.0	316.8	80.2	74.7
Social security costs	31.2	30.3	7.8	7.3
Pension costs:				
Defined contribution arrangements (note 31)	12.2	10.0	5.8	5.2
Past service costs	-	3.0	-	1.3
	362.4	360.1	93.8	88.5
Other administrative expenses	191.6	176.4	56.8	54.9
Central administrative costs recharged to Group undertakings	-	-	(4.3)	(4.7)
	554.0	536.5	146.3	138.7
Other administrative expenses comprise:				
Depreciation and amortisation (notes 18, 19, 20 and 21)	37.7	21.1	8.2	5.5
Impairment of property, plant and equipment and investment property (notes 18 and 20)	0.5	2.3	0.5	2.3
Impairment of goodwill (note 21)	-	2.5	-	-
Impairment (credit) / losses on trade receivables (note 38c))	(0.1)	0.8	-	-
Lease expenses post-IFRS 16 adoption:				
Short-term leases	2.1	-	0.8	-
Variable lease payments not included in measurement of lease liability	0.1	-	-	-
Lease expenses pre-IFRS 16 adoption - operating leases	-	18.3	-	4.4
Other property and establishment costs	18.1	18.3	5.4	5.1
Postage and communications	15.9	15.0	6.0	5.5
IT costs	14.3	14.3	9.5	8.5
Marketing and advertising	22.1	21.5	7.4	6.3
Insurance	4.8	5.3	2.2	2.3
Legal, professional and consultancy	17.2	16.1	12.1	9.9
Training, recruitment and other employee related costs	16.7	16.5	4.6	4.0
Costs of Connells' management incentive scheme (note 28)	1.8	(4.2)	-	-
Other	40.4	28.6	0.1	1.1
	191.6	176.4	56.8	54.9

* The Group comparatives are restated as outlined in note 4a), resulting in a £15.5m increase in other administrative expenses.

Included within legal, professional and consultancy costs above are amounts relating to external auditor remuneration. During the year, the Group appointed a new external auditor (see page 63 for details); the Group therefore presents information below for both the Group's former external auditor (KPMG) and the Group's new external auditor (EY).

The remuneration of the Group's former external auditor KPMG, up until the date of their resignation on 29 April 2019, is set out below (excluding VAT):

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Audit of the Society and Group Annual Accounts	-	0.2	-	0.2
Audit of the Group's subsidiary undertakings' accounts pursuant to legislation	-	0.5	-	-
Audit of the transition to new accounting standards	-	0.3	-	0.3
Audit-related assurance services	-	0.1	-	0.1
Other non-audit services	0.1	0.3	0.1	0.3
	0.1	1.4	0.1	0.9

Notes to the Accounts *(continued)*

5. Administrative expenses *(continued)*

The remuneration of the Group's new external auditor EY, from the date of their appointment on 10 May 2019, is set out below (excluding VAT):

	Group 2019 £m	Society 2019 £m
Audit of the Society and Group Annual Accounts	0.3	0.3
Audit of the Group's subsidiary undertakings' accounts pursuant to legislation	0.6	-
Audit-related assurance services	0.1	0.1
Other non-audit services	0.1	0.1
	1.1	0.5

6. Employee numbers

The average number of full and part-time persons employed during the year (including Executive Directors) was as follows:

	Group 2019	Group 2018	Society 2019	Society 2018
Principal office	1,476	1,399	1,476	1,399
Society branches	813	769	813	769
Subsidiary undertakings	7,243	7,346	-	-
	9,532	9,514	2,289	2,168

7. Directors' emoluments

Directors' emoluments are set out within the Directors' Remuneration Report on pages 74 to 93.

Total Directors' emoluments for 2019 amounted to £2.9m (2018: £3.0m).

8. Related party transactions

A number of transactions are entered into with related parties in the normal course of business; these are detailed below.

Key management personnel

For the purposes of these disclosures key management personnel comprises the Executive Directors and Non-Executive Directors of the Society, plus all other members of the Society's Executive Committee. Executive Committee members are, in addition to the Executive and Non-Executive Directors, responsible for ensuring the Society meets its strategic and operational objectives.

The table below summarises the benefits paid to key management personnel in the year:

Group and Society	2019 £m	2018 £m
Salary, benefits and annual performance pay	3.9	3.9
Employer pension contributions	0.3	0.3
	4.2	4.2

The table below sets out the outstanding balances in relation to related party transactions with key management personnel and persons who are connected with key management personnel:

	2019 £000	2018 £000
Mortgage loans outstanding at 31 December	45	89
Savings balances at 31 December	2,351	1,666

Interest receivable and payable on the above accounts during the year was as follows:

	2019 £000	2018 £000
Interest receivable	1	2
Interest payable	20	15

Loans and savings of key management personnel are at normal commercial rates. There are no provisions for impairment against these loans.

Key management personnel loans and transactions

At 31 December 2019 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £45,213 (2018: £89,371) to two (2018: two) key management personnel or persons who are connected with key management personnel. These mortgages are provided at market interest rates and are subject to repayment under normal lending terms. No amounts have been waived or written off.

A register is maintained at the Principal Office of the Society which shows details of all loans, transactions and arrangements with Directors and connected persons. A statement for the current financial year of the appropriate details contained in the register will be available for inspection at the Principal Office for a period of 15 days up to and including the Annual General Meeting.

Contributions to pension schemes

During the year, the Group and Society paid contributions of £26.8m (2018: £19.2m) and £10.3m (2018: £8.7m) respectively to pension schemes, which are classified as related parties.

Related party transactions

During the year the Society had the following related party transactions with subsidiary undertakings:

	2019 £m	2018 £m
Rendering and receiving of services	0.3	0.3
Recharges of central costs	4.3	4.7
Interest receivable	34.5	26.2
Interest payable	(29.8)	(18.3)
Mortgage referral, valuation and legal fees (note 1)	(11.9)	(12.1)
Other income	5.0	2.8
Collateral transferred to funding vehicles	1,996.7	489.5
Collateral transferred from funding vehicles	(168.5)	(16.0)
Repayment of debt securities	(7.6)	(9.1)

Note
1. These are fees payable by the Society to Connells for the above services, which are amortised through net interest receivable in the Society's books on an effective interest basis.

All the above transactions were entered into on an arm's-length basis. For details of the relationship between the Society and its principal subsidiary undertakings see note 17a).

At 31 December 2019 the Society owed £381.5m (2018: £560.3m) to subsidiary undertakings and was owed £777.9m (2018: £854.4m) by subsidiary undertakings. Interest on intra-Group borrowings is charged at an appropriate market rate. As at 31 December 2019 the Society recognised no impairment loss allowance in respect of loans to subsidiary undertakings, on the grounds of immateriality (2018: £nil).

During the year the Group had the following related party transactions with joint ventures and associates:

	2019 £m	2018 £m
Services provided to the Group	4.2	4.0
Services provided by the Group	3.5	4.0

At 31 December 2019 the Group was owed £0.2m (2018: £0.2m) by joint ventures, and owed £0.2m (2018: £nil) to joint ventures.

There were no provisions in respect of sales of goods and services or in respect of outstanding loans to or from related parties as at 31 December 2019 or 31 December 2018.

9. Tax expense

	Group 2019 £m	Group 2018* £m	Society 2019 £m	Society 2018 £m
Current tax	31.6	40.0	16.1	21.1
Deferred tax (note 30)	(0.8)	0.7	1.2	1.5
	30.8	40.7	17.3	22.6

* The comparative period has been restated as outlined in note 1b).

A reconciliation of the tax expense on profit before tax at the standard UK corporation tax rate to the actual tax expense is as follows:

	Group 2019 £m	Group 2018* £m	Society 2019 £m	Society 2018* £m
Profit before tax	153.2	188.7	111.4	167.4
Share of profits from joint ventures, net of tax	(1.7)	(0.8)	-	-
	151.5	187.9	111.4	167.4
Tax calculated at standard UK corporation tax rate of 19.00% (2018: 19.00%)	28.8	35.7	21.2	31.8
Effects of:				
Expenses not deductible for tax purposes	1.8	2.2	0.3	0.7
Adjustment to tax expense in respect of prior periods	(0.3)	0.9	(0.6)	0.9
Tax assets not recognised on losses	0.1	-	-	-
Non-taxable income	(1.0)	(1.1)	(7.5)	(15.8)
Corporation tax rate change	0.3	-	0.4	(0.1)
Higher tax rates on overseas earnings	0.1	0.3	-	-
Effects of lower tax rates in other jurisdictions (see below)	(1.9)	(1.8)	-	-
Banking surcharge	3.6	5.2	3.6	5.2
Recognition of tax losses not previously recognised	(0.5)	(0.9)	-	-
Other	(0.2)	0.2	(0.1)	(0.1)
Tax expense	30.8	40.7	17.3	22.6

* The comparative periods have been restated as outlined in note 1b).

The effective tax rate for the Group for the year ended 31 December 2019 is 20.3% (2018: 21.7%) compared with the standard rate of UK corporation tax of 19.0% (2018: 19.0%). The rate is higher than the standard rate due to the impact of the 8% surcharge on bank profits introduced by the Finance (No. 2) Act 2015 which is charged on the Society's taxable profits above £25m. The rate for the year is also increased by expenditure disallowable for tax purposes and reduced by the lower tax rate in Guernsey which applies to the taxable profits of Skipton International Limited.

The effective tax rate for the Society for the year ended 31 December 2019 is 15.5% (2018: 13.5%). The major impact on the effective rate of tax is the non-taxable dividend income received of £38.5m (2018: £82.9m). This is partially offset by the impact of the 8% surcharge on taxable profits above £25m.

10. Loans and advances to credit institutions

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Gross carrying amount	546.6	422.8	465.8	349.5
Loss allowance	-	(0.1)	-	-
Net carrying amount	546.6	422.7	465.8	349.5

As outlined in note 1e), loans and advances to credit institutions are held at amortised cost.

The table below provides information on movements in the gross carrying amount of loans and advances to credit institutions during the year.

	Group Stage 1 £m	Group Stage 2 £m	Group Total £m	Society Stage 1 £m	Society Stage 2 £m	Society Total £m
Gross carrying amount at 1 January 2019	417.3	5.5	422.8	349.5	-	349.5
Net movements in the period	129.3	(5.5)	123.8	116.3	-	116.3
Gross carrying amount at 31 December 2019	546.6	-	546.6	465.8	-	465.8

	Group Stage 1 £m	Group Stage 2 £m	Group Total £m	Society Stage 1 £m	Society Stage 2 £m	Society Total £m
Gross carrying amount at 31 December 2017	342.3	3.0	345.3	260.8	-	260.8
Impact of adopting IFRS 9 at 1 January 2018	-	-	-	-	-	-
Gross carrying amount at 1 January 2018	342.3	3.0	345.3	260.8	-	260.8
Net movements in the period	75.0	2.5	77.5	88.7	-	88.7
Gross carrying amount at 31 December 2018	417.3	5.5	422.8	349.5	-	349.5

The table below provides information on movements in the loss allowance for loans and advances to credit institutions during the year.

	Group Stage 1 £m	Group Total £m	Society Stage 1 £m	Society Total £m
Loss allowance at 1 January 2019	0.1	0.1	-	-
Net movements in the period	(0.1)	(0.1)	-	-
Loss allowance at 31 December 2019	-	-	-	-

	Group Stage 1 £m	Group Total £m	Society Stage 1 £m	Society Total £m
Loss allowance as at 31 December 2017	-	-	-	-
Impact of adopting IFRS 9 at 1 January 2018	0.1	0.1	-	-
Loss allowance as at 31 December 2018	0.1	0.1	-	-

No amounts were written off during the year in either the Group or the Society. For further details on the assessment of ECLs on liquid assets, see note 1g).

Notes to the Accounts *(continued)*

10. Loans and advances to credit institutions *(continued)*

The table below provides maturity information for the net carrying amounts.

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Repayable on demand:				
Cash and cash equivalents	108.3	71.3	29.0	-
Cash pledged as collateral	436.4	299.4	436.4	299.4
	544.7	370.7	465.4	299.4
In not more than three months:				
Cash and cash equivalents	1.5	1.8	-	-
Other loans and advances to credit institutions	-	50.2	-	50.1
	1.5	52.0	-	50.1
In more than one year but not more than five years:				
Cash pledged as collateral	0.4	-	0.4	-
	0.4	-	0.4	-
Total loans and advances to credit institutions	546.6	422.7	465.8	349.5
Total included within cash and cash equivalents	109.8	73.1	29.0	-

Collateral

Cash is pledged and received as collateral against derivative contracts which are used by the Group to manage its exposure to market risk. Collateral is pledged to derivative contract counterparties where there is a net amount outstanding to the counterparty and collateral is received from derivative contract counterparties where there is a net amount due to the Group.

Non-standardised and some legacy derivatives are collateralised based on bilateral Credit Support Annex (CSA) agreements. Under the terms of a CSA, collateral is passed between parties to mitigate the credit risk of counterparties which is inherent in the outstanding derivative contracts. Standardised derivatives are cleared with a central clearing counterparty in accordance with the European Market Infrastructure Regulation (EMIR). Under the arrangements for cleared derivatives, additional collateral is required to protect the central clearing house against credit risk of the counterparties and to cover intra-day market movements and variations in valuation of the derivative contracts. At 31 December 2019 the Group and Society pledged £152.1m (2018: £102.7m) of this additional collateral, which is included in the figures in the table below.

Collateral pledged and received is ring-fenced by all parties to the derivative contract for the sole purpose of collateralisation of the contracts. All derivatives are marked to market on a daily basis, with collateral being either returned or pledged based on the market valuation of the derivatives.

The Group's derivative contracts have an outstanding contractual period of up to 38 years (2018: 38 years).

In addition, cash collateral can be pledged or received as repurchase agreement contracts. Repurchase agreements are funding arrangements which allow a party to sell a financial asset as security to raise funds and the borrower agrees to repurchase the financial asset at a later agreed date. Where there is a movement in valuation of the underlying financial asset used as security, the borrower is required to pledge cash (known as 'valuation margin') to make up the shortfall in the value of the security. This valuation margin protects the counterparty against the risk that the security changes in value over time. Cash pledged in this way is ring-fenced for the sole purpose of collateralisation and it is separate to the funds raised as part of the underlying repurchase agreement.

The table below provides further detail on the cash the Group has pledged against financial contracts.

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Cash pledged against derivative contracts	436.8	299.4	436.8	299.4
Total on-balance sheet cash pledged as collateral	436.8	299.4	436.8	299.4

The table below provides further detail on the cash the Group holds against financial contracts.

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Cash held against derivative contracts	-	9.8	5.0	10.1
Total off-balance sheet cash held as collateral	-	9.8	5.0	10.1

11. Debt securities

The majority of debt securities held are highly liquid assets which are used on a continuing basis in the Group's activities.

Group	2019 FVOCI and Total £m	2018 FVOCI and Total £m
Gilts	291.9	219.0
Certificates of deposit	31.0	316.5
Fixed rate bonds	446.1	242.6
Floating rate notes	204.2	20.0
Treasury bills	779.8	169.0
Covered bonds	286.4	208.6
Residential mortgage backed securities	143.5	207.4
	2,182.9	1,383.1
Debt securities have remaining maturities as follows:		
In not more than three months	331.1	195.8
In more than three months but not more than one year	692.0	461.5
In more than one year but not more than five years	1,038.3	537.8
In more than five years	121.5	188.0
	2,182.9	1,383.1
Transferable debt securities comprise:		
Listed on a recognised investment exchange	2,151.9	1,066.6
Unlisted	31.0	316.5
	2,182.9	1,383.1

Society	2019 FVOCI £m	2019 FVTPL £m	2019 Total £m	2018 FVOCI £m	2018 FVTPL £m	2018 Total £m
Gilts	291.9	-	291.9	203.8	-	203.8
Certificates of deposit	31.0	-	31.0	301.5	-	301.5
Fixed rate bonds	446.1	-	446.1	242.6	-	242.6
Floating rate notes	204.2	-	204.2	20.0	-	20.0
Treasury bills	571.8	-	571.8	49.8	-	49.8
Covered bonds	286.4	-	286.4	208.6	-	208.6
Residential mortgage backed securities	165.1	36.0	201.1	236.6	82.0	318.6
	1,996.5	36.0	2,032.5	1,262.9	82.0	1,344.9
Debt securities have remaining maturities as follows:						
In not more than three months	227.9	-	227.9	165.9	46.9	212.8
In more than three months but not more than one year	587.2	-	587.2	342.0	-	342.0
In more than one year but not more than five years	1,059.9	36.0	1,095.9	567.0	35.1	602.1
In more than five years	121.5	-	121.5	188.0	-	188.0
	1,996.5	36.0	2,032.5	1,262.9	82.0	1,344.9
Transferable debt securities comprise:						
Listed on a recognised investment exchange	1,965.5	36.0	2,001.5	961.4	82.0	1,043.4
Unlisted	31.0	-	31.0	301.5	-	301.5
	1,996.5	36.0	2,032.5	1,262.9	82.0	1,344.9

11. Debt securities *(continued)*

The tables below provides further detail on the movement in debt securities during the year.

Group	2019	2018		
	FVOCI and Total	Amortised cost	FVOCI	Total
	£m	£m	£m	£m
At 1 January	1,383.1	1.7	789.4	791.1
Additions	2,611.5	-	1,763.2	1,763.2
Disposals	(1,811.0)	(1.7)	(1,165.2)	(1,166.9)
Changes in fair value	(0.7)	-	(4.3)	(4.3)
At 31 December	2,182.9	-	1,383.1	1,383.1

Society	2019			2018			
	FVOCI	FVTPL	Total	Amortised cost	FVOCI	FVTPL	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January	1,262.9	82.0	1,344.9	1.7	674.8	81.1	757.6
Additions	2,035.1	-	2,035.1	-	1,313.9	-	1,313.9
Disposals	(1,300.8)	(47.0)	(1,347.8)	(1.7)	(721.4)	-	(723.1)
Changes in fair value	(0.7)	1.0	0.3	-	(4.4)	0.9	(3.5)
At 31 December	1,996.5	36.0	2,032.5	-	1,262.9	82.0	1,344.9

The tables below provide further detail on the movement in the impairment loss allowance held in respect of debt securities during the year. There were no amounts written off by the Group or Society during the current or prior year.

Group	2019		2018	
	FVOCI Stage 1	Total	FVOCI Stage 1	Total
	£m	£m	£m	£m
Loss allowance at 1 January	0.2	0.2	0.1	0.1
Increases due to origination, acquisition and additions	0.1	0.1	0.2	0.2
Decrease due to derecognition, repayments and disposals	(0.2)	(0.2)	(0.1)	(0.1)
Loss allowance at 31 December	0.1	0.1	0.2	0.2

Society	2019		2018	
	FVOCI Stage 1	Total	FVOCI Stage 1	Total
	£m	£m	£m	£m
Loss allowance at 1 January	0.3	0.3	0.1	0.1
Increases due to origination, acquisition and additions	0.1	0.1	0.2	0.2
Decrease due to derecognition, repayments and disposals	(0.2)	(0.2)	-	-
Loss allowance at 31 December	0.2	0.2	0.3	0.3

Collateral

At 31 December 2019, £0.4m (2018: £0.2m) of debt securities have been pledged by the Group, and £117.8m (2018: £121.8m) have been pledged by the Society, as collateral in repurchase transactions. These transactions are used to either obtain liquidity or to test the liquidity of the assets pledged as collateral. Where debt securities are pledged as collateral in repurchase transactions, the debt securities are not derecognised from the balance sheet and the transaction is accounted for as a secured loan.

Further detail on debt securities that have been pledged as collateral is found in the table below.

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Gilts	-	-	-	98.7
Fixed rate bonds	0.4	0.2	0.4	0.2
Treasury bills	-	-	61.7	22.9
Covered bonds	-	-	34.0	-
Residential mortgage backed securities	-	-	21.7	-
Total on-balance sheet debt securities pledged as collateral	0.4	0.2	117.8	121.8

The collateral is pledged for the duration of the repurchase agreement, and is returned on maturity of the agreement, subject to the repayment of the amount raised. The securities cannot be pledged again by the Group until maturity of the repurchase agreement, however the recipient of the collateral is free to sell or further repurchase the assets. As at 31 December 2019, the Group's repurchase agreements have a contractual period of up to two months (2018: two months).

There were no debt securities held by the Group or the Society at the end of 2019 or 2018 that were pledged as collateral by counterparties (known as 'reverse repurchase agreements').

Residential mortgage backed securities

The Group's investments in residential mortgage backed securities represent investments in unconsolidated structured entities, as described in note 1c).

The maximum exposure to losses from unconsolidated structured entities is equivalent to the book value plus accrued interest, determined by the carrying value of these investments plus any unrealised losses / less any unrealised gains recognised within the fair value reserve as shown below.

Group and Society	2019 £m	2018 £m
Carrying value of assets	143.5	207.4
Cumulative unrealised losses recognised in fair value reserve	0.4	1.4
Maximum exposure to loss at 31 December	143.9	208.8

During the year, the Group and Society received interest income of £2.3m (2018: £2.5m) from its investments in unconsolidated structured entities and incurred impairment charges of £nil (2018: £nil). In addition, £1.0m of unrealised gains were recognised through the fair value reserve (2018: £2.0m of unrealised losses).

No collateral has been received by the Group in respect of the above third party funding entities. The total size of unconsolidated structured entities as shown in the table above is determined by reference to the Group's total notional exposure to the unconsolidated structured entities in question.

The Group did not provide any non-contractual support, nor any contractual guarantees, during the current or prior year to unconsolidated structured entities and currently has no intentions to provide any such support. The Group is not required to absorb losses of any unconsolidated structured entities before other parties and the Group did not act as a sponsor to any unconsolidated structured entities during the current or prior year. The Group would, in general, be regarded as a sponsor of an unconsolidated structured entity if market participants would reasonably associate the entity with the Group.

At 31 December 2019 the Society also held £21.6m of residential mortgage backed securities held at FVOCI and £36.0m of residential mortgage backed securities held at FVTPL that were issued by the Group's securitisation vehicle Darrowby No. 4 plc.

12. Loans and advances to customers held at amortised cost

	Group 2019 £m	Group 2018* £m	Society 2019 £m	Society 2018* £m
Loans fully secured on residential property	19,612.8	17,715.8	17,609.8	15,747.7
Other loans:				
Loans fully secured on land	230.2	259.7	230.2	259.7
Other loans and advances	164.9	159.9	-	-
Fair value adjustment for hedged risk	57.7	(16.4)	51.6	(16.2)
	20,065.6	18,119.0	17,891.6	15,991.2
The remaining maturity of loans and advances to customers from the reporting date is as follows:				
On call and at short notice	102.8	95.9	1.1	1.8
In not more than three months	29.7	35.1	19.5	22.6
In more than three months but not more than one year	58.2	50.8	27.7	23.4
In more than one year but not more than five years	650.0	595.1	454.6	405.4
In more than five years	19,241.8	17,360.7	17,399.5	15,550.3
	20,082.5	18,137.6	17,902.4	16,003.5
Less: Impairment (note 14)	(16.9)	(18.6)	(10.8)	(12.3)
	20,065.6	18,119.0	17,891.6	15,991.2

* The comparative periods have been restated as outlined in note 1b).

Included in loans fully secured on residential property is a £21.7m adjustment (2018: £15.5m) in Group and a £36.1m adjustment (2018: £30.0m) in Society that arises as a result of applying the effective interest method of accounting for these mortgages. A critical factor in calculating this adjustment, which determines the overall carrying value of these mortgages and associated interest income recognised, is the expected life of the mortgages in question as the total interest income expected to be received is spread over this expected life using the effective interest method. Further details can be found in note 1t).

13. Transfers of financial assets

As outlined in note 1c) the Society has transferred the beneficial interest in certain portfolios of loans and advances to customers to the Group's special purpose vehicles (SPVs) Darrowby No. 4 plc and Skipton Covered Bonds LLP, to enable the subsequent raising of debt to investors who gain the security of the underlying mortgage loans as collateral.

The transfers of the beneficial interest in the mortgage loans to the SPVs are not treated as sales by the Society and are not derecognised. The Society continues to recognise these assets within its own Statement of Financial Position because it substantially retains the risks and rewards of these mortgage portfolios. The Society continues to operationally manage these mortgage loans in the same manner as the remainder of its mortgage portfolio and is exposed to the rewards of these assets, primarily through the receipt of interest income, and is exposed to the risks of these assets, which is primarily exposure to the credit risk associated with these mortgage loans.

The underlying mortgage loans are ring-fenced and cannot be used for any purpose by the Society or the SPV other than as security for the debt raised.

At 31 December 2019, loans and advances to customers held at amortised cost include £2,860.1m (2018: £1,484.8m) of balances for both the Group and Society which have been used in these secured funding arrangements, resulting in the beneficial interest in these loans being transferred to Darrowby No. 4 plc (£150.1m; 2018: £195.1m), Darrowby No. 3 plc (£nil; 2018: £129.8m) and Skipton Covered Bonds LLP (£2,710.0m; 2018: £1,159.9m). These loans secure £1,989.5m (2018: £1,065.9m) of funding for the Group.

The proceeds received from the transfer of mortgage loans are accounted for as a deemed loan repayable to the SPVs. At 31 December 2019 the balance on the deemed loan repayable to Darrowby No. 4 plc (and in 2018 Darrowby No. 3), which represents the proceeds received for the transferred financial assets, included in 'Amounts owed to other customers' in the Society was £150.1m (2018: £324.9m).

At 31 December 2019, the deemed loan repayable to Skipton Covered Bonds LLP, which represents the proceeds received for the transferred financial assets, was included within 'Loans to subsidiary undertakings' and netted against the term advance between the Society and the LLP. The balance on the deemed loan at 31 December 2019 was £1,832.1m (2018: £821.0m).

The Group's accounting policies for the derecognition of financial assets held at amortised cost are set out in note 1h). During the year, no gains or losses arose in respect of loans and advances to customers held at amortised cost that were derecognised by the Group or Society.

14. Impairment losses on loans and advances to customers

Group	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans and advances £m	Total £m
Loss allowance as at 1 January 2019	9.9	7.9	0.8	18.6
Amounts written off during the year, net of recoveries	(0.8)	(1.2)	(0.2)	(2.2)
Income statement charge / (credit) for the year	0.5	(0.2)	0.2	0.5
Loss allowance as at 31 December 2019	9.6	6.5	0.8	16.9

Group	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans and advances £m	Fair value of embedded derivatives on equity release portfolio £m	Total £m
Loss allowance as at 31 December 2017	7.3	8.0	0.8	25.7	41.8
Adjustments on initial adoption of IFRS 9	2.7	(1.1)	-	(25.7)	(24.1)
Adjusted loss allowance as at 1 January 2018	10.0	6.9	0.8	-	17.7
Amounts written off during the year, net of recoveries	(1.5)	-	(0.2)	-	(1.7)
Income statement charge for the year	1.3	1.0	0.2	-	2.5
Transfer of engagements	0.1	-	-	-	0.1
Loss allowance as at 31 December 2018	9.9	7.9	0.8	-	18.6

Society	Loans fully secured on residential property £m	Loans fully secured on land £m	Total £m
Loss allowance as at 1 January 2019	4.4	7.9	12.3
Amounts written off during the year, net of recoveries	-	(1.2)	(1.2)
Income statement credit for the year	(0.1)	(0.2)	(0.3)
Loss allowance as at 31 December 2019	4.3	6.5	10.8

Society	Loans fully secured on residential property £m	Loans fully secured on land £m	Fair value of embedded derivatives on equity release portfolio £m	Total £m
Loss allowance as at 31 December 2017	4.5	8.0	25.7	38.2
Adjustments on initial adoption of IFRS 9	0.2	(1.1)	(25.7)	(26.6)
Adjusted loss allowance as at 1 January 2018	4.7	6.9	-	11.6
Amounts written off during the year, net of recoveries	(0.5)	-	-	(0.5)
Income statement charge for the year	0.1	1.0	-	1.1
Transfer of engagements	0.1	-	-	0.1
Loss allowance as at 31 December 2018	4.4	7.9	-	12.3

Notes to the Accounts *(continued)*

15. Equity release portfolio held at FVTPL

Movements during the year in the equity release portfolio are outlined below.

	Group and Society 2019 £m	2018 £m
At 1 January	410.9	426.6
Redemptions	(3.9)	(6.2)
Further advances	0.2	0.3
Movements in fair value	(6.0)	(17.1)
Realised losses on redemption	(0.5)	(0.7)
Accrued interest	9.3	8.0
At 31 December	410.0	410.9

Further details on how the valuation of the equity release portfolio is derived including the key inputs into the calculation are found in note 1e) and note 1t).

The Group holds derivative financial instruments to economically hedge the movements in fair value of the equity release portfolio. The gain in fair value of the derivatives held to hedge the equity release portfolio during the year was £2.6m and is included in the Income Statement line 'Fair value gains / (losses) on other derivatives' (2018: £18.1m gain).

The equity release portfolio comprises loans, against which collateral is held in the form of property in the UK. As at 31 December 2019 this collateral is valued at £563.8m (2018: £581.4m).

16. Loans and advances to customers held at FVTPL

Movements during the year are outlined below.

	Group and Society 2019 £m	2018 £m
At 1 January	1.9	-
Transfer of engagements	-	1.7
Repayments	(0.5)	(0.7)
Accrued interest	0.1	-
Other movements	-	0.9
At 31 December	1.5	1.9

As outlined in note 1e), the above loans consist mainly of certain lifetime mortgages that are required, under IFRS 9, to be held at FVTPL.

Collateral is held against the above loans in the form of property in the UK and is valued as at 31 December 2019 at £9.2m (2018: £20.2m).

17. Investments in Group undertakings

a) Subsidiary undertakings

The net movement in investments in subsidiary undertakings during the year was as follows:

Society	Shares in subsidiary undertakings 2019 £m	Shares in subsidiary undertakings 2018 £m	Loans to subsidiary undertakings 2019 £m	Loans to subsidiary undertakings 2018 £m	Total 2019 £m	Total 2018 £m
Cost						
At 1 January	183.5	186.0	854.4	965.4	1,037.9	1,151.4
Additions	-	-	21.2	11.6	21.2	11.6
Repayments	-	-	(97.7)	(122.6)	(97.7)	(122.6)
Written off	-	(2.5)	-	-	-	(2.5)
At 31 December	183.5	183.5	777.9	854.4	961.4	1,037.9
Provisions						
At 1 January	62.9	65.4	-	-	62.9	65.4
Written off	-	(2.5)	-	-	-	(2.5)
At 31 December	62.9	62.9	-	-	62.9	62.9
Net book value at 31 December	120.6	120.6	777.9	854.4	898.5	975.0

In respect of loans provided by the Society to its subsidiary undertakings, limits in place define the maximum amount that can be advanced to each subsidiary and any changes to these limits are required to be pre-approved by the Group Wholesale Credit Committee.

At the end of the current and preceding financial year the Group held a controlling interest in the following principal trading subsidiary undertakings:

Name of subsidiary undertaking	Principal business activity	Registered office	Percentage of ownership interest 2019	Percentage of ownership interest 2018
Amber Homeloans Limited	Lending body	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Connells Limited and subsidiary undertakings*	Estate agency and related businesses	The Bailey, Skipton, North Yorkshire, BD23 1DN	99.8	99.9
Darrowby No. 3 plc	Funding vehicle	35 Great St. Helen's, London, EC3A 6AP	(See below)	(See below)
Darrowby No. 4 plc	Funding vehicle	35 Great St. Helen's, London, EC3A 6AP	(See below)	(See below)
Jade Software Corporation Limited and subsidiary undertakings	Provider of software development services	5 Sir Gil Simpson Drive, Christchurch, New Zealand	99.98	99.98
North Yorkshire Mortgages Limited	Lending body	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Northwest Investments NZ Limited	Provider of software development services	C/- Bell Gully, Level 22 Vero Centre, 48 Shortland Street, Auckland, New Zealand	100.0	100.0
Skipton Business Finance Limited	Provider of debt factoring services	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Skipton Covered Bonds Limited Liability Partnership	Mortgage acquisition and guarantor of covered bonds	The Bailey, Skipton, North Yorkshire, BD23 1DN	(See below)	(See below)
Skipton Financial Services Limited	Financial adviser	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Skipton Group Holdings Limited (SGHL)	Intermediate holding company	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0
Skipton International Limited (SIL)	Offshore deposit taker and lender	Tudor House, Le Bordage, St Peter Port, Guernsey, GY1 6DS	100.0	100.0
Skipton Trustees Limited	Provider of will writing services	The Bailey, Skipton, North Yorkshire, BD23 1DN	100.0	100.0

* Indicates where an option to purchase non-controlling interests in the future exists.

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17. Investments in Group undertakings *(continued)*

All the above entities are incorporated, registered and operate in the United Kingdom except for SIL, which is incorporate and registered in Guernsey and operates in Guernsey, Jersey and the UK; Northwest Investments NZ Limited, which i incorporated, registered and operates in New Zealand; and Jade Software Corporation Limited, which is incorporated an registered in New Zealand and operates worldwide.

Consolidation of special purpose vehicles (SPVs)

Darrowby No. 4 plc is a securitisation vehicle formed with only nominal share capital. Skipton Covered Bonds LLP, of which the Society is a member, was formed to guarantee payments on covered bonds that the Society issues to the wholesale market. These SPVs are funded through loans from the Society and their activities are carried out under the direction of the Society, in line with the transaction documentation. The Society is exposed to variable returns from these entities and has the ability to affect those returns in line with the transaction documentation; these SPVs therefore pass the test of control under IFRS 10 and are fully consolidated into the Group Accounts. During 2019 the securitisation vehicle Darrowby No. 3 plc was fully repaid and terminated.

The Society has no contractual arrangements or intention to provide additional financial or other support to these SPVs.

b) Acquisitions

In 2019 Connells Limited acquired a further 5.5% shareholding in Gascoigne Halman Group Limited for cash consideration of £0.6m, increasing the Group's shareholding to 82.75%. Connells also purchased the trade and assets of a number of small businesses for total consideration of £0.3m (with a further £0.1m deferred consideration), generating goodwill of £0.2m.

In the prior year Connells Limited acquired a further 2.25% shareholding in Gascoigne Halman Group Limited for cash consideration of £0.3m, increasing the Group's shareholding to 77.25%. Connells also purchased the trade and assets of a number of small businesses for total consideration of £0.6m (with a further £0.1m deferred consideration), generating goodwill of £0.1m.

c) Disposals

The profit on disposal of subsidiary undertakings for the year was £1.1m for the Group (2018: £3.3m) and £nil for the Society (2018: £nil).

During 2014, the Group sold its then subsidiary Homeloan Management Limited (HML). The sale of HML to Computershare included contingent consideration dependent on HML's performance over a period following the disposal and this resulted in amounts being receivable by the Group of £32.5m between 2018 and 2022.

The second instalment of £6.2m was received by the Group in May 2019 (May 2018: £6.9m) and the discounted contingent consideration asset stands at £17.9m at 31 December 2019 (2018: £23.0m). The profit recognised in the Income Statement in relation to the HML disposal during the year of £1.1m (2018: £3.3m) is included in the 'Profit on disposal of subsidiary undertakings' line in the Income Statement.

d) Joint ventures

At 31 December 2019, the Group held interests in the following companies that are classed as joint ventures:

Name of investment	Principal business activity	Registered office	Class of shares held	Percentage o ownership interest 2019	201
TM Group (UK) Limited	Property search services	1200 Delta Business Park, Swindon, Wiltshire, SN5 7XZ	Ordinary	33.3	33
Cybele Solutions Holdings Limited	Conveyancing services	Bickerton House, Lloyd Drive, Ellesmere Port, Cheshire, CH65 9HQ	Ordinary	50.0	50
Vibrant Energy Matters Limited	Home energy, property and eco services	2 Foxes Lane, Oakdale Business Park, Blackwood, Gwent, NP12 4AB	Ordinary	46.1	46

The Group's combined share of net assets and the Group's combined share of profit after tax for the above joint ventures are as shown within the Statement of Financial Position and Income Statement respectively.

17. Investments in Group undertakings *(continued)*

e) Equity share investments

At 31 December 2019, the Group held interests in the following companies:

		Percentage of ownership interest		Carrying value	
		2019	2018	2019	2018
Name of investment	Principal business activity	%	%	£m	£m
Hearthstone Investments plc	Property fund management	17.1	17.1	-	-
OnTheMarket plc	Property search provider	0.1	0.1	0.2	0.1
Viewber Limited	Property viewings services	2.7	2.7	0.3	0.3
Tactile Limited	Software application provider	8.7	8.7	0.4	0.4
Global Property Ventures Limited	Property management services	5.7	-	0.6	-
Twenty7Tec	Software application provider	1.2	-	-	-
				1.5	0.8

The movement in the Group's equity share investments during the year is analysed below:

	Group 2019 £m	Group 2018 £m
At 1 January	0.8	0.4
Additions	0.7	0.7
Fair value losses recognised in Income Statement	-	(0.3)
At 31 December	1.5	0.8

Listed investments

The carrying value of the Group's investment in OnTheMarket plc is determined by reference to that company's share price.

Unlisted investments

The carrying values of the Group's investments in Tactile (trading as Fixflo) and Viewber are the cost of the amounts invested by the Group. The Directors have reviewed both these investments and consider that their respective carrying values represent the best indication of fair value.

Connells invested £0.6m in Global Property Ventures Limited during the year. The Directors have reviewed the carrying value of this investment, based on recent trading performance, outlook and expectations of the value of the business, and have concluded that the carrying value of £0.6m is the best indication of its fair value. The Group also acquired a small holding in Twenty7Tec, a software application provider, for a nominal sum.

Notes to the Accounts *(continued)*

18. Property, plant and equipment

Group	2019 Land and buildings £m	2019 Equipment, fixtures and fittings £m	2019 Total £m	2018 Land and buildings £m	2018 Equipment, fixtures and fittings £m	2018 Total £m
Cost						
At 1 January	99.7	94.4	194.1	95.0	91.6	186.6
Additions	5.7	7.0	12.7	4.6	9.9	14.5
Disposals	(4.6)	(4.0)	(8.6)	(1.0)	(7.1)	(8.1)
Transfer of engagements	-	-	-	0.9	-	0.9
Foreign exchange movements on translation	-	(0.1)	(0.1)	-	-	-
Reclassification from investment property	-	-	-	0.2	-	0.2
At 31 December	100.8	97.3	198.1	99.7	94.4	194.1
Depreciation						
At 1 January	46.7	69.5	116.2	42.1	66.3	108.4
Charge for the year	5.4	7.9	13.3	5.3	8.9	14.2
Impairment charge	-	0.5	0.5	-	0.4	0.4
Disposals	(4.4)	(3.1)	(7.5)	(0.8)	(6.1)	(6.9)
Foreign exchange movements on translation	-	(0.1)	(0.1)	-	-	-
Reclassification from investment property	-	-	-	0.1	-	0.1
At 31 December	47.7	74.7	122.4	46.7	69.5	116.2
Net book value at 1 January	53.0	24.9	77.9	52.9	25.3	78.2
Net book value at 31 December	53.1	22.6	75.7	53.0	24.9	77.9

Society	2019 Land and buildings £m	2019 Equipment, fixtures and fittings £m	2019 Total £m	2018 Land and buildings £m	2018 Equipment, fixtures and fittings £m	2018 Total £m
Cost						
At 1 January	53.2	38.1	91.3	50.3	34.4	84.7
Additions	4.3	2.7	7.0	2.3	3.7	6.0
Disposals	(4.3)	(0.1)	(4.4)	(0.3)	-	(0.3)
Transfer of engagements	-	-	-	0.9	-	0.9
At 31 December	53.2	40.7	93.9	53.2	38.1	91.3
Depreciation						
At 1 January	23.2	31.6	54.8	21.4	29.4	50.8
Charge for the year	2.0	1.6	3.6	2.1	1.8	3.9
Impairment charge	-	0.5	0.5	-	0.4	0.4
Disposals	(4.1)	(0.1)	(4.2)	(0.3)	-	(0.3)
At 31 December	21.1	33.6	54.7	23.2	31.6	54.8
Net book value at 1 January	30.0	6.5	36.5	28.9	5.0	33.9
Net book value at 31 December	32.1	7.1	39.2	30.0	6.5	36.5

The net book value of land and buildings comprises:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Freehold	40.5	39.0	26.2	24.8
Long leasehold	1.4	1.1	1.0	1.1
Short leasehold	11.2	12.9	4.9	4.1
	53.1	53.0	32.1	30.0

19. Right-of-use assets

	Group 2019 Land and buildings £m	Group 2019 Equipment, fixtures and fittings £m	Group 2019 Total £m	Society 2019 Land and buildings £m	Society 2019 Equipment, fixtures and fittings £m	Society 2019 Total £m
Cost						
Balance at 31 December 2018	-	-	-	-	-	-
Adjustments on initial adoption of IFRS 16 (note 1b))	67.0	1.1	68.1	13.7	0.1	13.8
Adjusted balance at 1 January 2019	67.0	1.1	68.1	13.7	0.1	13.8
Additions	11.2	5.7	16.9	3.0	0.1	3.1
Lease modifications and remeasurements	1.5	(0.1)	1.4	-	-	-
Disposals	(2.3)	(0.1)	(2.4)	(1.1)	-	(1.1)
At 31 December 2019	77.4	6.6	84.0	15.6	0.2	15.8
Depreciation						
Balance at 31 December 2018	-	-	-	-	-	-
Adjustments on initial adoption of IFRS 16 (note 1b))	0.6	-	0.6	0.3	-	0.3
Adjusted balance at 1 January 2019	0.6	-	0.6	0.3	-	0.3
Charge for the year	16.3	0.7	17.0	3.0	0.1	3.1
Disposals	(0.9)	(0.1)	(1.0)	(0.3)	-	(0.3)
At 31 December 2019	16.0	0.6	16.6	3.0	0.1	3.1
Net book value at 31 December 2019	61.4	6.0	67.4	12.6	0.1	12.7

The Group's leases relate mainly to branch premises operated by the Society and by Connells. The Group's leases are typically negotiated on an individual basis and thus include a wide variety of terms and conditions, including options to extend or terminate. There are no significant restrictions or covenants, residual value guarantees or sale and leaseback transactions. As at 31 December 2019, the lease liability is considered by the Group to represent an indication of the present value of the future cash outflows to which the Group is exposed.

A number of the Group's leased properties are sublet, in full or in part, by the Group. For the year ended 31 December 2019, other operating income includes £0.5m (Group) and £0.1m (Society) relating to the subleasing of properties accounted for as right-of-use assets. For the year ended 31 December 2018, other operating income included £0.5m (Group) and £0.1m (Society) relating to the subleasing of properties accounted for in 2018 as operating leases.

For details of the Group's lease liabilities, see note 27. For further details of the Group's lease expenses in the year, see note 5.

20. Investment property

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Cost				
At 1 January	28.1	28.1	28.0	27.8
Transfer of engagements	-	0.3	-	0.3
Disposals	(3.4)	(0.1)	(3.4)	(0.1)
Transfer to property, plant and equipment	-	(0.2)	-	-
Other	-	-	0.1	-
At 31 December	24.7	28.1	24.7	28.0
Depreciation				
At 1 January	16.1	13.7	16.0	13.5
Charge for the year	0.6	0.7	0.6	0.7
Impairment charge	-	1.9	-	1.9
Disposals	(1.4)	(0.1)	(1.4)	(0.1)
Transfer to property, plant and equipment	-	(0.1)	-	-
Other	-	-	0.1	-
At 31 December	15.3	16.1	15.3	16.0
Net book value at 1 January	12.0	14.4	12.0	14.3
Net book value at 31 December	9.4	12.0	9.4	12.0

All investment property relates to property purchased by the Society and is either unoccupied by the Society or relates to branches where part of the property is subleased.

The amount of rental income from investment property recognised in the Income Statement during the year was £1.9m (2018: £2.5m) for the Group and £1.7m (2018: £1.9m) for the Society.

The aggregate estimated market value of investment properties is set out in the table below:

	Group and Society 2019 £m	2018 £m
Market value of investment property	13.0	15.1

The estimated market value of the investment properties has been determined by an appropriately qualified internal valuer, supported by external valuations where appropriate, in accordance with RICS Appraisal and Valuation Standards and is an indication of fair value. This fair value measurement is categorised as a Level 3 fair value measurement, as described in note 39b).

For the majority of the Group's investment properties, fair value is estimated using the market valuation approach which uses prices and other relevant information generated by market transactions involving comparable properties. Where comparable transactions may not be available, the Group may also consider a discounted cash flow technique which considers the present value of the net cash flows to be generated from the property, taking into account expected rental growth, void periods and rent-free periods. The expected net cash flows are discounted using risk-adjusted discount rates.

The Directors have assessed the carrying value of the investment properties compared to their fair value and have concluded that no impairment should be recognised during the year (2018: £1.9m).

21. Intangible assets

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Goodwill	137.5	137.3	-	-
Other intangible assets	25.1	24.1	3.4	2.5
	162.6	161.4	3.4	2.5

Goodwill	Group 2019 £m	Group 2018 £m
Cost, less amortisation to 1 January 2004*		
At 1 January	147.4	147.3
Acquisitions of subsidiary undertakings and business units	0.2	0.1
Written off	(0.4)	-
At 31 December	147.2	147.4
Impairment losses		
At 1 January	10.1	7.6
Impairment loss during the year	-	2.5
Written off	(0.4)	-
At 31 December	9.7	10.1
Net book value at 1 January	137.3	139.7
Net book value at 31 December	137.5	137.3

* Prior to the transition to IFRS on 1 January 2005 goodwill was held at cost less accumulated amortisation in line with UK GAAP. Goodwill arising on acquisitions before the transition to IFRS on 1 January 2005 has been retained at its previous UK GAAP amount, as described in note 1d).

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating unit (operating segment) that is expected to benefit from that business combination. The carrying value of goodwill has been allocated as follows:

Operating segment	Group 2019 Cost of goodwill £m	Group 2019 Accumulated impairment £m	Group 2019 Carrying value £m	Group 2018 Cost of goodwill £m	Group 2018 Accumulated impairment £m	Group 2018 Carrying value £m
Mortgages and Savings	2.9	0.1	2.8	2.9	0.1	2.8
Estate Agency	135.9	4.7	131.2	135.7	4.7	131.0
Investment Portfolio	8.4	4.9	3.5	8.8	5.3	3.5
Total goodwill	147.2	9.7	137.5	147.4	10.1	137.3

Based upon the Directors' assessment of recoverable amounts, the Directors have concluded that no impairment is required to be recognised in respect of goodwill within the Estate Agency division in 2019 (2018: £2.5m).

The recoverable amounts of the operating segments are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding cash flows, discount rates and growth rates.

The cash flows are derived from the most recent corporate plans for the next five years, which take into account the risks inherent in each of the businesses. The cash flows are extrapolated for subsequent years indefinitely (or a specific number of years where circumstances dictate), to reflect that the subsidiary undertakings are held for long term investment, based on a long term growth rate of 2.5% (2018: 2.5%) or specific growth rates where circumstances dictate.

The cash flows from the corporate plans are based upon the following key drivers:

Operating segment	Key drivers
Mortgages and Savings	Volume of new business, level of unemployment, house price inflation and interest rates
Estate Agency	Volume of UK property transactions, house price inflation, level of unemployment and interest rates
Investment Portfolio	Volume of new business, level of unemployment and interest rates

Notes to the Accounts *(continued)*

21. Intangible assets *(continued)*

The Group estimates discount rates based upon the weighted average cost of capital which is adjusted to take account of the market risks associated with each cash generating unit.

The pre-tax discount rates are as follows:

Operating segment	Group 2019 %	Group 2018 %
Mortgages and Savings	11	14
Estate Agency	10	11
Investment Portfolio	10	11

Other intangible assets	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Cost				
At 1 January	92.0	86.5	19.7	18.9
Acquisition of other business assets	0.3	0.7	-	-
Additions	7.7	4.9	1.8	0.8
Foreign exchange movements on translation	(0.9)	-	-	-
Disposals	(3.4)	(0.1)	-	-
At 31 December	95.7	92.0	21.5	19.7
Amortisation and impairment				
At 1 January	67.9	61.8	17.2	16.3
Charge for the year	6.8	6.2	0.9	0.9
Foreign exchange movements on translation	(0.7)	-	-	-
Disposals	(3.4)	(0.1)	-	-
At 31 December	70.6	67.9	18.1	17.2
Net book value at 1 January	24.1	24.7	2.5	2.6
Net book value at 31 December	25.1	24.1	3.4	2.5

The net book value of other intangible assets comprises:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Brands	6.5	6.5	-	-
Customer contracts and relationships	4.6	6.5	-	-
Computer software and databases	14.0	11.1	3.4	2.5
	25.1	24.1	3.4	2.5

22. Other assets

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Trade receivables	30.7	31.3	1.4	1.8
Prepayments	14.8	17.6	10.6	11.8
Accrued income	9.8	6.4	3.9	-
Contingent consideration	17.9	23.0	-	-
Share warrants	3.2	-	-	-
Other	6.1	6.6	1.0	1.4
	82.5	84.9	16.9	15.0

Further details regarding trade receivables are included in note 38c).

23. Shares

	Group 2019 £m	Group 2018* £m	Society 2019 £m	Society 2018* £m
Held by individuals	17,201.1	15,986.4	17,201.1	15,986.4
Other shares	161.0	142.1	161.0	142.1
Fair value adjustment for hedged risk	2.0	(15.0)	0.2	(16.4)
	17,364.1	16,113.5	17,362.3	16,112.1

* Fair value adjustment for hedged risk is restated as outlined in note 1b).

A maturity analysis of shares is included in note 36.

24. Amounts owed to credit institutions

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Amounts owed to subsidiary undertakings	-	-	66.7	122.1
Other	1,678.3	1,878.0	1,676.9	1,877.8
	1,678.3	1,878.0	1,743.6	1,999.9

A maturity analysis of amounts owed to credit institutions is included in note 36.

25. Amounts owed to other customers

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Amounts owed to subsidiary undertakings	-	-	314.8	438.2
Other	1,816.6	1,691.3	100.6	91.0
Fair value adjustment for hedged risk	0.3	(0.8)	-	-
	1,816.9	1,690.5	415.4	529.2

A maturity analysis of amounts owed to other customers is included in note 36.

Amounts owed to other customers by the Group relate primarily to retail deposits accepted through the Group's Channel Islands based subsidiary, Skipton International Limited. At 31 December 2019 the amount of such deposits included above, net of fair value adjustment for hedged risk, is £1,644.7m (2018: £1,524.4m).

25. Amounts owed to other customers *(continued)*

Amounts owed to subsidiary undertakings by the Society include £150.1m in respect of a deemed loan from Darrowby No. 4 plc which has been designated as at FVTPL, in line with the accounting policy outlined in note 1f). The deemed loan is an agreement to pay over the income received by the Society on the mortgage pool. The only credit risk that arises is from the Society however the Society is not required to make up any shortfall (i.e. any bad debts from customers within the mortgage pool) as per the deemed loan contract and therefore the credit risk on cash flows owed to Darrowby No. 4 plc is considered very low. During the year, and cumulatively to the reporting date, there has been no change in the fair value of these liabilities that is attributable to changes in the Society's own credit risk; the Group has determined this on the grounds that the credit risk within this deemed loan is very low.

The difference between the amount the Society would be contractually obliged to pay at maturity in order to discharge these liabilities and the carrying value as at 31 December 2019 is £nil (2018: £0.8m). There have been no transfers of the cumulative gain or loss within equity during the year (2018: none).

26. Debt securities in issue

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Certificates of deposit	-	4.0	-	4.0
Senior unsecured debt	349.1	348.8	349.1	348.8
Covered bonds	1,889.1	846.3	1,846.2	846.3
Securitisation	100.4	219.6	-	-
Fair value adjustment for hedged risk	(36.0)	1.6	(0.4)	(4.7)
	2,302.6	1,420.3	2,194.9	1,194.4

A maturity analysis of debt securities in issue is included in note 36.

In March 2019, the Society issued a Sterling covered bond transaction, raising £600m of funding over a five year term. In September 2019 the Society issued a Euro denominated covered bond transaction, which raised €500m of five year funding. The amounts outstanding at 31 December 2019 are included in 'Covered bonds' above.

Group debt securities in issue include £1,989.5m (2018: £1,065.9m) of funding secured on certain loans and advances to customers through the Group's securitisation vehicle Darrowby No. 4 plc and the special purpose vehicle Skipton Covered Bonds LLP.

27. Lease liabilities

	Group 2019 £m	Society 2019 £m
Balance at 31 December 2018	-	-
Adjustments on initial adoption of IFRS 16 (note 1b))	64.7	13.0
Adjusted balance at 1 January 2019	64.7	13.0
Additions	17.0	3.0
Modifications / remeasurements of existing lease liabilities	1.4	-
Transfers from provision for the costs of surplus properties (note 29)	1.2	-
Interest charged	1.4	0.3
Lease payments (including interest)	(17.7)	(3.1)
Disposals	(1.4)	(0.7)
Balance at 31 December 2019	66.6	12.5

A maturity analysis of lease liabilities is included in note 36.

For details of the Group's right-of-use assets, see note 19. For further details of the Group's lease expenses in the year, see note 5.

28. Other liabilities

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Trade payables	6.7	5.4	2.5	1.8
Fair value of put option obligation	7.5	8.3	-	-
Fair value of liability of subsidiary management incentive scheme	3.8	10.6	-	-
VAT and employment taxes	15.0	15.2	2.1	2.0
Other	19.6	17.4	7.3	6.7
	52.6	56.9	11.9	10.5

Put option obligation

The movement in the fair value of the put option obligation is summarised below:

	Group 2019 £m	Group 2018 £m
At 1 January	8.3	9.9
Unwind of the discount factor	0.2	0.2
Exercise of put options by non-controlling shareholders	(0.6)	(0.3)
Revaluation of market values and changes to future exercise dates	(0.4)	(1.5)
At 31 December	7.5	8.3

Subsidiary management incentive scheme

Six members of Connells Limited senior management purchased equity shares in that company in either 2012 or 2014. At the same time, the Group issued options to these shareholders to require SGHL to purchase their shareholdings in Connells Limited at some future dates. At the end of 2018, four of the six options remained outstanding and three of these were fully exercised during 2019. In addition, two members of Connells' senior management were issued further options in 2019 and at the end of 2019 three options were outstanding in total, with the maximum option length being eight years from 31 December 2019. In accordance with IFRS 2 *Share-based Payment*, this is a cash-settled scheme in the Group Accounts, with the fair value of the liability being spread over the period to exercise. The fair value of the liability is subsequently remeasured at each reporting date with any changes in fair value recognised in the Income Statement.

The movement in the fair value of the liability of the subsidiary management incentive scheme is summarised below:

	Group 2019 £m	Group 2018 £m
At 1 January	10.6	24.6
Exercise of share options during the year	(9.3)	(9.8)
Share options issued in the year	0.7	-
Movement in fair value of the liability recognised in the Income Statement	1.8	(4.2)
At 31 December	3.8	10.6

29. Provisions for liabilities

The movements in provisions for liabilities during the year were as follows:

Group 2019	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks £m	Survey and valuation claims £m	Customer compens-ation £m	Other provisions £m	Total £m
At 31 December 2018	3.7	-	10.7	3.7	5.9	0.3	24.3
Adjustment on initial adoption of IFRS 16 (see note 1b))	(0.6)	-	-	-	-	-	(0.6)
At 1 January 2019	3.1	-	10.7	3.7	5.9	0.3	23.7
(Credit) / charge for the year	(0.1)	(0.3)	15.2	0.8	(0.8)	3.3	18.1
Transfers to lease liabilities (note 27)	(1.2)	-	-	-	-	-	(1.2)
Utilised during the year	(0.3)	0.3	(12.0)	(0.5)	(4.4)	-	(16.9)
At 31 December 2019	1.5	-	13.9	4.0	0.7	3.6	23.7

Group 2018	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks £m	Survey and valuation claims £m	Customer compens-ation £m	Other provisions £m	Total £m
At 1 January	3.7	1.2	8.2	4.2	8.5	0.3	26.1
Charge / (credit) for the year	0.2	(0.6)	12.7	-	(0.3)	-	12.0
Utilised during the year	(0.2)	(0.6)	(10.2)	(0.5)	(2.3)	-	(13.8)
At 31 December	3.7	-	10.7	3.7	5.9	0.3	24.3

Society 2019	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks £m	Customer compensation £m	Other provisions £m	Total £m
At 31 December 2018	0.3	-	0.4	3.5	0.2	4.4
Adjustment on initial adoption of IFRS 16 (see note 1b))	(0.3)	-	-	-	-	(0.3)
At 1 January 2019	-	-	0.4	3.5	0.2	4.1
Credit for the year	-	(0.3)	-	(0.8)	-	(1.1)
Utilised during the year	-	0.3	(0.1)	(2.2)	-	(2.0)
At 31 December 2019	-	-	0.3	0.5	0.2	1.0

Society 2018	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	0.4	1.2	0.6	4.7	0.2	7.1
(Credit) / charge for the year	-	(0.6)	(0.1)	0.3	-	(0.4)
Utilised during the year	(0.1)	(0.6)	(0.1)	(1.5)	-	(2.3)
At 31 December	0.3	-	0.4	3.5	0.2	4.4

Provision for the costs of surplus properties

The provision for the costs of surplus properties is expected to reverse over the remaining life of the leases or period to anticipated date of disposal, if sooner.

Commission clawbacks

The commission clawback provision represents an estimate of the repayment of commission to suppliers as a result of cancelled policies sold by the Estate Agency division and the financial advice activities of the Group. These are estimated based upon anticipated cancellation rates.

Survey and valuation claims

Provision is made for professional indemnity claims and potential claims that arise during the normal course of business in relation to surveys and valuations carried out by the Connells group. The provision is based upon the expected level of future professional indemnity claims relating to services already provided and the value provided on each claim is the lower of the professional indemnity insurance excess per claim or the estimated exposure. To assess the level of future claims, analysis is performed on the number of preliminary notifications expected to turn into future claims and on historical claim trends to forecast the number of future claims where a notification is yet to be received. Historical data on claims success frequency and value is also used to estimate the size of the liability.

The professional indemnity claim provision is stated at the Directors' best estimate of the eventual liability, based on the information available at the time. Whilst the level of future claims is uncertain, the Group has robust processes in place that aim to restrict the number and magnitude of these.

Due to the nature of the professional indemnity claims it is difficult to indicate approximate payment timescales or claims received in future years. The provision will be utilised as individual claims are settled.

Customer compensation

The customer compensation provision includes provisions for potential claims on payment protection insurance (PPI) of £0.3m (2018: £2.4m).

The Group has continued to experience an increase in PPI complaint levels during the year following the introduction of a deadline, by the FCA, for making PPI complaints (the deadline was 29 August 2019). A number of cases are referred to the Financial Ombudsman Service (FOS), each incurring a £550 fee. These provisions are expected to be utilised within the next twelve to eighteen months.

In the prior year the customer compensation provision included £3.1m for potential future redress payable following an evaluation during 2017 of some historical terms and conditions of a small number of mortgages, mainly within our specialist mortgage lenders Amber and NYM, which have been closed to new business since 2008.

30. Deferred tax

Deferred tax is calculated on temporary differences under the statement of financial position asset and liability method, using the enacted tax rate expected to apply in the relevant tax jurisdiction when these differences reverse, which is 25% (2018: 25%) for the Society and 17% (2018: 17%) for most other Group companies.

The 2018 comparative amounts for deferred tax assets and deferred tax liabilities have been restated to, where appropriate, present deferred tax on a net basis; this revised presentation more fairly reflects the nature of these items as the tax in question will ultimately be settled on a net basis. As a result of this restatement, the 2018 comparative amounts for both deferred tax assets and deferred tax liabilities have decreased (Group: by £4.3m; Society: by £nil), with corresponding decreases to total assets and total liabilities.

The movement in deferred tax during the year was as follows:

	Group 2019 £m	Group 2018* £m	Society 2019 £m	Society 2018 £m
At 1 January prior to impact of IFRS 9 adoption	35.9	23.2	25.7	13.2
Impact of IFRS 9 adoption	-	12.9	-	13.3
At 1 January including impact of IFRS 9 adoption	35.9	36.1	25.7	26.5
Income Statement credit / (charge) (note 9)	0.8	(0.7)	(1.2)	(1.5)
Items taken directly to other comprehensive income	0.2	0.7	1.8	0.8
Transfer of engagements	-	(0.1)	-	(0.1)
Acquired on acquisition of subsidiaries	-	(0.1)	-	-
At 31 December	36.9	35.9	26.3	25.7

* Items taken directly to other comprehensive income, the Income Statement credit / (charge) and deferred tax balances as at 1 January 2018 are restated for adjustments relating to hedge amortisation (see note 1b)).

The adoption of IFRS 9 in 2018 resulted in an adjustment to the deferred tax asset in the Group of £12.9m and in the Society of £13.3m, which is being released to the Income Statement over a 10 year period as permitted by the standard.

30. Deferred tax *(continued)*

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

Deferred tax assets

	Group 2019 £m	Group 2018 Restated*^ £m	Society 2019 £m	Society 2018 Restated* £m
Fixed asset temporary differences	2.0	0.7	0.8	0.1
Pension obligations	19.0	21.1	12.6	13.0
Provisions	1.9	2.4	0.4	0.9
Corporation tax losses	0.5	0.1	-	-
Derivatives and loans	12.2	7.3	11.4	12.1
Other	3.0	5.5	1.4	-
	38.6	37.1	26.6	26.1

Deferred tax liabilities	Group 2019 £m	Group 2018 Restated* £m	Society 2019 £m	Society 2018 Restated* £m
Fixed asset temporary differences	0.9	0.7	-	-
Derivatives and loans	0.5	0.1	-	0.1
Financial assets held at FVOCI	0.3	0.3	0.3	0.3
Other	-	0.1	-	-
	1.7	1.2	0.3	0.4
Net deferred tax asset	36.9	35.9	26.3	25.7

* As noted above, deferred tax assets and deferred tax liabilities are re-presented on a net basis. In the tables above, this impacts the lines 'derivatives and loans' and 'other'.

^ The comparative period has been restated in relation to hedge amortisation as outlined in note 1b).

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

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Fixed asset temporary differences	(1.2)	(0.4)	(0.7)	0.2
Provisions	0.4	(0.2)	0.5	(0.1)
Contingent consideration (note 1)	(0.8)	(0.3)	-	-
Other	0.8	1.6	1.4	1.4
	(0.8)	0.7	1.2	1.5

Note:

1. Deferred tax liabilities in relation to contingent consideration are netted against derivatives and other loans within deferred tax assets.

Unrecognised deferred tax relating to trading losses carried forward at 31 December 2019 amounts to £2.9m (2018: £3.4m) for the Group and £nil for the Society (2018: £nil).

The majority of deferred tax assets are anticipated to be recoverable after one year. The Group's plans indicate that the Group and Society will generate sufficient taxable profits over its five year planning period to absorb the corporation tax losses included within deferred tax at the reporting date, together with those other temporary differences that are expected to reverse during that period.

31. Pensions

Defined contribution schemes

The amount charged to the Income Statement in respect of contributions to the Group's defined contribution and stakeholder pension arrangements is the contribution payable in the year. The total pension cost charged to the Income Statement amounted to £12.2m for the Group (2018: £10.0m) and £5.8m for the Society (2018: £5.2m).

Defined benefit schemes

The Group sponsors two funded defined benefit arrangements and one hybrid arrangement (with a funded defined benefit element). Skipton Pension Trustees Limited, a company that acts as the sole Trustee of each scheme, has been appointed to manage all three schemes:

- The Skipton (2015) Group Pension Scheme (the 'Skipton (2015) Scheme').
- The Connells (2014) Group Pension Scheme (the 'Connells (2014) Scheme').
- The Holmesdale Building Society Pension Scheme (the 'Holmesdale Scheme').

These are separate trustee administered funds holding the pension scheme assets to meet long term liabilities for current and past employees as follows:

- Skipton (2015) Scheme – 738 members
- Connells (2014) Scheme – 992 members
- Holmesdale Scheme – 6 members

The level of retirement benefit in each scheme is principally based on salary and is linked to changes in inflation up to retirement. For all three schemes the level of retirement benefit is based on salary earned in each year of employment prior to leaving active service as follows:

- Skipton (2015) Scheme. There are two separate benefits sections within the scheme, as a result of the merger of two former pension schemes into the Skipton (2015) Scheme, where members' benefits in the former pension schemes were preserved. The benefits are as follows:
  - Old Skipton Scheme - the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service or, for members previously employed by Skipton Financial Services, the annual average salary earned in the last five years of employment prior to leaving active service;
  - Scarborough Scheme - the highest (prior to 2003) or the average (post 2003) annual salary earned in the last three years of employment prior to leaving active service.
- Connells (2014) Scheme. There are three separate benefit sections within the scheme, as the Connells (2014) Scheme is a result of three previous schemes merged into one scheme in 2014. The benefits are as follows:
  - Scheme 1 - the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service;
  - Scheme 2 - the annual average salary earned in the last three years of employment prior to leaving active service;
  - Scheme 3 - the greater of the annual average salary earned in the last three years and the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service.
- Holmesdale Scheme - the highest pensionable salary in the last five years immediately preceding 5 April 2004, or if earlier the highest pensionable salary in the last five years immediately preceding normal retirement date or the last date of employment prior to leaving active service.

The schemes are all closed to new members and to the future accrual of benefits, with the exception of the Scarborough section of the Skipton (2015) Scheme where active members retain a link to salary (capped at 5% per annum). The Scarborough Scheme closed to the future accrual of benefits, subject to the exception noted above, on 1 May 2007, the Connells (2014) Scheme on 1 January 2009, the Skipton (2015) Scheme on 31 December 2009 and the Holmesdale Scheme on 31 March 2004. Following the closure of all the schemes, all active members left pensionable service and became entitled to deferred benefits.

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

The Trustee of each scheme is required to act in the best interests of the scheme's beneficiaries. The appointment of the Trustee is determined by the scheme's trust documentation.

31. Pensions *(continued)*

Full actuarial valuations were carried out as at the dates set out below in accordance with the scheme funding requirements of the Pensions Act 2004 and the funding of each scheme is agreed between the Group and the Trustee in line with those requirements. This legislation requires the deficit to be calculated using prudent, as opposed to best estimate, actuarial assumptions. The most recent actuarial valuations for each of the schemes showed the following:

Scheme	Valuation date	Deficit £m	Recovery period	Annual contribution £m
Skipton (2015)	31 December 2016	43.6	7 years	4.5
Connells (2014)	30 April 2017	44.9	7 years	2.9
Holmesdale	31 December 2017	0.2	5 years	-

The actuarial valuations of each scheme showed deficits and the Group has agreed with the Trustees that it will aim to eliminate the deficit over a specified period by the payment of annual contributions as agreed by the Group and the Trustees. The current best estimate of contributions to be paid by the Group to the schemes for the year commencing 1 January 2020 is £7.4m, for further details of which see page 174. The next actuarial valuation dates for the Skipton and Connells schemes are 31 December 2019 and 30 April 2020 respectively, although the results of these valuations will not be known for some time after these dates.

The pension obligations are valued separately for accounting and funding purposes. For the purposes of IAS 19 *Employee Benefits*, the actuarial valuations, which were carried out by a qualified independent actuary, have been updated on an approximate basis to 31 December 2019. The actuarial valuation deficits shown in the table above will always be different to the IAS 19 accounting deficit of £87.0m (2018: £99.5m) as, in addition to the different dates of each valuation, accounting standards require best estimate assumptions to be used whereas the funding valuation uses more prudent assumptions. There have been no material changes in the valuation methodology adopted for this year's disclosures compared to the previous year's disclosures.

Scheme expenses and levies to the Pension Protection Fund are payable by the Group as and when they are due and are accounted for within the Group's administrative expenses.

The aggregate costs of the three schemes are recognised in accordance with IAS 19.

The main financial assumptions used in the actuarial valuation are as follows:

	Group and Society 2019 %	2018 %
Retail price inflation (RPI)	3.00	3.25
Consumer price inflation (CPI)	2.00	2.25
Discount rate	2.05	2.85
Increases to pension payment:		
in line with RPI, subject to a max of 5% pa	2.95	3.17
in line with RPI, subject to a min of 3% and max of 5% pa	3.52	3.63
in line with RPI, subject to a max of 2.5% pa	2.15	2.23
in line with CPI, subject to a max of 5% pa	2.04	2.27
in line with CPI, subject to a min of 3% and max of 5% pa	3.20	3.26
in line with CPI, subject to a max of 2.5% pa	1.69	1.83
Rate of increase for deferred pensions (in line with CPI, subject to a max of 5% pa)	2.00	2.25
Allowance for commutation of pension for cash at retirement	82% of post A day maximum	82% of post A day maximum

All the schemes' deferred pensions accrue inflationary increases based on CPI rather than RPI, unless the scheme rules specifically refer to RPI.

The most significant non-financial assumption is the assumed rate of longevity. For the year ended 31 December 2019, this has been based on mortality rates that are 100% of the S2PMA_L or S2PFA_L tables for males and females respectively, with an allowance for projected improvements in mortality in line with CMI 2017 improvements with a 1% per annum long term rate of convergence. The tables adopted imply the following life expectancy:

	Life expectancy at age 65 (years) 2019	2018
Male retiring in the current year	22.5	22.9
Female retiring in the current year	23.5	23.9
Male retiring in 15 years' time	23.2	23.9
Female retiring in 15 years' time	24.4	25.1

The table below shows the net pension liability recognised within the Statement of Financial Position:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Fair value of plan assets	183.8	149.0	96.8	80.0
Present value of defined benefit obligations	(270.6)	(248.4)	(145.4)	(132.1)
Impact of asset ceiling	(0.2)	(0.1)	(0.2)	(0.1)
Net pension liability	(87.0)	(99.5)	(48.8)	(52.2)

The present value of scheme liabilities is measured by discounting the best estimate of future cash flows to be paid out by the schemes using the projected unit credit method. The value calculated in this way is reflected in the net liability within the Statement of Financial Position as shown above.

The projected unit credit method is a valuation method in which each potential cash flow from the schemes (for example, annual pension payment or potential lump sum payment on death) is multiplied by an assumed probability of payment and discounted between the valuation date and the time the payment is needed.

All remeasurements are recognised in the year in which they occur in the Statement of Comprehensive Income. As all remeasurements and assets are recognised, the deficits shown above are those recognised within the Statement of Financial Position.

IAS 19 allows an employer to recognise a surplus as an asset to the extent that it is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme, even if the refunds may only be available at some distant time in the future, such as after the last benefit has been paid. The Holmesdale scheme is in surplus on an IAS 19 basis, therefore the amount recognised in the Statement of Financial Position is limited to the asset ceiling. The asset ceiling is the present value of any economic benefits available to the entity in the form of a refund or a reduction in future contributions.

The table below sets out a reconciliation of the present value of the defined benefit obligation for the year:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
At 1 January	248.4	265.5	132.1	142.7
Interest expense	6.9	6.6	3.7	3.6
Remeasurement (gains) / losses arising from changes in:				
Scheme experience	(0.5)	0.4	(0.3)	(0.2)
Demographic assumptions	(5.0)	(1.8)	(2.8)	(1.2)
Financial assumptions	30.7	(13.6)	17.0	(7.2)
Actual benefit payments	(9.9)	(12.5)	(4.3)	(7.7)
Past service costs	-	3.0	-	1.3
Liabilities assumed in a business combination	-	0.8	-	0.8
At 31 December	270.6	248.4	145.4	132.1

There have been no settlements, plan amendments or curtailments in the year.

The estimated average duration of the defined benefit obligation as at 31 December 2019 is 18 years (2018: 18 years).

31. Pensions *(continued)*

The table below sets out the reconciliation of the fair value of scheme assets for the year:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
At 1 January	149.0	165.3	80.0	91.0
Interest income	4.3	4.2	2.3	2.3
Return on plan assets (excluding amounts included in interest income)	25.8	(18.0)	14.3	(9.9)
Contributions by employer	14.6	9.2	4.5	3.5
Benefits paid	(9.9)	(12.5)	(4.3)	(7.7)
Assets acquired in a business combination	-	0.8	-	0.8
At 31 December	183.8	149.0	96.8	80.0

The actual return on the scheme assets, including interest income on plan assets, over the year ended 31 December 2019 was as follows:

- Group £30.1m (2018: £(13.8)m)
- Society £16.6m (2017: £(7.6)m)

The table below sets out the fair value of the scheme assets by each major category:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Diversified growth fund (note 1)	106.1	96.6	55.8	55.4
Liability driven investments (note 2)	40.2	28.4	21.1	15.8
Equities	35.8	22.8	18.7	8.3
Cash	1.1	1.0	0.6	0.3
Corporate Bonds	0.3	0.2	0.3	0.2
Government Bonds	0.3	-	0.3	-
	183.8	149.0	96.8	80.0

Notes

1. Diversified growth funds (DGF) target equity-like returns with lower volatility which is achieved through dynamic diversification. Funds are invested in a diversified range of assets, including equities, bonds, property and cash and the allocation between these asset classes is actively managed by a fund manager reflecting the changing correlations and risk characteristics.
2. Liability driven investments (LDI) are investments in assets which are expected to behave in a similar manner to liabilities and therefore aim to provide a better match against liability movements than conventional bonds or gilts.

Each of the schemes invests in an LDI fund which aims to provide protection against interest rate and inflation movements. The LDI funds aim to cover 50% of the interest rate sensitivity and 100% of the inflation sensitivity of the funded liabilities of each scheme on the scheme funding basis.

None of the fair values of the assets shown above include any of the Group's own financial instruments or any property occupied by, or other assets used by, the Group. All of the schemes' assets have a quoted market price with the exception of the Trustee's bank account balance.

It is the policy of the Trustee and the Group to review the investment strategy at the time of each funding valuation. The Trustee's investment objectives and the processes undertaken to measure and manage the risks inherent in the scheme investment strategy are documented in the scheme's Statement of Investment Principles.

The schemes are exposed to the following investment risks:

Credit risk: this is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Market risk: this comprises currency risk, interest rate risk and other price risk.

- Currency risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates.
- Interest rate risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market interest rates.
- Other price risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The main investment objective for the Trustee of the scheme is to maintain a portfolio of suitable assets to meet, together with future contributions, the benefits payable under the Trust Deed and Rules as they fall due. The scheme has exposure to investment risks because of the investments it makes to implement its investment strategy, as detailed in the Statement of Investment Principles.

The Trustee manages investment risks, including credit risk and market risk, within agreed risk limits which are set taking into account the scheme's strategic investment objectives. These investment objectives and risk limits are implemented through the investment management agreements in place with the scheme's investment managers and are monitored by the Trustee by regular reviews of the investment portfolios.

Credit risk

The schemes invest in pooled investment vehicles and are therefore directly exposed to credit risk in relation to the pooled investment vehicles and are indirectly exposed to credit risks arising on the financial instruments held by the vehicles.

The schemes' holdings in pooled investment vehicles are unrated. Direct credit risk arising from pooled investment vehicles is mitigated by the underlying assets of the pooled arrangements being ring-fenced from the pooled manager, the regulatory environments in which the pooled managers operate and diversification of investments amongst a number of pooled arrangements. The investment manager carries out its own due diligence checks before a new pooled fund is invested in, and on an ongoing basis monitors any changes to the regulatory and operating environment of the underlying pooled investment managers.

Indirect credit risk arises in relation to underlying investments held in the LDI pooled investment vehicles, as well as DGF pooled investment vehicles due to the bond holdings within these funds.

The LDI funds use robust collateralisation management procedures so as to mitigate the impact of credit risk.

Market risk

Currency risk

The schemes do not take explicit unhedged positions in overseas investments through their investment strategy, either directly or indirectly via pooled investment vehicles.

The DGF managers' default position is that any investment in overseas assets is hedged back to Sterling in order to reduce currency risk. The DGF managers may from time to time take unhedged overseas investment positions in pursuit of growth opportunities or to reduce overall fund risk. Overall however, their neutral position is considered to be 100% Sterling.

Interest rate risk

The schemes' assets are subject to indirect interest rate risk through their LDI pooled investment vehicles, as well as DGF pooled investment vehicles due to the bond holdings within these funds.

The schemes' liabilities are exposed to a significant level of interest rate movement and for this reason it is desirable for the assets to also be exposed to interest rate risk. The schemes manage interest rate risk by considering the net risk when taking account of the liabilities valued.

Other price risk

Other price risk arises principally in relation to the schemes' return seeking portfolio which includes DGFs held in pooled investment vehicles, as well as the LDI pooled investment vehicles due to the inflation sensitive elements of the fund. The scheme manages this exposure to other price risk by constructing a diverse portfolio of investments across various markets.

The table below sets out the amounts which have been recognised within the Income Statement. The service costs are recognised in 'Administrative expenses', whilst the net interest expense is recognised in 'Other income'.

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Service cost				
Past service costs	-	3.0	-	1.3
Net interest expense	2.6	2.4	1.4	1.3
Total recognised in Income Statement	2.6	5.4	1.4	2.6

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31. Pensions *(continued)*

The table below sets out the remeasurements of retirement benefit obligations which have been recognised within the Statement of Comprehensive Income:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Remeasurements of retirement benefit obligations:				
Actuarial gains / (losses) arising from:				
Experience adjustments	0.5	(0.4)	0.3	0.2
Demographic assumptions	5.0	1.8	2.8	1.2
Financial assumptions	(30.7)	13.6	(17.0)	7.2
Impact of asset ceiling	(0.1)	(0.1)	(0.1)	(0.1)
Return on plan assets (excluding amounts included in net interest expense)	25.8	(18.0)	14.3	(9.9)
Total amount recognised in Other Comprehensive Income	0.5	(3.1)	0.3	(1.4)

The table below sets out the Group's estimate of the aggregate contributions expected to be paid to the schemes during the year ending 31 December 2020, based on the most recent actuarial valuations.

	Group 2020 £m	Society 2020 £m
Estimated employer contributions		
Ongoing	7.4	4.5
Estimated employee contributions	-	-
Estimated total contributions	7.4	4.5

In line with UK pensions legislation, a formal actuarial valuation ('triennial valuation') of the assets and liabilities of the Schemes is carried out at least every three years by an independent actuary. The results of the most recent triennial valuations are set out on page 170.

32. Subscribed capital

	Group and Society 2019 £m	Group and Society 2018 £m
8.500% Sterling Permanent Interest Bearing Shares	15.2	15.2
12.875% Sterling Permanent Interest Bearing Shares	26.4	26.4
	41.6	41.6

All Permanent Interest Bearing Shares are unsecured and rank pari passu with each other. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated note holders, depositors, payables and investing members of the Society. These shares are measured at amortised cost.

The table below shows the movement during the year in subscribed capital for the Group and the Society.

	Group and Society 2019 £m	Group and Society 2018 £m
Balance at 1 January	41.6	41.6
Changes from financing cash flow:		
Interest paid	(4.5)	(4.5)
Total changes from financing cash flow	(4.5)	(4.5)
Liability-related changes:		
Interest expense	4.5	4.5
Total liability-related changes	4.5	4.5
Balance at 31 December	41.6	41.6

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

Group

	2019 Before-tax amount £m	2019 Tax benefit £m	2019 Net-of-tax amount £m	2018* Before-tax amount £m	2018* Tax benefit / (expense) £m	2018* Net-of-tax amount £m
Financial assets held at FVOCI	(0.4)	0.2	(0.2)	(2.2)	0.6	(1.6)
Cash flow hedges	(3.8)	0.9	(2.9)	1.2	(0.3)	0.9
Cost of hedging reserve	(5.2)	1.4	(3.8)	(0.5)	-	(0.5)
Remeasurements of defined benefit obligations	0.5	0.3	0.8	(3.1)	1.0	(2.1)
Translation of foreign operations	(0.7)	-	(0.7)	-	-	-
Other comprehensive income	(9.6)	2.8	(6.8)	(4.6)	1.3	(3.3)

Society

	2019 Before-tax amount £m	2019 Tax benefit £m	2019 Net-of-tax amount £m	2018* Before-tax amount £m	2018* Tax benefit £m	2018* Net-of-tax amount £m
Financial assets held at FVOCI	(0.4)	0.2	(0.2)	(2.3)	0.5	(1.8)
Cash flow hedges	(3.7)	0.8	(2.9)	0.3	-	0.3
Cost of hedging reserve^	-	1.4	1.4	-	-	-
Remeasurements of defined benefit obligations	0.3	0.2	0.5	(1.4)	0.5	(0.9)
Other comprehensive income	(3.8)	2.6	(1.2)	(3.4)	1.0	(2.4)

* Cash flow hedges is restated as outlined in note 1b).

^ As described in note 1e), a cost of hedging reserve arises in the LLP which relates to any cost of basis spread priced into the cross-currency swap held by the Group in relation to its Euro-denominated covered bond issuances. Any tax ultimately arising would however be borne by the Society, and therefore, in the Society figures above, this tax is shown in the cost of hedging reserve line.

34. Other financial commitments and contingent liabilities

a) The Society has confirmed it will provide continuing support to its subsidiary undertakings that have net liabilities or which rely on it for ongoing funding.

b) As referenced in the Group's half-yearly financial report, a third party supplier has instigated legal proceedings against two Group companies: alleged breach of contract against Gascoigne Halman Limited and a related alleged tortious claim against Connells Limited. The Directors believe, based on legal advice, that it is probable their defence will succeed and any liabilities not provided for in these Group consolidated financial statements will not be material. Having taken legal and expert advice, the Directors believe that the quantum of the claim cannot be supported and cannot, at this time, reliably estimate the quantum of the potential liabilities that may, ultimately, arise from this matter. Whilst the outcome of the case cannot be predicted with certainty, the Directors believe that, should their defence be unsuccessful, the final outcome will not materially affect the Group's consolidated financial position.

c) Total commitments under non-cancellable operating leases are as follows:

Group	2019 Land and buildings £m	2019 Other £m	2018 Land and buildings £m	2018 Other £m
Amounts falling due:				
Within one year	-	-	18.9	0.2
Within two to five years inclusive	-	-	31.5	0.1
Over five years	-	-	18.8	-
	-	-	69.2	0.3

34. Other financial commitments and contingent liabilities *(continued)*

Society	2019		2018	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Amounts falling due:				
Within one year	-	-	3.5	0.1
Within two to five years inclusive	-	-	8.5	-
Over five years	-	-	4.2	-
	-	-	16.2	0.1

As explained in note 1b), the Group has adopted IFRS 16 *Leases* with effect from 1 January 2019. Under IFRS 16, leases are no longer accounted for as operating leases but are instead held on the balance sheet (subject to limited exemptions for certain short-term leases and leases of low-value assets). For further details of the impacts of IFRS 16 adoption for the Group and the Society, see note 1b).

At 31 December 2018, the Group's commitments under non-cancellable operating leases for land and buildings included £67.7m relating to properties occupied by the Group used in the ordinary course of business, £1.4m relating to properties occupied by sub-tenants and £0.1m relating to buildings that were unoccupied.

At 31 December 2018, the Society's total land and buildings commitments related to branches used in the ordinary course of business, or former branches, £0.1m of which related to former branches that were unoccupied at 31 December 2018.

35. Derivative financial instruments

The Group uses derivative financial instruments (derivatives) to manage the risks arising from its operations.

The Board has authorised the use of derivatives by the Group to reduce the risk of loss arising from changes in market risks in accordance with Section 9A (4) of the Building Societies Act 1986 and derivatives are used by the Group for economic hedging purposes only. The Group does not run a trading book.

The principal derivatives used by the Group are interest rate swaps, index swaps and cross currency swaps that are used to hedge Group Statement of Financial Position (SOFP) exposures. The accounting policies for derivatives are described in note 1e) to the Accounts.

For the purpose of assessing hedge effectiveness, the Group determines the economic relationship between the hedged item and the hedging instrument by comparing the terms of each item, including reference rate, notional amount and maturity.

Risk management strategy

The Group has a formal structure for managing risk, including established risk limits, reporting requirements, mandates and other control procedures. This structure is reviewed regularly by the Asset & Liability Committee (ALCO).

Interest rate risk

The main market risk faced by the Group is interest rate risk. Interest rate risk is the risk that the fair values of financial assets or financial liabilities, or future cash flows receivable or payable on financial assets or financial liabilities, fluctuate as a result of changes in market interest rates.

Interest rate risk predominantly arises on the fixed rate mortgages and savings products offered by the Group. Further detail on the Group's exposure to interest rate risk is found in note 37.

The Group uses the following derivatives to hedge its exposure to interest rate risk:

Fair value hedges of interest rate risk

Portfolio hedging

The Group manages the interest rate risk arising from fixed rate mortgages and savings by entering into swaps on a frequent basis. The level of exposure from the mortgage portfolio frequently changes due to new loans being originated, contractual customer repayments and early customer repayments. As a result the Group adopts a dynamic hedging strategy to hedge the interest rate risk component within the exposure profile by entering into new swap agreements each month. The Group uses a portfolio of fair value hedges of interest rate risk to recognise fair value changes related to changes in interest rate risk on fixed rate mortgages and savings products, to therefore reduce the profit or loss volatility that would otherwise occur from changes in the fair value of the interest rate swaps alone.

The hedge relationship is reassessed prospectively each month in order that the ratio between the notional value of the hedged items and the notional value of the hedging instruments is recalibrated to be close to 100%.

Occasionally hedge ineffectiveness can arise, i.e. the derivative fails to hedge the interest rate risk to the extent that is expected. The Group assesses hedge ineffectiveness on an ongoing basis. Where the Group assesses that any existing basis risk within the hedge relationship has changed to such an extent that the existing hedge ratio is no longer suitable, the hedging relationship would be rebalanced.

The main sources of ineffectiveness in fair value hedges of interest rate risk are:

- Differences between the expected and actual volume of customer prepayments, as the Group hedges to the expected repayment date taking into account expected prepayments based on past experience;
- Differences in the timing of cash flows from monthly mortgage redemptions and cash flows from quarterly or annual interest payments or receipts on interest rate swaps; and
- Differences in the maturities of the interest rate swap and the mortgage loans.

Micro hedging

Additionally, fair value hedge relationships are designated for hedging the interest rate risk component arising from the Group's liquidity portfolio and Medium Term Note (MTN) liabilities. For these items, a hedge is taken out specifically for the individual asset or liability, and therefore critical terms of the hedged item and hedging instrument match. Where critical terms match, the fair value adjustment on the hedged item offsets exactly the change in fair value of the hedging instrument.

Fair value gains or losses on derivatives held in qualifying fair value hedging relationships and the hedging gain or loss on the hedged item are included in the 'Fair value gains / (losses) on hedging instruments and hedged items' line in the Income Statement.

The Group assesses all of its micro fair value hedges of interest rate risk to have a hedge effectiveness ratio of 100%, as all derivatives hedge an amount of underlying instrument equal to the notional amount.

Hedge ineffectiveness could potentially arise if amendments were made to either the hedged item or the hedging instrument, or if there were significant changes in the credit rating of the hedged item or hedging instrument's counterparties; the Group has assessed the likelihood of this to be low.

Cash flow hedges of interest rate risk

The Group also has exposure to interest rate risk arising from its free reserves portfolio, which is composed of reserves held in excess of required reserves. The Group uses derivatives to hedge this risk component and accounts for these derivatives as cash flow hedges against variable rate instruments. The aim of cash flow hedging is to reduce the exposure to variability in cash flows arising from a financial asset or liability. The variable rate on the hedging instrument, or swap, offsets the hedged items, which are LIBOR-linked financial assets or liabilities.

Hedge ineffectiveness for cash flow hedges is assessed using the 'hypothetical derivative' method and ineffectiveness has been assessed as £nil (2018: £nil) for the Group's cash flow hedges.

Hedge ineffectiveness could potentially arise if amendments were made to either the hedged item or the hedging instrument, or if there were significant changes in the credit rating of the hedged item or hedging instrument's counterparties; the Group has assessed the likelihood of this to be low.

Currency risk

The Group's exposure to foreign currency risk arises predominantly as a result of issuing Euro-denominated regulated covered bonds to the wholesale funding market.

Fair value hedges of currency risk

The Group has entered into a cross-currency swap agreement to hedge the foreign currency risk and interest rate risk components arising from the Society's Euro covered bond issuances. Fixed rate Euro-denominated receipts are swapped to floating rate Sterling payments through these derivatives. The derivative is entered into by the LLP, with the hedged item being the term advance from the Society to the LLP, which mirrors the bond issued by the Society. Foreign currency basis spread is priced into the derivative but is excluded from the hedging relationship as permitted by IFRS 9. Any gain or loss caused by this is recognised directly in reserves in the cost of hedging reserve.

Equity release portfolio

In addition to the above, the Group holds derivative financial instruments to economically hedge the equity release portfolio which do not qualify as being in a designated hedging relationship for accounting purposes. As the derivatives held to hedge the equity release portfolio are not in a hedge accounting relationship, they are not included in the tables on pages 178 to 183. Further information on the derivatives held to hedge this portfolio can be found on page 154.

Other derivatives not held in an accounting hedge

Certain other derivatives cannot be accounted for in a fair value or cash flow hedge as the economic hedging relationship does not meet the criteria set out by IFRS 9. These derivatives are held at FVTPL and their change in fair value is included in the 'Fair value gains / (losses) on hedging instruments and hedged items' line in the Income Statement.

35. Derivative financial instruments *(continued)*

Hedging instruments

The following table sets out the maturity profile and average price and rate of the hedging instruments used in the Group's hedge accounting strategies.

Group	2019				2018			
	Up to 3 months	3 – 12 months	1 – 5 years	Over 5 years	Up to 3 months	3 – 12 months	1 – 5 years	Over 5 years
Cash flow hedges:								
Interest rate swaps								
Notional (£m)	**39.0**	**51.6**	**756.0**	**144.0**	-	44.0	145.6	-
Average fixed interest rate (%)	1.8%	1.9%	0.6%	0.6%	-	2.1%	1.6%	-
Fair value hedges:								
Interest rate swaps								
Notional (£m)	**1,505.7**	**5,761.1**	**13,061.2**	**275.5**	1,739.4	6,699.1	10,298.7	315.5
Average fixed interest rate (%)	0.8%	0.8%	0.8%	0.9%	0.7%	0.8%	0.9%	1.2%
Cross currency swaps								
Notional (£m)	**-**	**-**	**891.6**	**-**	-	-	448.1	-
Average fixed interest rate (%)	-	-	0.3%	-	-	-	0.5%	-

Society	2019				2018			
	Up to 3 months	3 – 12 months	1 – 5 years	Over 5 years	Up to 3 months	3 – 12 months	1 – 5 years	Over 5 years
Cash flow hedges:								
Interest rate swaps								
Notional (£m)	**39.0**	**51.6**	**815.0**	**144.0**	-	44.0	223.7	-
Average fixed interest rate (%)	1.8%	1.9%	0.6%	0.6%	-	2.1%	1.4%	-
Fair value hedges:								
Interest rate swaps								
Notional (£)	**1,558.1**	**5,919.8**	**13,967.7**	**281.0**	1,804.0	6,749.1	10,921.7	315.5
Average fixed interest rate (%)	0.8%	0.8%	0.8%	0.9%	0.7%	0.8%	0.9%	1.2%

The table below provides further detail on the Group's fair value hedges used in hedge accounting relationships:

2019	Notional	Carrying amount Assets	Carrying amount Liabilities	SOFP line	Change in fair value (charge) / credit (note 1)	Hedge ineffectiveness (charge) / credit (note 2)	Income Statement line
Group	£m	£m	£m		£m	£m	
Interest rate swaps	**20,603.5**	**28.4**	**(105.5)**	note 3	**(80.7)**	**(6.7)**	note 4
Cross currency swaps	**891.6**	**-**	**(41.7)**	note 3	**(42.4)**	**(0.1)**	note 4
Society							
Interest rate swaps	**21,726.6**	**36.5**	**(106.8)**	note 3	**(74.7)**	**(5.2)**	note 4

2018	Notional	Carrying amount Assets	Carrying amount Liabilities	SOFP line	Change in fair value (charge) / credit (note 1)	Hedge ineffectiveness (charge) / credit (note 2)	Income Statement line
Group							
Interest rate swaps	19,052.7	61.0	(57.4)	note 3	1.9	5.4	note 4
Cross currency swaps	448.1	5.9	-	note 3	6.4	-	note 4
Society							
Interest rate swaps	19,790.3	63.3	(58.9)	note 3	(1.8)	5.3	note 4

Notes

1. The change in fair value during the period that was used as the basis for calculating hedge ineffectiveness and which was recognised in the Income Statement during the period.
2. The amount of hedge ineffectiveness recognised in the Income Statement during the period.
3. The Statement of Financial Position line that includes these items is 'Derivative financial instruments'.
4. The Income Statement line that includes the hedge ineffectiveness recognised during the period is 'Fair value gains / (losses) on hedging instruments and hedged items'.

The table below provides further detail on the Group's cash flow hedges used in hedge accounting relationships.

2019	Notional	Carrying amount Assets	Carrying amount Liabilities	SOFP line	Change in fair value credit / (charge) (note 1)	Change in fair value recognised in OCI credit / (charge) (note 2)	Hedge ineffect-iveness (note 2)	Income Statement line	Gains reclassified from OCI to Income Statement
Group	£m	£m	£m		£m	£m	£m		£m
Interest rate swaps	**990.6**	**5.5**	**(0.8)**	note 3	**1.9**	**1.9**	**-**	note 4	**6.9**
Society									
Interest rate swaps	**1,049.6**	**5.5**	**(1.4)**	note 3	**2.0**	**2.0**	**-**	note 4	**6.9**

2018	Notional	Carrying amount Assets	Carrying amount Liabilities	SOFP line	Change in fair value credit / (charge) (note 1)	Change in fair value recognised in OCI credit / (charge) (note 2)	Hedge ineffect-iveness (note 2)	Income Statement line	Gains reclassified from OCI to Income Statement
Group									
Interest rate swaps	189.6	3.1	(0.3)	note 3	(2.5)	(2.5)	-	note 4	-
Society									
Interest rate swaps	267.7	3.1	(1.0)	note 3	(2.9)	(2.9)	-	note 4	-

Notes

1. The change in fair value during the period that was used as the basis for calculating hedge ineffectiveness.
2. The amount of hedge ineffectiveness recognised in the Income Statement during the period.
3. The Statement of Financial Position line that includes these items is 'Derivative financial instruments'.
4. The Income Statement line that includes any hedge ineffectiveness recognised during the period is 'Fair value gains / (losses) on hedging instruments and hedged items'.

35. Derivative financial instruments *(continued)*

Hedged items

The tables below provide further detail on the Group's hedged items:

Group – 2019

	Carrying amount Assets £m	Carrying amount Liabilities £m	Fair value adjustments on hedged item (note 1) £m	SOFP line	Change in fair value credit / (charge) (note 2) £m	Amount remaining on items de-designated from hedge relationship (note 3) £m
Cash flow hedges:						
Floating rate assets	587.0	-	n/a	note 4	n/a	(8.1)
Floating rate liabilities	-	403.6	n/a	note 5	n/a	0.4
Fair value hedges:						
Fixed rate mortgages	13,170.9	-	57.7	note 6	74.1	-
Debt securities	718.3	-	2.7	note 4	(0.4)	-
Fixed rate savings	-	6,140.8	2.3	note 7	(18.1)	-
Covered bonds	-	813.7	(35.6)	note 5	41.9	-
Debt securities in issue	-	349.5	(0.4)	note 5	(4.3)	-

Group – 2018*

	Carrying amount Assets £m	Carrying amount Liabilities £m	Fair value adjustments on hedged item (note 1) £m	SOFP line	Change in fair value credit / (charge) (note 2) £m	Amount remaining on items de-designated from hedge relationship (note 3) £m
Cash flow hedges:						
Floating rate assets	189.6	-	n/a	note 4	n/a	0.6
Floating rate liabilities	-	-	n/a	note 5	n/a	1.0
Fair value hedges:						
Fixed rate mortgages	11,233.3	-	(16.4)	note 6	(10.8)	-
Debt securities	417.6	-	3.1	note 4	(2.0)	-
Fixed rate savings	-	6,427.6	(15.8)	note 7	26.7	-
Covered bonds	-	454.7	6.3	note 5	(6.3)	-
Debt securities in issue	-	345.2	(4.7)	note 5	0.5	-

* Restated as described in note 1b).

Society – 2019

	Carrying amount Assets £m	Carrying amount Liabilities £m	Fair value adjustments on hedged item (note 1) £m	SOFP line	Change in fair value credit / (charge) (note 2) £m	Amount remaining on items de-designated from hedge relationship (note 3) £m
Cash flow hedges:						
Floating rate assets	587.0	-	n/a	note 4	n/a	(8.1)
Floating rate liabilities	-	462.6	n/a	note 5	n/a	1.7
Fair value hedges:						
Fixed rate mortgages	13,399.1	-	51.6	note 6	67.8	-
Debt securities	728.4	-	2.7	note 4	(0.4)	-
Fixed rate savings	-	6,985.7	0.2	note 7	(16.6)	-
Debt securities in issue	-	349.5	(0.4)	note 5	(4.3)	-

Society – 2018*

	Carrying amount Assets £m	Carrying amount Liabilities £m	Fair value adjustments on hedged item (note 1) £m	SOFP line	Change in fair value credit / (charge) (note 2) £m	Amount remaining on items de-designated from hedge relationship (note 3) £m
Cash flow hedges:						
Floating rate assets	267.7	-	n/a	note 4	n/a	0.6
Floating rate liabilities	-	-	n/a	note 5	n/a	1.0
Fair value hedges:						
Fixed rate mortgages	11,377.5	-	(16.2)	note 6	(8.2)	-
Debt securities	417.6	-	3.1	note 4	(2.0)	-
Fixed rate savings	-	7,021.0	(16.4)	note 7	26.2	-
Debt securities in issue	-	345.2	(4.7)	note 5	0.5	-

* Restated as described in note 1b).

Notes

1. Fair value adjustments on hedged items are included within the Statement of Financial Position as adjustments to the relevant SOFP line; see below notes for details.
2. The change in fair value during the period that is used as the basis for calculating hedge ineffectiveness.
3. The accumulated amount of fair value hedge adjustments remaining (in the Statement of Financial Position for fair value hedges; in the cash flow hedging reserve for cash flow hedges) for any hedged items that have ceased to be adjusted for hedging gains and losses.
4. The Statement of Financial Position line that includes these items is 'Debt securities'.
5. The Statement of Financial Position line that includes these items is 'Debt securities in issue'.
6. The Statement of Financial Position line that includes these items is 'Loans and advances to customers'.
7. The Statement of Financial Position line that includes these items is 'Shares' and 'Amounts owed to other customers' in Group and 'Shares' in Society.

35. Derivative financial instruments *(continued)*

	2019				
	Carrying amount			Change in fair value recognised in OCI	Amount reclassified from OCI to Income Statement
Group	Notional £m	Assets £m	Liabilities £m	£m	£m
Cross currency swaps	**891.6**	**-**	**(41.7)**	**(5.2)**	**-**
	2018				
Cross currency swaps	448.1	5.9	-	(0.5)	-

The table below provides an analysis of amounts recognised in other comprehensive income resulting from hedge accounting during the period:

	2019					
	Group			Society		
	Cash flow hedging reserve £m	Cost of hedging reserve £m	Total £m	Cash flow hedging reserve £m	Cost of hedging reserve £m	Total £m
Balance at 1 January 2019	(0.4)	(0.5)	**(0.9)**	0.2	-	**0.2**
Change in fair value of derivatives in effective hedging relationships:						
Held to hedge interest rate risk	2.2	(5.2)	**(3.0)**	2.2	-	**2.2**
Net amounts reclassified to profit or loss from derivatives:						
Held to hedge interest rate risk	(6.0)	-	**(6.0)**	(5.9)	-	**(5.9)**
Tax on movements in reserves during the period	0.9	1.4	**2.3**	0.8	1.4	**2.2**
Balance at 31 December 2019	**(3.3)**	**(4.3)**	**(7.6)**	**(2.7)**	**1.4**	**(1.3)**

	2018*				
	Group			Society	
	Cash flow hedging reserve £m	Cost of hedging reserve £m	Total £m	Cash flow hedging reserve £m	Total £m
Balance at 1 January 2018	(1.3)	-	(1.3)	(0.1)	(0.1)
Change in fair value of derivatives in effective hedging relationships:					
Held to hedge interest rate risk	(2.2)	(0.5)	(2.7)	(2.9)	(2.9)
Net amounts reclassified to profit or loss from derivatives:					
Held to hedge interest rate risk	3.4	-	3.4	3.2	3.2
Tax on movements in reserves during the period	(0.3)	-	(0.3)	-	-
Balance at 31 December 2018	(0.4)	(0.5)	(0.9)	0.2	0.2

* 'Balance at 1 January 2018', 'Net amounts reclassified to profit or loss from derivatives' and 'Tax on movements in reserves during the period' are restated as outlined in note 1b).

Interest rate benchmark reform (IBOR reform)

The Group is exposed to the benchmark interest rate GBP LIBOR within its hedge accounting relationships. This benchmark rate is subject to interest rate benchmark reform. As noted in note 1b), the Group's impacted hedged items include fixed rate Sterling mortgage lending, fixed rate Sterling savings balances, foreign currency risk associated with the Group's Euro-denominated covered bond issuances and GBP LIBOR linked investments.

The Group has established a project to manage the transition for any of its contracts that may be affected. The project is sponsored by the Group Finance Director.

The table below indicates the nominal amount and weighted average maturity of the Group's derivatives in hedging relationships that will be affected by IBOR reform. The derivative hedging instruments provide a close approximation to the extent of the risk exposure the Group manages through hedging relationships.

	Group		Society	
	Nominal amount £m	Average maturity Years	Nominal amount £m	Average maturity Years
Interest rate swaps:				
LIBOR GBP (3 months)	771.1	1.3	771.1	1.3
Cross-currency swaps:				
LIBOR GBP (1 month) to Euro (fixed)	448.1	3.8	-	n/a
Total at 31 December 2019	**1,219.2**		**771.1**	

36. Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost. It is an inherent part of the Group's business as long term mortgages are funded mainly by shorter term retail customer balances. Mortgages can have a contractual maturity date of, for example, 25 years but in practice are frequently repaid early; conversely retail deposits, nominally repayable on demand or with short notice periods, frequently remain with the Group beyond their contractual notice. It is this mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity policy is designed to ensure the maintenance of sufficient liquid assets to cover statutory, regulatory and operational requirements. This is achieved through maintaining a sufficient level of liquid assets in realisable form to ensure the Group is able to meet its liabilities as they arise and to absorb potential cash flow requirements created by the maturity mismatches referred to above or by a liquidity stress scenario. ALCO manages liquidity under delegated authority, within risk appetite limits established by the Board, and also monitors the composition of liquidity in line with risk management objectives.

The Group's liquidity is managed as follows:

- the Board establishes limits over the quantity and quality of the Group's portfolio of liquid assets. The portfolio is managed by the Treasury function, monitored by the Market & Liquidity Risk function and overseen by ALCO under a series of delegated authorities;
- the Group's Market & Liquidity Risk function conducts a series of daily, weekly and monthly stress tests that are designed to ensure that the Group's liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding; and
- under the Regulatory liquidity regime, the Group is required to hold highly liquid assets (such as government and supranational debt securities and cash) to satisfy the Liquidity Coverage Ratio (LCR).

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

- LCR – which analyses daily the amount of high quality liquidity that it is necessary to hold; and
- liquidity stress tests – whereby, as noted above, the Group models how far its liquid asset holdings would fall under a number of different stress scenarios.

36. Liquidity risk *(continued)*

The tables below analyse the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining maturity period at the reporting date to the contractual maturity. In practice, customer deposits, i.e. shares, amounts owed to credit institutions and amounts owed to other customers, are likely to be repaid later than on the earliest date on which repayment can be required.

Group	2019					
	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets:						
Cash in hand and balances with the Bank of England	1,793.1	-	-	-	-	**1,793.1**
Loans and advances to credit institutions	544.7	1.5	-	0.4	-	**546.6**
Debt securities	-	331.1	692.0	1,038.3	121.5	**2,182.9**
Derivative financial instruments	-	1.8	5.6	26.8	4.3	**38.5**
Loans and advances to customers held at amortised cost	102.7	29.7	58.2	649.5	19,225.5	**20,065.6**
Loans and advances to customers held at FVTPL	1.5	-	-	-	-	**1.5**
Equity release portfolio at FVTPL	-	2.2	11.0	60.7	336.1	**410.0**
Equity share investments	-	-	-	-	1.5	**1.5**
Trade receivables	18.3	12.4	-	-	-	**30.7**
Contingent consideration	-	-	6.3	11.6	-	**17.9**
Share warrants	3.2	-	-	-	-	**3.2**
Other assets	-	3.2	-	-	-	**3.2**
Total financial assets	**2,463.5**	**381.9**	**773.1**	**1,787.3**	**19,688.9**	**25,094.7**
Liabilities:						
Shares	4,275.2	10,150.7	1,722.8	1,212.3	3.1	**17,364.1**
Amounts owed to credit institutions	23.6	13.1	2.4	1,639.2	-	**1,678.3**
Amounts owed to other customers	448.7	380.7	817.7	169.8	-	**1,816.9**
Debt securities in issue	-	0.2	-	2,302.4	-	**2,302.6**
Derivative financial instruments	-	3.9	17.8	176.9	162.5	**361.1**
Lease liabilities	-	4.2	9.8	38.6	14.0	**66.6**
Trade payables	-	6.7	-	-	-	**6.7**
Fair value of put option obligation	-	-	7.5	-	-	**7.5**
Subscribed capital	-	-	-	-	41.6	**41.6**
Total financial liabilities	**4,747.5**	**10,559.5**	**2,578.0**	**5,539.2**	**221.2**	**23,645.4**
Net liquidity gap	**(2,284.0)**	**(10,177.6)**	**(1,804.9)**	**(3,751.9)**	**19,467.7**	**1,449.3**

Group	2018*					
	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets:						
Cash in hand and balances with the Bank of England	2,395.7	-	-	-	-	2,395.7
Loans and advances to credit institutions	370.7	52.0	-	-	-	422.7
Debt securities	-	195.8	461.5	537.8	188.0	1,383.1
Derivative financial instruments	-	7.2	19.9	42.9	2.3	72.3
Loans and advances to customers held at amortised cost	95.8	35.1	50.7	594.5	17,342.9	18,119.0
Loans and advances to customers held at FVTPL	1.9	-	-	-	-	1.9
Equity release portfolio at FVTPL	-	2.1	9.7	52.9	346.2	410.9
Equity share investments	-	-	-	-	0.8	0.8
Trade receivables	18.2	13.1	-	-	-	31.3
Contingent consideration	-	-	6.1	16.9	-	23.0
Total financial assets	2,882.3	305.3	547.9	1,245.0	17,880.2	22,860.7
Liabilities:						
Shares	3,865.5	9,653.1	1,378.8	1,214.3	1.8	16,113.5
Amounts owed to credit institutions	1.6	16.9	0.8	1,858.7	-	1,878.0
Amounts owed to other customers	413.5	366.8	682.7	227.5	-	1,690.5
Debt securities in issue	-	87.3	0.5	1,332.5	-	1,420.3
Derivative financial instruments	-	5.0	15.9	86.9	171.6	279.4
Trade payables	-	5.4	-	-	-	5.4
Fair value of put option obligation	-	-	7.0	1.3	-	8.3
Subscribed capital	-	-	-	-	41.6	41.6
Total financial liabilities	4,280.6	10,134.5	2,085.7	4,721.2	215.0	21,437.0
Net liquidity gap	(1,398.3)	(9,829.2)	(1,537.8)	(3,476.2)	17,665.2	1,423.7

* Loans and advances to customers held at amortised cost and shares are restated as outlined in note 1b).

36. Liquidity risk *(continued)*

Society — 2019

	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets:						
Cash in hand and balances with the Bank of England	1,793.1	-	-	-	-	1,793.1
Loans and advances to credit institutions	465.4	-	-	0.4	-	465.8
Debt securities	-	227.9	587.2	1,095.9	121.5	2,032.5
Derivative financial instruments	-	1.9	6.1	34.4	4.2	46.6
Loans and advances to customers held at amortised cost	1.1	19.5	27.7	454.3	17,389.0	17,891.6
Loans and advances to customers held at FVTPL	1.5	-	-	-	-	1.5
Equity release portfolio at FVTPL	-	2.2	11.0	60.7	336.1	410.0
Loans to subsidiary undertakings	777.9	-	-	-	-	777.9
Trade receivables	1.4	-	-	-	-	1.4
Total financial assets	3,040.4	251.5	632.0	1,645.7	17,850.8	23,420.4
Liabilities:						
Shares	4,275.2	10,150.7	1,722.8	1,212.3	1.3	17,362.3
Amounts owed to credit institutions	20.9	62.3	2.0	1,658.4	-	1,743.6
Amounts owed to other customers	187.8	6.5	81.4	139.7	-	415.4
Debt securities in issue	-	-	-	2,194.9	-	2,194.9
Derivative financial instruments	-	4.0	18.0	137.3	162.4	321.7
Lease liabilities	-	0.6	1.8	6.9	3.2	12.5
Trade payables	-	2.5	-	-	-	2.5
Subscribed capital	-	-	-	-	41.6	41.6
Total financial liabilities	4,483.9	10,226.6	1,826.0	5,349.5	208.5	22,094.5
Net liquidity gap	(1,443.5)	(9,975.1)	(1,194.0)	(3,703.8)	17,642.3	1,325.9

Society — 2018*

	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets:						
Cash in hand and balances with the Bank of England	2,395.7	-	-	-	-	2,395.7
Loans and advances to credit institutions	299.4	50.1	-	-	-	349.5
Debt securities	-	212.8	342.0	602.1	188.0	1,344.9
Derivative financial instruments	-	7.3	20.3	39.2	1.4	68.2
Loans and advances to customers held at amortised cost	1.8	22.6	23.4	405.1	15,538.3	15,991.2
Loans and advances to customers held at FVTPL	1.9	-	-	-	-	1.9
Equity release portfolio at FVTPL	-	2.1	9.7	52.9	346.2	410.9
Loans to subsidiary undertakings	854.4	-	-	-	-	854.4
Trade receivables	1.3	0.5	-	-	-	1.8
Total financial assets	3,554.5	295.4	395.4	1,099.3	16,073.9	21,418.5
Liabilities:						
Shares	3,865.5	9,653.1	1,378.8	1,214.3	0.4	16,112.1
Amounts owed to credit institutions	1.8	138.6	0.8	1,858.7	-	1,999.9
Amounts owed to other customers	154.3	165.0	25.7	184.2	-	529.2
Debt securities in issue	-	3.5	0.5	1,190.4	-	1,194.4
Derivative financial instruments	-	5.0	16.0	89.7	171.6	282.3
Trade payables	-	1.8	-	-	-	1.8
Subscribed capital	-	-	-	-	41.6	41.6
Total financial liabilities	4,021.6	9,967.0	1,421.8	4,537.3	213.6	20,161.3
Net liquidity gap	(467.1)	(9,671.6)	(1,026.4)	(3,438.0)	15,860.3	1,257.2

* Loans and advances to customers held at amortised cost and shares are restated as outlined in note 1b).

Loans and advances to customers classified as repayable on demand represent those loans and advances that are on call and at short notice.

Group debt securities in issue include £100.4m (2018: £219.6m) of funding obtained through the Group's securitisation issuances carried out through Darrowby No. 4 plc (and in 2018 Darrowby No. 3 plc). The final maturity dates of the securitisation notes are significantly out into the future, however the Group can exercise call options to repurchase the outstanding notes at dates within the next 5 years and these are expected to be exercised. As a result all such amounts have been shown within less than 5 years in the tables above.

The following table is an analysis of undiscounted gross contractual cash flows payable on financial liabilities:

Group — 2019

	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	14,427.8	1,738.4	1,259.1	3.1	17,428.4
Amounts owed to credit institutions, other customers and debt securities in issue	874.1	847.2	4,184.4	-	5,905.7
Derivative financial instruments	13.1	47.3	158.4	157.5	376.3
Lease liabilities	4.5	10.7	40.0	17.8	73.0
Trade payables	6.7	-	-	-	6.7
Fair value of put option obligation	-	7.5	-	-	7.5
Subscribed capital	1.6	2.9	18.0	44.9	67.4
	15,327.8	2,654.0	5,659.9	223.3	23,865.0

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36. Liquidity risk *(continued)*

Group	Up to 3 months £m	3-12 months £m	2018 1-5 years £m	Over 5 years £m	Total £m
Shares	13,521.1	1,391.2	1,262.2	1.8	16,176.3
Amounts owed to credit institutions, other customers and debt securities in issue	890.2	716.7	3,497.7	-	5,104.6
Derivative financial instruments	8.8	38.6	159.3	173.7	380.4
Trade payables	5.4	-	-	-	5.4
Fair value of put option obligation	-	7.0	1.4	-	8.4
Subscribed capital	1.6	2.9	18.0	44.9	67.4
	14,427.1	2,156.4	4,938.6	220.4	21,742.5

The undiscounted gross contractual cash flows of debt securities in issue that have been issued as securitisation funding in the tables above have been calculated on the assumption that the call options referred to on page 187 are exercised.

Society	**Up to 3 months £m**	**3-12 months £m**	**2019 1-5 years £m**	**Over 5 years £m**	**Total £m**
Shares	14,427.8	1,738.4	1,259.1	1.3	**17,426.6**
Amounts owed to credit institutions, other customers and debt securities in issue	284.1	110.7	4,063.4	-	**4,458.2**
Derivative financial instruments	9.8	37.9	114.0	157.0	**318.7**
Lease liabilities	0.8	2.1	7.4	3.0	**13.3**
Trade payables	2.5	-	-	-	**2.5**
Subscribed capital	1.6	2.9	18.0	44.9	**67.4**
	14,726.6	**1,892.0**	**5,461.9**	**206.2**	**22,286.7**

Society	Up to 3 months £m	3-12 months £m	2018 1-5 years £m	Over 5 years £m	Total £m
Shares	13,521.1	1,391.2	1,262.2	0.4	16,174.9
Amounts owed to credit institutions, other customers and debt securities in issue	468.0	49.4	3,306.2	-	3,823.6
Derivative financial instruments	9.4	39.8	161.9	173.7	384.8
Trade payables	1.8	-	-	-	1.8
Subscribed capital	1.6	2.9	18.0	44.9	67.4
	14,001.9	1,483.3	4,748.3	219.0	20,452.5

Amounts owed to other customers in the Society tables above include a deemed loan from the Group's securitisation vehicle Darrowby No. 4 plc, which arises from the funding transactions carried out through this entity. The undiscounted gross contractual cash flows arising on this loan have been calculated on the assumption that the call options referred to on page 187 are exercised.

37. Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk (including the use of derivatives) and foreign currency risk.

The Group's Treasury function is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's Treasury policy, which is reviewed and recommended by ALCO and approved by the Board. The Group's Market & Liquidity Risk function measures and monitors adherence to the Treasury policy and reports regularly on all aspects of market risk exposure, including interest rate risk and foreign currency risk.

a) Interest rate risk

The main market risk faced by the Group is interest rate risk.

The Group uses a number of different metrics to monitor interest rate risk and details of these are set out below.

The Group monitors interest rate risk exposure against limits by determining the effect on the Group's current net notional value of assets and liabilities for a parallel shift in interest rates equivalent to 2% for all maturities, in line with regulatory requirements. These results are compared to the Board limit and operational trigger at least weekly, and are formally reported to ALCO and the Board monthly.

Other interest rate risk metrics employed by the Group incorporate earnings-at-risk and market value methodologies. The market value exposure position is calculated using at least 250 monthly yield curve movements from, approximately, the last seven years. The earnings-at-risk methodology is calculated using at least 100 stochastically (randomly) generated rate paths. Both of these approaches employ 95% confidence intervals. The outputs of these interest rate risk measurement methodologies are compared to their respective Board limits and operational triggers at least weekly and are reported to ALCO and the Board monthly. All these measures are used to guide interest rate risk management decisions.

The levels of Group interest rate risk exposures throughout the reporting period, based on measures taken at each month end, were as follows:

	As at 31 December 2019 £m	**Average 2019 £m**	**High 2019 £m**	**Low 2019 £m**	As at 31 December 2018 £m
Static earnings-at-risk	**6.0**	**4.6**	**7.8**	**2.5**	7.4
Historical value-at-risk	**0.2**	**0.4**	**0.8**	**0.2**	0.1
2% parallel interest rate shift	**0.4**	**4.4**	**7.6**	**0.4**	0.1

Although these measures provide valuable insights into the market risk to which the Group is exposed, they need to be viewed in the context of the following limitations:

- Historical data is not necessarily the best guide to future events, but is a reasonable proxy;
- The use of 95% confidence levels, by definition, does not take account of changes that may occur beyond this level of confidence and therefore may not fully take into account the most extreme events; and
- Exposures are calculated on static Statement of Financial Position positions and therefore future changes in the structure of the Statement of Financial Position are ignored.

Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics, for example LIBOR and Bank of England Base Rate), are also monitored closely and regularly reported to ALCO.

b) Currency risk

The currency risk appetite of the Group is low and any funding issues denominated in foreign currency are immediately swapped into Sterling.

The Group has issued two regulated covered bonds in Euros totalling €1,000m (2018: one bond, €500m). The exposure to foreign currency fluctuations on these bonds are fully hedged as derivative contracts were taken out to swap the Euros into Sterling on issuance of the covered bonds.

The Group has investments in its subsidiary undertakings Jade Software Corporation Limited and Northwest Investments NZ Limited, which are denominated in New Zealand Dollars. The foreign currency fluctuations in relation to these investments are not hedged, and are recognised in the Group's translation reserve.

In addition, a number of the Group's businesses undertake transactions denominated in foreign currency as part of their normal business. Any amounts outstanding at 31 December 2019 are not material.

c) Other price risk

The Group also has exposure to market risk arising from the movement in the Retail Price Index and house price indices. In particular, movements in these indices impact on the valuation of the equity release portfolio, as outlined further on pages 137 and 138.

Notes to the Accounts *(continued)*

38. Credit risk

Credit risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group.

The Group faces this risk from its lending to:

- individual customers (retail mortgages);
- businesses (through past commercial lending and current debt factoring / invoice discounting); and
- wholesale counterparties (including other financial institutions). Credit risk within our treasury portfolio arises from the investments held by the Group in order to meet liquidity requirements and for general business purposes.

Changes in the credit quality and the recoverability of loans and amounts due from counterparties influence the Group's exposure to credit risk. The Group's strategy is to maintain a cautious approach to credit risk and new lending. Adverse changes in the credit quality of counterparties, collateral values or deterioration in the wider economy, including rising unemployment, changes in interest rates, deterioration in household finances and any contraction in the UK property market leading to falling property values, could affect the recoverability and value of the Group's assets and influence its financial performance. An economic downturn and falls in house prices and commercial property values would adversely affect the level of impairment losses.

The Group has embedded a comprehensive risk management framework with clear lines of accountability and oversight as part of its overall governance framework.

The Group has processes and policies to monitor, control, mitigate and manage credit risk within the Group's credit risk appetite. The Retail Credit Committee and the Group Wholesale Credit Committee provide oversight to the effectiveness of all credit management across the Group and the controls in place ensure lending is within the Board approved credit risk appetite. The reporting structure ensures timely and accurate reporting of all substantive risk matters to the Board and the Board Risk Committee. The Board receives monthly updates on the credit risk profile of the Group.

Management makes use of the Group's IFRS 9 ECL information for purposes that include regulatory capital management, certain product pricing models and credit risk forecasting.

The maximum exposure to credit risk for financial assets is represented by the carrying amount of each financial asset, except for the following:

- A fair value adjustment for hedged risk of £57.7m (2018: £(16.4)m) is included within loans and advances to customers. This is indirectly exposed to credit risk through the relationship with the underlying loans covered by the Group's hedging strategy.
- The Group has credit risk exposure from commitments to lend where a mortgage has been offered but not yet completed, which leads to the recognition of a financial asset (within loans and advances to customers) on completion of the mortgage. As outlined in note 1g), an impairment loss allowance is held against these commitments in accordance with IFRS 9. The total amount of such loan commitments at 31 December 2019 is £1,324.7m (2018: £1,068.6m) and the impairment loss allowance held is less than £0.1m (2018: less than £0.1m).

With respect to collateral held by the Group at 31 December 2019, the Group considers that the quality of that collateral has not significantly changed as a result of deterioration in collateral or changes in the collateral policies of the Group during the year.

Retail mortgage lending to customers

The Group currently lends in the prime residential UK mortgage market, including buy-to-let, through the Society, whilst SIL lends in the Channel Islands and in the UK. The Board's credit risk appetite defines a number of limits regarding customer and collateral credit quality to which all lending activity must adhere.

The credit decision process utilises automated credit scoring and policy rules with lending policy criteria supporting manual underwriting. All aspects of the credit decision process are subject to regular independent review and development ensuring they support decisions in line with the Board's credit risk appetite.

The Group also has credit exposures through Amber Homeloans Limited (Amber) and North Yorkshire Mortgages Limited (NYM) which comprise residential UK mortgages, including buy-to-let, across prime and non-prime lending markets. These portfolios closed to new customer origination and lending in 2008 and are managed by adherence to clear policies in relation to mortgage servicing and credit management.

Commercial lending to customers and businesses

The Society's commercial mortgage portfolio was closed to new lending in November 2008.

Other loans and advances

These include advances made by our factored debt and invoice discounting business, Skipton Business Finance Limited, which continue to be managed by appropriately skilled teams. In addition other loans and advances include advances made to residential mortgage customers in Guernsey and Jersey by SIL; these are secured on shares in a property management company which owns the building in which the properties are located. These loans are monitored by appropriately skilled teams in SIL.

Wholesale lending to other financial institutions

Wholesale credit risk arises from the wholesale investments held by the Society's Treasury function which is responsible for managing this aspect of credit risk in line with the Board approved credit risk appetite and wholesale credit policies. Wholesale counterparty limits are reviewed monthly by the Group Wholesale Credit Committee based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within our risk appetite. We regularly review and closely monitor the number of counterparties to whom we will lend and, for those counterparties to whom we have lent, we review both the amount and duration of any limits.

A deterioration in wholesale credit markets could lead to volatility in the value of the Group's portfolio of treasury assets together with the risk of further impairment within our treasury investments portfolio.

ALCO provides oversight to the effectiveness of wholesale credit risk management.

a) Credit risk - loans and advances to customers held at amortised cost

The table below shows the breakdown of the Group and Society's loans and advances to customers held at amortised cost at the reporting date:

Group	2019				
	Gross carrying amount £m	ECL allowance (note 14) £m	Fair value adjustment for hedged risk £m	Carrying amount £m	%
Residential mortgages	19,622.4	(9.6)	57.7	19,670.5	98.1
Loans fully secured on land^	236.7	(6.5)	-	230.2	1.1
Other lending:					
Debt factoring advances	97.9	(0.8)	-	97.1	0.5
Other loans	67.8	-	-	67.8	0.3
	20,024.8	(16.9)	57.7	20,065.6	100.0

Society	2019				
	Gross carrying amount £m	ECL allowance (note 14) £m	Fair value adjustment for hedged risk £m	Carrying amount £m	%
Residential mortgages	17,614.1	(4.3)	51.6	17,661.4	98.7
Loans fully secured on land^	236.7	(6.5)	-	230.2	1.3
	17,850.8	(10.8)	51.6	17,891.6	100.0

^ Also known as commercial mortgages.

Group	2018*				
	Gross carrying amount £m	ECL allowance (note 14) £m	Fair value adjustment for hedged risk £m	Carrying amount £m	%
Residential mortgages	17,725.7	(9.9)	(16.4)	17,699.4	97.7
Loans fully secured on land^	267.6	(7.9)	-	259.7	1.4
Other lending:					
Debt factoring advances	91.4	(0.8)	-	90.6	0.5
Other loans	69.3	-	-	69.3	0.4
	18,154.0	(18.6)	(16.4)	18,119.0	100.0

38. Credit risk *(continued)*

Society

	2018*				
	Gross carrying amount	ECL allowance (note 14)	Fair value adjustment for hedged risk	Carrying amount	
	£m	£m	£m	£m	%
Residential mortgages	15,752.1	(4.4)	(16.2)	15,731.5	98.4
Loans fully secured on land^	267.6	(7.9)	-	259.7	1.6
	16,019.7	(12.3)	(16.2)	15,991.2	100.0

* Fair value adjustment for hedged risk is restated as outlined in note 1b).
^ Also known as commercial mortgages.

For details on how the Group assesses ECLs see note 1g).

i) Residential mortgages

The majority of loans and advances to customers are secured on UK residential properties and are geographically diverse.

The tables below provide information on residential loans and advances by payment due status:

	2019							
	Group				Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Not past due	19,012.0	412.1	11.5	**19,435.6**	17,151.6	355.7	7.9	**17,515.2**
Up to 30 days past due	-	73.2	2.4	**75.6**	-	30.9	1.7	**32.6**
31 to 60 days past due	-	36.1	8.6	**44.7**	-	21.0	5.6	**26.6**
61 to 90 days past due	-	13.0	9.4	**22.4**	-	6.1	5.8	**11.9**
Over 90 days past due	-	-	44.1	**44.1**	-	-	27.8	**27.8**
	19,012.0	**534.4**	**76.0**	**19,622.4**	**17,151.6**	**413.7**	**48.8**	**17,614.1**

	2018							
	Group				Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Not past due	17,304.2	198.8	12.9	17,515.9	15,530.4	99.5	9.6	15,639.5
Up to 30 days past due	-	84.1	3.1	87.2	-	33.8	1.7	35.5
31 to 60 days past due	-	41.4	7.3	48.7	-	25.9	4.7	30.6
61 to 90 days past due	-	13.6	8.8	22.4	-	6.1	4.9	11.0
Over 90 days past due	-	-	51.5	51.5	-	-	35.5	35.5
	17,304.2	337.9	83.6	17,725.7	15,530.4	165.3	56.4	15,752.1

The tables below provide information on movements in the gross carrying amount of residential loans and advances to customers during the year:

	2019							
	Group				Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross carrying amount as at 1 January	17,304.2	337.9	83.6	**17,725.7**	15,530.4	165.3	56.4	**15,752.1**
Transfers due to changes in credit risk:								
From stage 1 to stage 2	(337.1)	324.2	-	**(12.9)**	(304.1)	291.6	-	**(12.5)**
From stage 1 to stage 3	(9.2)	-	9.1	**(0.1)**	(6.1)	-	6.0	**(0.1)**
From stage 2 to stage 1	86.5	(88.9)	-	**(2.4)**	27.7	(28.9)	-	**(1.2)**
From stage 2 to stage 3	-	(13.3)	13.3	**-**	-	(6.3)	6.3	**-**
From stage 3 to stage 2	-	9.6	(9.9)	**(0.3)**	-	6.2	(6.4)	**(0.2)**
From stage 3 to stage 1	3.1	-	(3.3)	**(0.2)**	1.7	-	(1.8)	**(0.1)**
Modification of contractual cashflows	(11.1)	3.3	4.1	**(3.7)**	(12.2)	5.1	2.8	**(4.3)**
Increases due to origination	4,750.5	6.4	0.5	**4,757.4**	4,449.2	6.4	0.5	**4,456.1**
Decrease due to derecognition and repayments	(2,783.4)	(44.6)	(15.4)	**(2,843.4)**	(2,543.3)	(25.9)	(11.8)	**(2,581.0)**
Written off	(0.5)	(1.1)	(6.1)	**(7.7)**	(0.3)	(0.4)	(3.2)	**(3.9)**
Other movements	9.0	0.9	0.1	**10.0**	8.6	0.6	-	**9.2**
Gross carrying amount as at 31 December	**19,012.0**	**534.4**	**76.0**	**19,622.4**	**17,151.6**	**413.7**	**48.8**	**17,614.1**

	2018							
	Group				Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross carrying amount as at 1 January	15,636.5	349.4	86.7	16,072.6	13,913.8	155.8	57.5	14,127.1
Transfers due to changes in credit risk:								
From stage 1 to stage 2	(80.2)	78.4	-	(1.8)	(58.2)	56.6	-	(1.6)
From stage 1 to stage 3	(10.0)	-	10.1	0.1	(6.6)	-	6.7	0.1
From stage 2 to stage 1	51.7	(53.4)	-	(1.7)	31.7	(33.3)	-	(1.6)
From stage 2 to stage 3	-	(11.0)	11.0	-	-	(5.3)	5.3	-
From stage 3 to stage 2	-	11.8	(12.1)	(0.3)	-	5.8	(6.0)	(0.2)
From stage 3 to stage 1	4.2	-	(4.3)	(0.1)	2.5	-	(2.6)	(0.1)
Modification of contractual cashflows	(11.5)	3.8	3.4	(4.3)	(9.9)	3.2	2.8	(3.9)
Transfer of engagements	123.2	3.2	1.6	128.0	123.2	3.2	1.6	128.0
Increases due to origination	4,208.4	2.4	0.2	4,211.0	3,940.7	2.4	0.2	3,943.3
Decrease due to derecognition and repayments	(2,624.4)	(45.4)	(6.9)	(2,676.7)	(2,412.8)	(22.7)	(4.5)	(2,440.0)
Written off	(0.3)	(1.6)	(6.2)	(8.1)	-	(0.5)	(4.6)	(5.1)
Other movements	6.6	0.3	0.1	7.0	6.0	0.1	-	6.1
Gross carrying amount as at 31 December	17,304.2	337.9	83.6	17,725.7	15,530.4	165.3	56.4	15,752.1

The amounts included in the tables above represent the movement in the gross carrying amount between each reporting period end and not the balance as at the date of the movement.

As shown in the table above, during 2019 there was a net increase in stage 2 loans of £196.5m for the Group and £248.4m for the Society. This increase is partly due to the Group having revised during 2019 the PD thresholds and risk band definitions which are applied by the Group when assessing significant increase in credit risk (see note 1t)) for further details).

38. Credit risk *(continued)*

Gains and losses arising during the year from loan modifications that did not result in derecognition were not significant. Amounts written off are in accordance with the Group's accounting policy for write-offs (see note 1g)). Amounts presented within 'other movements' in the tables above include movements in the Group's effective interest rate asset as described in note 1e).

For residential mortgages, stage 3 loans which no longer meet any of the default criteria are subject to a six month probation period before they become eligible for transfer out of stage 3. At 31 December 2019, stage 3 loans include £24.9m for the Group (2018: £23.6m) and £14.8m for the Society (2018: £13.9m) being held in stage 3 under this probation period.

The table below provides information on movements in the impairment loss allowance for residential loans and advances to customers during the year:

2019	Group				Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Loss allowance as at 1 January	2.8	3.8	3.3	**9.9**	1.7	1.1	1.6	**4.4**
Transfers due to changes in credit risk:								
From stage 1 to stage 2	(0.2)	1.3	-	**1.1**	(0.1)	0.4	-	**0.3**
From stage 1 to stage 3	-	-	0.4	**0.4**	-	-	0.2	**0.2**
From stage 2 to stage 1	0.3	(0.8)	-	**(0.5)**	-	(0.2)	-	**(0.2)**
From stage 2 to stage 3	-	(0.3)	0.6	**0.3**	-	(0.1)	0.3	**0.2**
From stage 3 to stage 2	-	0.3	(0.3)	**-**	-	0.1	(0.1)	**-**
Remeasurements within existing stage	(0.8)	(0.2)	(0.1)	**(1.1)**	(0.6)	0.1	(0.1)	**(0.6)**
Increases due to origination	0.4	-	-	**0.4**	0.4	-	-	**0.4**
Decrease due to derecognition and repayments	(0.3)	(0.2)	(0.2)	**(0.7)**	(0.2)	(0.1)	(0.1)	**(0.4)**
Changes due to modification without derecognition	-	0.1	0.6	**0.7**	-	0.1	0.4	**0.5**
Written off	-	(0.2)	(0.7)	**(0.9)**	-	-	(0.5)	**(0.5)**
Loss allowance as at 31 December	**2.2**	**3.8**	**3.6**	**9.6**	**1.2**	**1.4**	**1.7**	**4.3**

2018	Group				Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Loss allowance as at 1 January	3.3	3.3	3.4	10.0	2.3	0.6	1.8	4.7
Transfers due to changes in credit risk:								
From stage 1 to stage 2	-	0.9	-	0.9	-	0.4	-	0.4
From stage 1 to stage 3	-	-	0.5	0.5	-	-	0.2	0.2
From stage 2 to stage 1	-	(0.4)	-	(0.4)	-	(0.1)	-	(0.1)
From stage 2 to stage 3	-	(0.2)	0.6	0.4	-	-	0.2	0.2
From stage 3 to stage 2	-	0.2	(0.2)	-	-	0.1	(0.1)	-
Remeasurements within existing stage	(0.6)	0.4	0.1	(0.1)	(0.7)	0.1	-	(0.6)
Transfer of engagements	-	-	0.1	0.1	-	-	0.1	0.1
Increases due to origination	0.2	-	-	0.2	0.2	-	-	0.2
Decrease due to derecognition and repayments	(0.1)	-	(0.1)	(0.2)	(0.1)	-	(0.1)	(0.2)
Written off	-	(0.4)	(1.1)	(1.5)	-	-	(0.5)	(0.5)
Loss allowance as at 31 December	2.8	3.8	3.3	9.9	1.7	1.1	1.6	4.4

The tables below provide information on residential loans and advances to customers grouped by credit risk rating (probability of default). For further details on how the probability of default (PD) affects the Group's assessment of ECLs, see note 1g) and note 1t). ECL coverage shows the level of loss allowance expressed as a percentage of the gross carrying amount.

The PDs used by the Group for IFRS 9 accounting purposes are not directly comparable to the PDs used by the Group for IRB regulatory purposes; this is due to significant differences in the requirements and methodologies applied by the Group for IFRS 9 and for IRB respectively.

Group 2019	**Gross carrying amount**				**Loss allowance**			
Probability of default	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
<0.15%	6,181.7	0.8	-	**6,182.5**	0.4	-	-	**0.4**
0.15% - <0.25%	8,564.9	0.1	-	**8,565.0**	0.6	-	-	**0.6**
0.25% - <0.5%	3,820.0	1.5	-	**3,821.5**	0.6	-	-	**0.6**
0.5% - <0.75%	282.6	1.7	-	**284.3**	0.2	-	-	**0.2**
0.75% - <2.5%	150.6	38.8	-	**189.4**	0.4	-	-	**0.4**
2.5% - <10%	11.8	220.2	-	**232.0**	-	0.2	-	**0.2**
10% - <100%	0.4	271.3	-	**271.7**	-	3.6	-	**3.6**
Default	-	-	76.0	**76.0**	-	-	3.6	**3.6**
	19,012.0	**534.4**	**76.0**	**19,622.4**	**2.2**	**3.8**	**3.6**	**9.6**
ECL coverage by stage (%)					**0.01%**	**0.71%**	**4.74%**	**0.05%**

Group 2018	Gross carrying amount				Loss allowance			
Probability of default	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<0.15%	4,315.0	2.5	-	4,317.5	0.2	-	-	0.2
0.15% - <0.25%	7,846.5	0.1	-	7,846.6	0.7	-	-	0.7
0.25% - <0.5%	4,286.9	0.2	-	4,287.1	0.9	-	-	0.9
0.5% - <0.75%	562.4	1.6	-	564.0	0.2	-	-	0.2
0.75% - <2.5%	269.6	16.4	-	286.0	0.6	-	-	0.6
2.5% - <10%	23.1	49.3	-	72.4	0.2	-	-	0.2
10% - <100%	0.7	267.8	-	268.5	-	3.8	-	3.8
Default	-	-	83.6	83.6	-	-	3.3	3.3
	17,304.2	337.9	83.6	17,725.7	2.8	3.8	3.3	9.9
ECL coverage by stage (%)					0.02%	1.12%	3.95%	0.06%

Society 2019	**Gross carrying amount**				**Loss allowance**			
Probability of default	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
<0.15%	6,167.1	0.4	-	**6,167.5**	0.3	-	-	**0.3**
0.15% - <0.25%	7,128.2	0.1	-	**7,128.3**	0.6	-	-	**0.6**
0.25% - <0.5%	3,606.5	1.3	-	**3,607.8**	0.3	-	-	**0.3**
0.5% - <0.75%	184.6	1.7	-	**186.3**	-	-	-	**-**
0.75% - <2.5%	58.6	37.2	-	**95.8**	-	-	-	**-**
2.5% - <10%	6.6	212.7	-	**219.3**	-	0.2	-	**0.2**
10% - <100%	-	160.3	-	**160.3**	-	1.2	-	**1.2**
Default	-	-	48.8	**48.8**	-	-	1.7	**1.7**
	17,151.6	**413.7**	**48.8**	**17,614.1**	**1.2**	**1.4**	**1.7**	**4.3**
ECL coverage by stage (%)					**0.01%**	**0.34%**	**3.48%**	**0.02%**

Notes to the Accounts *(continued)*

38. Credit risk *(continued)*

Society	2018							
	Gross carrying amount				Loss allowance			
Probability of default	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<0.15%	4,310.5	1.7	-	4,312.2	0.2	-	-	0.2
0.15% - <0.25%	6,554.1	0.1	-	6,554.2	0.7	-	-	0.7
0.25% - <0.5%	4,075.3	0.2	-	4,075.5	0.6	-	-	0.6
0.5% - <0.75%	446.6	0.8	-	447.4	0.1	-	-	0.1
0.75% - <2.5%	133.1	13.6	-	146.7	0.1	-	-	0.1
2.5% - <10%	10.2	30.8	-	41.0	-	-	-	-
10% - <100%	0.6	118.1	-	118.7	-	1.1	-	1.1
Default	-	-	56.4	56.4	-	-	1.6	1.6
	15,530.4	165.3	56.4	15,752.1	1.7	1.1	1.6	4.4
ECL coverage by stage (%)					0.01%	0.67%	2.84%	0.03%

The table below provides an analysis of residential loans held in stage 2 as at the balance sheet date, reflecting the reasons for inclusion in stage 2. For the purpose of this analysis, where a loan satisfies at the balance sheet date more than one of the stage 2 criteria, the loan is included below within one category only and in order of the categories presented. The amounts presented below as 'Over 30 days past due' therefore include all stage 2 loans which are over 30 days past due as at the balance sheet date, including those where this was not the initial reason for being classified as stage 2.

Stage 2 analysis	2019					
	Group			Society		
	Gross carrying amount £m	ECL allowance £m	ECL coverage %	Gross carrying amount £m	ECL allowance £m	ECL coverage %
Over 30 days past due	49.1	1.3	2.6%	27.1	0.4	1.5%
In forbearance	45.8	0.2	0.4%	31.7	0.1	0.3%
In arrears	71.4	1.1	1.5%	29.1	0.3	1.0%
Term expired	20.0	0.1	0.5%	16.2	-	-
Increase in PD since origination	348.1	1.1	0.3%	309.6	0.6	0.2%
	534.4	**3.8**	**0.7%**	**413.7**	**1.4**	**0.3%**

The tables below provide further information on the types of lending and geographical split:

Group	2019				2018 Restated*			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Prime:								
Residential	14,430.9	356.2	47.7	**14,834.8**	13,400.5	161.3	52.8	13,614.6
Buy-to-let	4,204.9	86.1	6.4	**4,297.4**	3,505.3	46.3	9.6	3,561.2
Self build	34.0	6.3	1.8	**42.1**	30.1	9.5	1.7	41.3
Fast track	26.7	2.5	0.4	**29.6**	33.9	1.6	0.6	36.1
Self certified	240.9	52.1	11.7	**304.7**	255.4	78.8	12.0	346.2
Sub-prime^:								
Residential	12.3	7.8	1.1	**21.2**	14.6	8.4	1.1	24.1
Buy-to-let	20.3	1.5	0.4	**22.2**	24.9	1.6	0.1	26.6
Self build	0.2	0.3	-	**0.5**	0.2	-	0.3	0.5
Self certified	41.8	21.6	6.5	**69.9**	39.3	30.4	5.4	75.1
	19,012.0	**534.4**	**76.0**	**19,622.4**	17,304.2	337.9	83.6	17,725.7

^ Sub-prime mortgages are defined as loans to borrowers that typically had weakened credit histories at the time the loan was advanced.
* The 2018 comparative amounts for prime residential and prime self certified loans in the table above have been restated to show a small number of loans that were previously included as residential as self certified.

Society	2019				2018 Restated*			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Prime:								
Residential	13,519.1	333.1	43.6	**13,895.8**	12,480.4	130.1	47.6	12,658.1
Buy-to-let	3,584.3	75.4	3.9	**3,663.6**	2,997.8	31.3	7.8	3,036.9
Self build	14.0	1.9	0.7	**16.6**	9.2	2.0	0.2	11.4
Fast track	26.7	2.5	0.4	**29.6**	33.9	1.6	0.6	36.1
Self certified	7.5	0.8	0.2	**8.5**	9.1	0.3	0.2	9.6
	17,151.6	**413.7**	**48.8**	**17,614.1**	15,530.4	165.3	56.4	15,752.1

* The 2018 comparative amounts for prime residential and prime self certified loans in the table above have been restated to show a small number of loans that were previously included as residential as self certified.

Group	2019				2018			
Region	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
North	734.9	23.4	4.5	**762.8**	698.9	11.7	5.3	715.9
Yorkshire	1,750.8	56.5	9.5	**1,816.8**	1,669.2	34.6	9.9	1,713.7
East Midlands	1,336.5	42.6	5.4	**1,384.5**	1,245.6	23.9	5.1	1,274.6
East Anglia	566.7	13.9	2.5	**583.1**	518.0	9.9	2.3	530.2
London	2,932.9	80.5	9.2	**3,022.6**	2,450.0	46.7	11.8	2,508.5
South East	3,578.2	94.3	12.5	**3,685.0**	3,189.2	67.3	12.9	3,269.4
South West	1,883.2	47.6	5.5	**1,936.3**	1,731.0	27.3	9.9	1,768.2
West Midlands	1,396.9	45.7	5.5	**1,448.1**	1,285.7	27.2	6.4	1,319.3
North West	1,775.9	61.1	9.2	**1,846.2**	1,621.8	41.7	9.8	1,673.3
Wales	656.9	24.0	2.8	**683.7**	622.0	17.4	3.3	642.7
Scotland	1,477.8	37.8	8.2	**1,523.8**	1,337.1	24.2	5.8	1,367.1
Northern Ireland	21.9	4.4	1.2	**27.5**	23.6	5.1	1.1	29.8
Channel Islands	899.4	2.6	-	**902.0**	912.1	0.9	-	913.0
	19,012.0	**534.4**	**76.0**	**19,622.4**	17,304.2	337.9	83.6	17,725.7

Society	2019				2018			
Region	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
North	716.1	19.8	3.1	**739.0**	680.0	6.0	3.6	689.6
Yorkshire	1,702.4	46.8	8.0	**1,757.2**	1,618.6	22.4	8.1	1,649.1
East Midlands	1,298.2	33.4	3.5	**1,335.1**	1,203.7	12.3	3.2	1,219.2
East Anglia	540.0	11.2	1.9	**553.1**	489.8	5.8	1.8	497.4
London	2,535.6	57.8	2.6	**2,596.0**	2,137.8	13.5	5.3	2,156.6
South East	3,415.1	66.8	7.7	**3,489.6**	3,030.1	28.0	7.6	3,065.7
South West	1,822.0	39.9	3.5	**1,865.4**	1,668.9	16.5	7.7	1,693.1
West Midlands	1,346.2	36.1	3.6	**1,385.9**	1,242.7	12.5	4.3	1,259.5
North West	1,694.1	47.4	6.4	**1,747.9**	1,544.0	23.3	7.3	1,574.6
Wales	623.3	18.0	1.7	**643.0**	588.3	7.0	2.3	597.6
Scotland	1,444.1	34.1	6.6	**1,484.8**	1,309.8	16.6	4.7	1,331.1
Northern Ireland	14.5	2.4	0.2	**17.1**	16.7	1.4	0.5	18.6
	17,151.6	**413.7**	**48.8**	**17,614.1**	15,530.4	165.3	56.4	15,752.1

38. Credit risk *(continued)*

Indexed loan-to-value information on the Group's residential loan portfolio is set out below:

Group	2019				2018			
Loan-to-value	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<40%	3,207.9	87.7	10.7	**3,306.3**	2,824.7	49.9	11.7	2,886.3
40% - 50%	2,763.6	71.4	11.7	**2,846.7**	2,416.1	46.4	11.9	2,474.4
50% - 60%	3,650.0	100.0	14.1	**3,764.1**	3,353.2	62.8	15.8	3,431.8
60% - 70%	3,540.4	116.4	14.3	**3,671.1**	3,398.8	78.7	15.8	3,493.3
70% - 80%	3,011.4	103.6	11.2	**3,126.2**	2,897.2	52.4	12.3	2,961.9
80% - 90%	2,198.2	44.0	7.4	**2,249.6**	2,068.8	31.8	5.7	2,106.3
90% - 100%	616.6	6.9	2.6	**626.1**	319.4	9.9	6.6	335.9
>100%	23.9	4.4	4.0	**32.3**	26.0	6.0	3.8	35.8
	19,012.0	**534.4**	**76.0**	**19,622.4**	17,304.2	337.9	83.6	17,725.7

Society	2019				2018			
Loan-to-value	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<40%	2,996.8	78.4	8.9	**3,084.1**	2,624.6	38.7	9.9	2,673.2
40% - 50%	2,513.5	59.2	8.5	**2,581.2**	2,205.8	27.8	8.7	2,242.3
50% - 60%	3,279.8	74.4	7.9	**3,362.1**	2,999.2	28.4	10.4	3,038.0
60% - 70%	3,085.1	85.7	9.7	**3,180.5**	2,992.8	33.0	9.7	3,035.5
70% - 80%	2,642.5	78.7	6.5	**2,727.7**	2,531.6	22.5	8.7	2,562.8
80% - 90%	2,044.4	33.1	4.1	**2,081.6**	1,889.3	9.3	1.9	1,900.5
90% - 100%	577.4	2.7	0.8	**580.9**	277.2	2.4	5.0	284.6
>100%	12.1	1.5	2.4	**16.0**	9.9	3.2	2.1	15.2
	17,151.6	**413.7**	**48.8**	**17,614.1**	15,530.4	165.3	56.4	15,752.1

Balances between 90% and 100% loan-to-value in the tables above have increased during the year primarily due to new lending in the year at loan-to-values between 90% and 95%.

The Group indexes property prices using the quarterly Halifax regional non-seasonally adjusted index. The new lending policy is currently a maximum loan-to-value ratio of 95% for residential mortgages and 75% for buy-to-let lending. In addition SIL lend up to 100% on their 'Next Generation' mortgages whereby 15% is required to be guaranteed by a guarantor.

At 31 December 2019, the average indexed loan-to-value of Group residential mortgages on a valuation weighted basis (calculated as the total outstanding balance divided by the total value of collateral held), was 46.8% (2018: 46.1%) and for Society residential mortgages was 46.2% (2018: 45.2%).

Forbearance

Where appropriate for customers, the Group applies a policy of forbearance. This may be applied where the actual or apparent financial stress of the customer is considered to be short term with a potential to be recovered. Forbearance may involve arrears capitalisation, a reduction in the monthly payment (known as a concession), a conversion to interest only or a mortgage term extension. Forbearance is undertaken in order to achieve the best outcome for both the customer and the business through dealing with repayment difficulties at an early stage.

Possession is generally considered only as a last resort, once all other options for the customer have been exhausted. Possession balances represent loans against which the Group has taken ownership of properties pending their sale. The Group does not occupy repossessed properties for business use or use assets acquired in its operations. All customer accounts are monitored to ensure that these strategies remain appropriate.

For the Group, at 31 December 2019 the balance of residential loans where the property has been taken into possession was £3.3m and represents less than 0.1% of total outstanding loans (2018: £3.6m; less than 0.1%). For the Society, at 31 December 2019 the balance of residential loans where the property has been taken into possession was £1.9m and represents less than 0.1% of total outstanding loans (2018: £1.8m; less than 0.1%). All possessions balances are classified as stage 3.

The tables below provide further information on residential mortgages regarded as being in forbearance as at 31 December 2019, showing the type of account renegotiations applied. For the purpose of these forbearance tables, the Group applies the European Banking Authority (EBA) definition of forbearance. Under the EBA definition, loans are required to meet certain payment and arrears criteria before they are deemed to exit forbearance; this includes a minimum two year probation period following the forbearance event (extended to three years in certain situations).

For the purpose of the tables below, the following loans are therefore regarded as being in forbearance as at 31 December 2019:

- any loan to which forbearance measures were applied within the two years prior to the reporting date (regardless of whether the loan remains on renegotiated terms at 31 December 2019); and
- any loan to which forbearance measures were applied and which remains on renegotiated terms at 31 December 2019 (even if the forbearance event was more than two years prior to the reporting date).

For the purpose of the tables below, loans are presented according to the ECL stage in which they were held as at the reporting date.

For the avoidance of doubt, the Group does not, and is not required to, apply the EBA definition of forbearance in its accounting policies; the Group's accounting policy for forbearance does not therefore include the minimum two year probation period that is included in the EBA definition (for full details of the Group's accounting policies for forbearance and the measurement of impairment losses, see note 1g)).

Group 2019	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Stage 1							
Not past due	19,012.0	-	11.0	8.5	0.7	20.2	0.1
	19,012.0	**-**	**11.0**	**8.5**	**0.7**	**20.2**	**0.1**
Stage 2							
Not past due	412.1	0.2	13.3	9.6	3.5	26.6	6.5
Past due up to 30 days	73.2	-	10.4	0.9	0.2	11.5	15.7
Over 30 days past due	49.1	-	8.4	0.4	0.2	9.0	18.3
	19,546.4	**0.2**	**43.1**	**19.4**	**4.6**	**67.3**	**0.3**
Stage 3							
Not past due	11.5	-	1.5	0.5	0.3	2.3	20.0
Past due up to 90 days	20.4	0.1	5.4	1.7	1.1	8.3	40.7
Over 90 days past due	44.1	-	16.8	2.7	0.9	20.4	46.3
	19,622.4	**0.3**	**66.8**	**24.3**	**6.9**	**98.3**	**0.5**
Loss allowance	(9.6)	-	(1.5)	(0.1)	(0.2)	(1.8)	18.8
	19,612.8	**0.3**	**65.3**	**24.2**	**6.7**	**96.5**	**0.5**

Group 2018	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Stage 1							
Not past due	17,304.2	-	11.8	10.8	0.2	22.8	0.1
	17,304.2	-	11.8	10.8	0.2	22.8	0.1
Stage 2							
Not past due	198.8	0.4	11.4	6.8	6.2	24.8	12.5
Past due up to 30 days	84.1	-	11.2	1.1	0.4	12.7	15.1
Over 30 days past due	55.0	0.1	7.5	0.7	0.4	8.7	15.8
	17,642.1	0.5	41.9	19.4	7.2	69.0	0.4
Stage 3							
Not past due	12.9	-	2.1	0.7	0.3	3.1	24.0
Past due up to 90 days	19.2	-	5.7	0.8	0.1	6.6	34.4
Over 90 days past due	51.5	-	18.6	3.3	1.3	23.2	45.0
	17,725.7	0.5	68.3	24.2	8.9	101.9	0.6
Loss allowance	(9.9)	-	(1.0)	(0.1)	(0.1)	(1.2)	12.1
	17,715.8	0.5	67.3	24.1	8.8	100.7	0.6

38. Credit risk *(continued)*

Society 2019	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Stage 1							
Not past due	17,151.6	-	7.7	8.3	0.1	16.1	0.1
	17,151.6	**-**	**7.7**	**8.3**	**0.1**	**16.1**	**0.1**
Stage 2							
Not past due	355.7	0.2	11.0	7.4	2.5	21.1	5.9
Past due up to 30 days	30.9	-	6.3	0.8	0.2	7.3	23.6
Over 30 days past due	27.1	-	6.4	0.4	0.2	7.0	25.8
	17,565.3	**0.2**	**31.4**	**16.9**	**3.0**	**51.5**	**0.3**
Stage 3							
Not past due	7.9	-	1.4	0.5	0.3	2.2	27.8
Past due up to 90 days	13.1	0.1	3.2	1.7	1.0	6.0	45.8
Over 90 days past due	27.8	-	10.8	2.7	0.9	14.4	51.8
	17,614.1	**0.3**	**46.8**	**21.8**	**5.2**	**74.1**	**0.4**
Loss allowance	**(4.3)**	**-**	**(0.7)**	**(0.1)**	**(0.2)**	**(1.0)**	**23.3**
	17,609.8	**0.3**	**46.1**	**21.7**	**5.0**	**73.1**	**0.4**

Society 2018	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Stage 1							
Not past due	15,530.4	-	10.6	6.7	0.2	17.5	0.1
	15,530.4	-	10.6	6.7	0.2	17.5	0.1
Stage 2							
Not past due	99.5	0.4	10.0	6.8	3.4	20.6	20.7
Past due up to 30 days	33.8	-	9.1	1.1	0.3	10.5	31.1
Over 30 days past due	32.0	0.1	4.4	0.5	0.4	5.4	16.9
	15,695.7	0.5	34.1	15.1	4.3	54.0	0.3
Stage 3							
Not past due	9.6	-	1.4	0.7	0.3	2.4	25.0
Past due up to 90 days	11.3	-	4.3	0.7	0.1	5.1	45.1
Over 90 days past due	35.5	-	15.3	3.2	1.3	19.8	55.8
	15,752.1	0.5	55.1	19.7	6.0	81.3	0.5
Loss allowance	(4.4)	-	(0.7)	(0.1)	(0.1)	(0.9)	20.5
	15,747.7	0.5	54.4	19.6	5.9	80.4	0.5

Collateral

Collateral held consists predominantly of residential properties. The use of such collateral is in line with terms that are usual and customary to standard lending activities.

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated by reference to market prices or indices of similar assets.

Fair value of capped collateral held

Some properties in the Group's mortgage book are in negative equity, which increases the possibility of the Group incurring a loss if the property is taken into possession.

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Stage 1	**19,006.9**	17,300.0	**17,149.0**	15,528.5
Stage 2	**533.5**	337.7	**413.5**	165.3
Stage 3	**75.0**	82.9	**48.4**	56.0
	19,615.4	17,720.6	**17,610.9**	15,749.8
Gross loan balances	**19,622.4**	17,725.7	**17,614.1**	15,752.1
Negative equity	**7.0**	5.1	**3.2**	2.3
Capped collateral held in respect of possessions (included within Stage 3 above)	**1.9**	3.1	**1.0**	1.5

The fair value of residential property used to derive the figures in the table above is determined by reference to a recognised house price index. Movements in this index to the reporting date are applied to all properties in the portfolio on a regional basis. For the majority of the Group's loans, the Group holds excess collateral however this cannot be used to offset those instances where the loan amount exceeds the collateral held. The fair value of capped collateral in the table above therefore represents, on an individual loan basis, the lower of the value of the property and the outstanding loan amount. It does not reflect the overall value of properties against which the loans are secured. The total fair value of collateral held in respect of residential mortgages for the Group at 31 December 2019 is £41,943.5m (2018: £38,479.8m) and for the Society is £38,133.9m (2018: £34,813.1m).

At 31 December 2019 the contractual amount outstanding on loans written off during the year due to there being no reasonable expectation of recovery, but which remain subject to enforcement activity, is £1.5m (2018: £2.1m) for the Group and £0.5m (2018: £0.8m) for the Society.

ii) Commercial mortgages

The commercial mortgage portfolio (also known as loans fully secured on land) is currently closed to new business.

The tables below provide information on commercial loans by payment due status.

	2019 Group and Society				2018 Group and Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Not past due	204.6	22.5	4.1	**231.2**	236.3	22.2	2.7	261.2
Up to 30 days	-	3.0	-	**3.0**	-	1.0	-	1.0
31 to 60 days	-	0.8	0.1	**0.9**	-	0.8	-	0.8
61 to 90 days	-	0.2	-	**0.2**	-	1.9	-	1.9
Over 90 days	-	-	1.4	**1.4**	-	-	2.7	2.7
	204.6	**26.5**	**5.6**	**236.7**	236.3	25.9	5.4	267.6

38. Credit risk *(continued)*

The table below provides information on movements in the gross carrying amount of commercial loans during the year.

	2019 Group and Society				2018 Group and Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Gross carrying amount as at 1 January	236.3	25.9	5.4	**267.6**	262.6	26.0	5.2	293.8
Transfers due to changes in credit risk:								
From stage 1 to stage 2	(4.3)	4.1	-	**(0.2)**	(0.9)	0.9	-	-
From stage 1 to stage 3	(2.4)	-	2.4	**-**	(0.7)	-	0.7	-
From stage 2 to stage 1	0.4	(0.4)	-	**-**	1.8	(2.0)	-	(0.2)
From stage 2 to stage 3	-	(0.2)	0.2	**-**	-	-	-	-
From stage 3 to stage 2	-	0.3	(0.3)	**-**	-	-	-	-
From stage 3 to stage 1	-	-	-	**-**	0.3	-	(0.3)	-
Modification of contractual cashflows	1.3	(1.0)	(0.7)	**(0.4)**	(2.5)	1.2	0.8	(0.5)
Transfer of engagements	-	-	-	**-**	2.1	-	0.4	2.5
Decrease due to derecognition and repayments	(26.1)	(2.2)	(1.4)	**(29.7)**	(26.2)	(0.2)	(0.8)	(27.2)
Written off	-	-	-	**-**	-	-	(0.6)	(0.6)
Other movements	(0.6)	-	-	**(0.6)**	(0.2)	-	-	(0.2)
Gross carrying amount as at 31 December	**204.6**	**26.5**	**5.6**	**236.7**	236.3	25.9	5.4	267.6

The amounts included in the table above represent the movement in the gross carrying amount between each reporting period end and not the balance as at the date of the movement.

Gains and losses arising during the year from loan modifications that did not result in derecognition were not significant. Amounts written off are in accordance with the Group's accounting policy for write-offs (see note 1g)).

The table below provides information on movements in the impairment loss allowance for commercial loans during the year.

	2019 Group and Society				2018 Group and Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Loss allowance as at 1 January	0.2	5.8	1.9	**7.9**	0.2	4.9	1.8	6.9
Transfers due to changes in credit risk:								
From stage 1 to stage 2	-	-	-	**-**	-	0.1	-	0.1
From stage 1 to stage 3	-	-	0.2	**0.2**	-	-	-	-
From stage 2 to stage 1	-	-	-	**-**	-	(0.1)	-	(0.1)
Remeasurements within existing stage	-	(0.4)	(0.1)	**(0.5)**	-	0.9	0.3	1.2
Decrease due to derecognition and repayments	-	(0.7)	(0.6)	**(1.3)**	-	-	-	-
Changes due to modification without derecognition	-	0.5	(0.3)	**0.2**	-	-	-	-
Written off	-	-	-	**-**	-	-	(0.2)	(0.2)
Loss allowance as at 31 December	**0.2**	**5.2**	**1.1**	**6.5**	0.2	5.8	1.9	7.9
ECL coverage (%)	**0.10%**	**19.62%**	**19.64%**	**2.75%**	0.08%	22.39%	35.19%	2.95%

Given the size and nature of the Group's commercial portfolio, it is not meaningful to manage credit risk by reference to behavioural scores or PD percentages. Credit risk is predominantly managed by individual review of loans in accordance with certain criteria and includes the use of 'watchlists'. To aid an understanding of significant credit risk concentrations for the Group's commercial portfolio, the tables below provide analyses of loans by industry type, by geography and by loan-to-value percentage.

Industry analysis	2019 Group and Society				2018 Group and Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Leisure and hotels	14.8	5.6	0.4	**20.8**	18.2	5.6	0.7	24.5
Retail	5.5	-	0.8	**6.3**	6.7	0.1	0.4	7.2
Nursing / residential homes	12.2	-	-	**12.2**	13.2	-	-	13.2
Offices	2.7	-	-	**2.7**	3.4	-	-	3.4
Commercial and industrial units	167.5	19.2	4.2	**190.9**	191.1	18.1	4.1	213.3
Miscellaneous	1.9	1.7	0.2	**3.8**	3.7	2.1	0.2	6.0
	204.6	**26.5**	**5.6**	**236.7**	236.3	25.9	5.4	267.6

Geographical analysis	2019 Group and Society				2018 Group and Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
North	9.3	2.3	0.3	**11.9**	10.4	1.7	1.1	13.2
Yorkshire	16.7	5.3	0.1	**22.1**	17.8	5.6	0.1	23.5
East Midlands	10.7	8.2	-	**18.9**	12.3	8.2	-	20.5
East Anglia	4.7	-	0.2	**4.9**	6.0	-	0.1	6.1
London	49.6	2.7	1.4	**53.7**	60.6	1.4	-	62.0
South East	46.0	1.4	0.7	**48.1**	52.4	-	0.9	53.3
South West	23.4	0.3	0.6	**24.3**	26.8	2.4	0.5	29.7
West Midlands	16.9	0.6	-	**17.5**	18.6	0.6	-	19.2
North West	19.0	4.4	2.2	**25.6**	21.8	4.4	2.6	28.8
Wales	5.0	0.7	0.1	**5.8**	6.1	1.0	-	7.1
Scotland	3.3	0.6	-	**3.9**	3.5	0.6	0.1	4.2
	204.6	**26.5**	**5.6**	**236.7**	236.3	25.9	5.4	267.6

Loan-to-value	2019 Group and Society				2018 Group and Society			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<40%	45.2	0.6	0.3	**46.1**	49.2	1.1	0.3	50.6
40% - 50%	27.9	1.3	2.4	**31.6**	34.5	0.3	0.8	35.6
50% - 60%	43.3	2.4	0.2	**45.9**	46.8	0.4	0.2	47.4
60% - 70%	35.8	1.6	0.1	**37.5**	44.9	0.7	0.2	45.8
70% - 80%	21.9	-	0.1	**22.0**	26.2	2.6	0.4	29.2
80% - 90%	11.6	4.1	-	**15.7**	15.6	1.5	-	17.1
90% - 100%	9.6	1.2	0.5	**11.3**	12.2	0.3	0.3	12.8
>100%	9.3	15.3	2.0	**26.6**	6.9	19.0	3.2	29.1
	204.6	**26.5**	**5.6**	**236.7**	236.3	25.9	5.4	267.6

At 31 December 2019 the average loan-to-value of commercial mortgages on a valuation weighted basis (calculated as the total outstanding balance divided by the total value of collateral held) was 49.1% (2018: 50.0%). The average loan-to-value is based on the latest external valuation of the properties within the portfolio.

38. Credit risk *(continued)*

Forbearance

The Group's policy on forbearance for commercial mortgages is the same as the policy for residential mortgages, which is found in note 38a)(i).

At 31 December 2019 the balance of commercial mortgages where the property has been taken into possession was £nil for the Group and Society (2018: £nil). Possessions balances are classified as stage 3.

The tables below provide further information on commercial mortgages regarded as being in forbearance as at 31 December 2019, showing the type of account renegotiations applied. The tables below are presented on the same basis as the corresponding tables for residential mortgages, the basis for which is described on pages 198 and 199.

Group and Society 2019	Total £m	Reduced payment £m	Transfer to interest only £m	Total renegotiations £m	%
Stage 1					
Not past due	204.6	5.7	0.6	6.3	3.1
	204.6	**5.7**	**0.6**	**6.3**	**3.1**
Stage 2					
Not past due	22.5	-	7.0	7.0	31.1
Past due up to 30 days	3.0	-	-	-	-
Over 30 days past due	1.0	0.2	0.7	0.9	90.0
	231.1	**5.9**	**8.3**	**14.2**	**6.1**
Stage 3					
Not past due	4.1	-	-	-	-
Past due up to 90 days	0.1	-	-	-	-
Over 90 days past due	1.4	0.2	-	0.2	14.3
	236.7	**6.1**	**8.3**	**14.4**	**6.1**
Loss allowance	(6.5)	(0.1)	(2.4)	(2.5)	**38.5**
	230.2	**6.0**	**5.9**	**11.9**	**5.2**

Group and Society 2018	Total £m	Reduced payment £m	Transfer to interest only £m	Total renegotiations £m	%
Stage 1					
Not past due	236.3	0.5	0.2	0.7	0.3
	236.3	0.5	0.2	0.7	0.3
Stage 2					
Not past due	22.2	1.7	7.2	8.9	40.1
Past due up to 30 days	1.0	0.5	-	0.5	50.0
Over 30 days past due	2.7	1.7	-	1.7	63.0
	262.2	4.4	7.4	11.8	4.5
Stage 3					
Not past due	2.7	-	-	-	-
Over 90 days past due	2.7	1.2	0.9	2.1	77.8
	267.6	5.6	8.3	13.9	5.2
Loss allowance	(7.9)	(1.4)	(2.2)	(3.6)	45.6
	259.7	4.2	6.1	10.3	4.0

Collateral

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

Fair value of capped collateral held

An analysis of capped collateral, where the collateral is capped to the lower of the value of the property and the amount outstanding on an individual loan basis, is shown below.

	Group and Society 2019 £m	2018 £m
Stage 1	**202.6**	234.4
Stage 2	**22.6**	20.9
Stage 3	**4.5**	3.6
	229.7	258.9
Gross loan balances	**236.7**	267.6
Negative equity	**7.0**	8.7
Capped collateral held in respect of possessions (included within Stage 3 above)	**-**	-

The fair value of commercial property used to derive the figures in the table above is determined by reference to the latest external valuation of the properties in question. The total fair value of collateral held in respect of commercial loans for the Group and the Society at 31 December 2019 is £482.5m (2018: £535.3m).

At 31 December 2019 the contractual amount outstanding on loans written off during the year due to there being no reasonable expectation of recovery, but which remain subject to enforcement activity, is £nil (2018: £nil) for the Group and £nil (2018: £nil) for the Society.

iii) Other lending

Other lending comprises the following:

Group	2019 Gross carrying amount £m	2019 ECL allowance £m	2019 Net carrying amount £m	2018 Gross carrying amount £m	2018 ECL allowance £m	2018 Net carrying amount £m
Debt factoring advances	97.9	(0.8)	**97.1**	91.4	(0.8)	90.6
Other loans	67.8	-	**67.8**	69.3	-	69.3
	165.7	**(0.8)**	**164.9**	160.7	(0.8)	159.9

The table below provides information on movements in the gross carrying amount of other loans and advances during the year.

Group	2019 Stage 1 £m	2019 Stage 2 £m	2019 Stage 3 £m	2019 Total £m	2018 Stage 1 £m	2018 Stage 2 £m	2018 Stage 3 £m	2018 Total £m
Gross carrying amount as at 1 January	156.5	4.2	-	**160.7**	139.4	2.4	-	141.8
Transfers due to changes in credit risk:								
From stage 1 to stage 2	(2.5)	2.5	-	-	(2.8)	2.8	-	-
From stage 2 to stage 1	2.7	(2.7)	-	-	0.6	(0.6)	-	-
From stage 2 to stage 3	-	(0.2)	0.2	-	-	(0.2)	0.2	-
Increases due to origination	47.7	-	-	**47.7**	37.1	-	-	37.1
Decrease due to derecognition and repayments	(41.9)	(0.6)	-	**(42.5)**	(17.8)	(0.2)	-	(18.0)
Write-offs	-	-	(0.2)	**(0.2)**	-	-	(0.2)	(0.2)
Gross carrying amount as at 31 December	**162.5**	**3.2**	**-**	**165.7**	156.5	4.2	-	160.7

The amounts included in the table above represent the movement in the gross carrying amount between each reporting period end and not the balance as at the date of the movement.

38. Credit risk (continued)

The table below provides information on movements in the impairment loss allowance for other loans and advances during the year.

	2019 Group Stage 1 £m	2019 Group Stage 2 £m	2019 Group Stage 3 £m	2019 Group Total £m	2018 Group Stage 1 £m	2018 Group Stage 2 £m	2018 Group Stage 3 £m	2018 Group Total £m
Loss allowance as at 1 January	-	0.8	-	0.8	-	0.8	-	0.8
Transfers due to changes in credit risk:								
From stage 1 to stage 2	-	0.6	-	0.6	(0.6)	0.6	-	-
From stage 2 to stage 1	-	(0.4)	-	(0.4)	0.5	(0.5)	-	-
From stage 2 to stage 3	-	(0.2)	0.2	-	-	(0.2)	0.2	-
Increases due to origination	-	-	-	-	0.1	-	-	0.1
Remeasurements within existing stage	-	-	-	-	-	0.1	-	0.1
Write-offs	-	-	(0.2)	(0.2)	-	-	(0.2)	(0.2)
Loss allowance as at 31 December	-	0.8	-	0.8	-	0.8	-	0.8

Debt factoring advances

Debt factoring advances relate to amounts advanced to clients by Skipton Business Finance Limited (SBF), the Group's debt factoring and invoice discounting business.

Credit risk is predominantly managed by rigorous due diligence controls and regular monitoring of client accounts, and includes the use of concentration limits, credit reference checks and 'watchlists' on clients' debtors. Advances are typically made to clients only against notified invoices that are less than 90 days past due.

Debt factoring and invoice discounting advances are typically secured via a legal charge against the relevant client's sales ledger. Additional security may also be taken in the form of an all assets debenture that may incorporate other unencumbered assets as well as personal guarantees. At 31 December 2019 and 31 December 2018, the fair value of the total collateral held by the Group against debt factoring and invoice discounting advances was in excess of the value of the total advances outstanding.

Other loans

The table below provides information on the gross carrying amount of other loans by payment due status.

	Group 2019 Stage 1 £m	Group 2019 Stage 2 £m	Group 2019 Total £m	Group 2018 Stage 1 £m	Group 2018 Stage 2 £m	Group 2018 Total £m
Not past due	67.8	-	67.8	68.9	-	68.9
31 to 60 days past due	-	-	-	-	0.4	0.4
	67.8	-	67.8	68.9	0.4	69.3

The other loans of £67.8m (2018: £69.3m) were advanced by Skipton International Limited to customers in respect of residential properties owned by a property management holding company. The loans are secured on shares in that property management holding company and the fair value of the total collateral held is £113.8m (2018: £108.0m).

b) Credit risk – balances with the Bank of England, debt securities and loans and advances to credit institutions

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

Collateral held for treasury assets is determined by the nature of the instrument. Loans and debt securities are generally unsecured with the exception of asset backed securities and covered bonds which are secured by pools of financial assets. For details of collateral held against debt securities see note 11. For details of collateral held against loans and advances to credit institutions see note 10. No collateral is held against balances with the Bank of England.

At 31 December 2019 none of the Group or the Society's treasury assets were past due (2018: none past due). At 31 December 2019 the ECLs on the Group and the Society's treasury assets were all held as stage 1 (2018: all stage 1).

At 31 December 2019 all the Group and the Society's treasury investments were assessed to have a probability of default (PD) of less than 0.15% (2018: all less than 0.15%).

The Group's accounting policies on impairment losses on treasury assets and how the Group assesses ECLs and PDs on treasury assets are detailed in note 1g).

At 31 December 2019, 93.6% (2018: 95.7%) of the Group's treasury investment assets (including cash in hand and with the Bank of England) were rated A3 or better, and for the Society 93.2% (2018: 95.6%) were rated A3 or better. The table below provides further details of the credit ratings for both the Group and the Society's treasury investment portfolios:

Rating	Group 2019 £m	Group 2019 %	Group 2018 £m	Group 2018 %	Society 2019 £m	Society 2019 %	Society 2018 £m	Society 2018 %
Aaa	930.4	20.6	610.5	14.5	988.0	23.0	721.7	17.6
Aa1	153.1	3.4	43.3	1.0	153.1	3.6	43.3	1.1
Aa2	2,890.6	63.8	2,777.0	66.1	2,682.5	62.5	2,642.6	64.6
Aa3	197.3	4.4	424.1	10.1	144.1	3.4	404.0	9.9
A1	8.9	0.2	102.7	2.5	6.2	0.1	64.3	1.6
A2	25.7	0.6	63.3	1.5	0.9	-	33.6	0.8
A3	25.0	0.6	-	-	25.0	0.6	-	-
Baa2	83.0	1.8	74.3	1.8	83.0	1.9	74.3	1.8
Unrated:								
Other	208.6	4.6	106.3	2.5	208.6	4.9	106.3	2.6
	4,522.6	100.0	4,201.5	100.0	4,291.4	100.0	4,090.1	100.0

'Other' in the above analysis comprises an exposure to a central clearing house used to clear derivatives to manage interest rate risk, as required by regulation.

The Group also monitors exposure concentrations against a variety of criteria including industry sector / asset class and country of risk.

Industry sector / asset class	Group 2019 £m	Group 2019 %	Group 2018 £m	Group 2018 %	Society 2019 £m	Society 2019 %	Society 2018 £m	Society 2018 %
Cash in hand and balances with the Bank of England	1,793.1	39.6	2,395.7	67.7	1,793.1	41.7	2,395.7	58.6
Loans and advances to banks and building societies	546.6	12.1	422.7	9.8	465.8	10.9	349.5	8.5
Gilts	291.9	6.5	219.0	4.3	291.9	6.8	203.8	5.0
Certificates of deposit	31.0	0.7	316.5	1.6	31.0	0.7	301.5	7.4
Fixed rate bonds	446.1	9.9	242.6	5.1	446.1	10.4	242.6	5.9
Floating rate notes	204.2	4.5	20.0	0.7	204.2	4.8	20.0	0.5
Treasury bills	779.8	17.2	169.0	2.7	571.8	13.3	49.8	1.2
Covered bonds	286.4	6.3	208.6	2.5	286.4	6.7	208.6	5.1
Residential mortgage backed securities	143.5	3.2	207.4	5.6	201.1	4.7	318.6	7.8
	4,522.6	100.0	4,201.5	100.0	4,291.4	100.0	4,090.1	100.0

Geographical exposure	Group 2019 £m	Group 2019 %	Group 2018 £m	Group 2018 %	Society 2019 £m	Society 2019 %	Society 2018 £m	Society 2018 %
UK	3,889.9	86.0	3,750.6	89.3	3,693.5	86.1	3,676.6	89.9
Rest of Europe	240.4	5.3	388.4	9.2	240.4	5.6	388.4	9.5
North America	321.7	7.1	32.6	0.8	291.2	6.8	0.1	-
Rest of World	70.6	1.6	29.9	0.7	66.3	1.5	25.0	0.6
	4,522.6	100.0	4,201.5	100.0	4,291.4	100.0	4,090.1	100.0

Notes to the Accounts *(continued)*

38. Credit risk *(continued)*

c) Credit risk – trade receivables

The tables below provide information on movements in trade receivables during the year.

As outlined in note 1g), the Group's accounting policy for trade receivables is to always recognise lifetime ECLs in accordance with the simplified approach in IFRS 9. Trade receivables are therefore not allocated to ECL stages.

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Gross carrying amount	33.0	33.8	1.5	1.9
Loss allowance	(2.3)	(2.5)	(0.1)	(0.1)
Net carrying amount	30.7	31.3	1.4	1.8

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Loss allowance as at 1 January	2.5	1.7	0.1	0.1
Net allowances made during the year	(0.1)	0.8	-	-
Write-offs	(0.1)	-	-	-
Loss allowance as at 31 December	2.3	2.5	0.1	0.1

The table below provides information on the gross carrying amount of trade receivables by payment due status.

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Not past due	12.4	13.1	-	0.5
Up to 30 days past due	13.2	12.3	0.3	0.5
31 to 120 days past due	4.5	5.9	0.6	0.6
Over 120 days past due	2.9	2.5	0.6	0.3
	33.0	33.8	1.5	1.9

No collateral is held against trade receivables. At 31 December 2019 the contractual amount outstanding on trade receivables written off during the year due to there being no reasonable expectation of recovery, but which remain subject to enforcement activity, is £nil (2018: £nil) for the Group and £nil (2018: £nil) for the Society.

d) Credit risk – derivative financial instruments

A credit exposure could arise in respect of derivative contracts entered into by the Group if the counterparty was unable to fulfil its contractual obligations. The Group addresses the risks associated with these activities by monitoring counterparty credit exposure and requiring additional collateral to be posted or returned as necessary. For all but two derivatives, the only form of collateral accepted by the Group in respect of derivatives is cash. Derivatives are either transacted under International Swaps and Derivatives Association (ISDA) Master Agreements or Cleared Derivatives Execution Agreements. For swaps that are cash collateralised, no Credit (CVA) or Debit (DVA) Value Adjustments have been made in respect of credit risk in determining the fair value of these derivatives as the risk is significantly mitigated. Credit Support Annexes executed with certain counterparties in conjunction with the ISDA Master Agreement require collateral to be posted regularly, as required by specific terms and conditions of the arrangements. Due to the frequency of the posting of collateral, there is no material exposure from these minimal timing differences that would require CVA or DVA adjustments. At 31 December 2019 the Group held two derivatives (2018: one) that are not fully collateralised for cash; CVA and DVA adjustments are made to the valuation of these derivatives.

Netting arrangements do not necessarily result in an offset of Statement of Financial Position (SOFP) assets and liabilities, as transactions are usually settled on a gross basis. The Group's legal documentation for derivative transactions does grant legal rights of set-off for those transactions with the same counterparty. Accordingly the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will offset positive mark to market values on derivatives. The table below provides further detail on the net exposure to derivative transaction counterparties.

Group	2019 As reported within SOFP £m	2019 Netting agreements £m	2019 Cash collateral £m	2019 Net amounts after offsetting £m	2018 As reported within SOFP £m	2018 Netting agreements £m	2018 Cash collateral £m	2018 Net amounts after offsetting £m
Financial assets								
Derivative financial instruments	38.5	(38.3)	-	0.2	72.3	(55.4)	(9.8)	7.1
Financial liabilities								
Derivative financial instruments	361.1	(38.3)	(284.7)	38.1	279.4	(55.4)	(196.7)	27.3

Society	2019 As reported within SOFP £m	2019 Netting agreements £m	2019 Cash collateral £m	2019 Net amounts after offsetting £m	2018 As reported within SOFP £m	2018 Netting agreements £m	2018 Cash collateral £m	2018 Net amounts after offsetting £m
Financial assets								
Derivative financial instruments	46.6	(40.6)	(5.0)	1.0	68.2	(57.3)	(10.1)	0.8
Financial liabilities								
Derivative financial instruments	321.7	(40.6)	(284.7)	(3.6)	282.3	(57.3)	(196.7)	28.3

With regards to the Group's derivative assets, there is a net amount after offsetting of £0.2m (2018: £7.1m) between the value of the derivatives and the cash collateral held. The comparative figure related mostly to the collateral arrangements for one of the Group's derivatives where the counterparty is not required to post collateral up to a threshold.

With regards to the Group's derivative liabilities, there is a net amount after offsetting of £38.1m (2018: £27.3m) between the value of the derivatives and the cash collateral pledged. This relates mostly to the collateral arrangements for two of the Group's derivatives where the Group is not required to post collateral up to a threshold. It also comprises net amounts relating to two of the derivatives the Society holds to hedge its equity release portfolio. These derivatives are long dated and bespoke in nature. They contain optionality relating to the pool balance they are linked to and an RPI cap and floor. As a result, their valuation can vary significantly depending on the assumptions and modelling techniques used. Both swap counterparties arrive at valuations that are different to the Society's, resulting in this difference between the valuation and the collateral pledged.

39. Fair values

a) Classification and measurement

The tables below summarise the classification of the carrying amounts of the Group's and Society's financial assets and liabilities:

Group	2019				2018*			
	Amortised cost £m	FVOCI £m	FVTPL £m	Total £m	Amortised cost £m	FVOCI £m	FVTPL £m	Total £m
Cash in hand and balances with the Bank of England	1,793.1	-	-	1,793.1	2,395.7	-	-	2,395.7
Loans and advances to credit institutions	546.6	-	-	546.6	422.7	-	-	422.7
Debt securities	-	2,182.9	-	2,182.9	-	1,383.1	-	1,383.1
Derivative financial instruments	-	-	38.5	38.5	-	-	72.3	72.3
Loans and advances to customers	20,065.6	-	1.5	20,067.1	18,119.0	-	1.9	18,120.9
Equity release portfolio	-	-	410.0	410.0	-	-	410.9	410.9
Equity share investments	-	-	1.5	1.5	-	-	0.8	0.8
Trade receivables	30.7	-	-	30.7	31.3	-	-	31.3
Contingent consideration	-	-	17.9	17.9	-	-	23.0	23.0
Share warrants	-	-	3.2	3.2	-	-	-	-
Other assets	-	-	3.2	3.2	-	-	-	-
Total financial assets	22,436.0	2,182.9	475.8	25,094.7	20,968.7	1,383.1	508.9	22,860.7
Other non-financial assets				394.7				331.2
Total assets				25,489.4				23,191.9
Shares	17,364.1	-	-	17,364.1	16,113.5	-	-	16,113.5
Amounts owed to credit institutions and other customers	3,495.2	-	-	3,495.2	3,568.5	-	-	3,568.5
Debt securities in issue	2,302.6	-	-	2,302.6	1,420.3	-	-	1,420.3
Derivative financial instruments	-	-	361.1	361.1	-	-	279.4	279.4
Lease liabilities (note 1b))	66.6	-	-	66.6	-	-	-	-
Trade payables	6.7	-	-	6.7	5.4	-	-	5.4
Fair value of put option obligation	-	-	7.5	7.5	-	-	8.3	8.3
Subscribed capital	41.6	-	-	41.6	41.6	-	-	41.6
Total financial liabilities	23,276.8	-	368.6	23,645.4	21,149.3	-	287.7	21,437.0
Other non-financial liabilities				211.8				238.3
Total liabilities				23,857.2				21,675.3

* Loans and advances to customers, shares and other non-financial assets and liabilities are restated as outlined in note 1b).

All financial assets and liabilities in the table above that are held as at FVTPL are mandatorily held as such.

Society	2019				2018*			
	Amortised cost £m	FVOCI £m	FVTPL £m	Total £m	Amortised cost £m	FVOCI £m	FVTPL £m	Total £m
Cash in hand and balances with the Bank of England	1,793.1	-	-	1,793.1	2,395.7	-	-	2,395.7
Loans and advances to credit institutions	465.8	-	-	465.8	349.5	-	-	349.5
Debt securities	-	1,996.5	36.0	2,032.5	-	1,262.9	82.0	1,344.9
Derivative financial instruments	-	-	46.6	46.6	-	-	68.2	68.2
Loans and advances to customers	17,891.6	-	1.5	17,893.1	15,991.2	-	1.9	15,993.1
Equity release portfolio	-	-	410.0	410.0	-	-	410.9	410.9
Loans to subsidiary undertakings	777.9	-	-	777.9	854.4	-	-	854.4
Trade receivables	1.4	-	-	1.4	1.8	-	-	1.8
Total financial assets	20,929.8	1,996.5	494.1	23,420.4	19,592.6	1,262.9	563.0	21,418.5
Other non-financial assets				227.4				210.9
Total assets				23,647.8				21,629.4
Shares	17,362.3	-	-	17,362.3	16,112.1	-	-	16,112.1
Amounts owed to credit institutions and other customers (note 1)	2,008.9	-	150.1	2,159.0	2,204.2	-	324.9	2,529.1
Debt securities in issue	2,194.9	-	-	2,194.9	1,194.4	-	-	1,194.4
Derivative financial instruments	-	-	321.7	321.7	-	-	282.3	282.3
Lease liabilities (note 1b))	12.5	-	-	12.5	-	-	-	-
Trade payables	2.5	-	-	2.5	1.8	-	-	1.8
Subscribed capital	41.6	-	-	41.6	41.6	-	-	41.6
Total financial liabilities	21,622.7	-	471.8	22,094.5	19,554.1	-	607.2	20,161.3
Other non-financial liabilities				84.9				92.6
Total liabilities				22,179.4				20,253.9

* Loans and advances to customers, shares and other non-financial assets are restated as outlined in note 1b).

Note

1. Included within 'Amounts owed to credit institutions and other customers' is £150.1m (2018: £324.9m) of deemed loans payable to the Group's SPVs which, under IFRS 9, were voluntarily designated as FVTPL (see note 1f)). All other financial assets and liabilities shown above as FVTPL are mandatorily held as such.

b) Valuation of financial instruments carried at fair value

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

Valuation techniques

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

Level 1

The most reliable fair values of financial instruments are quoted market prices in an actively traded market. The Group's Level 1 portfolio mainly comprises gilts, fixed rate bonds and floating rate notes for which traded prices are readily available.

Level 2

These are valuation techniques for which all significant inputs are taken from observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed when no active market exists and quoted prices are available for similar instruments in active markets. Examples of Level 2 instruments are certificates of deposit and interest rate swaps.

39. Fair values *(continued)*

Level 3

These are valuation techniques for which one or more significant inputs are not based on observable market data.

Valuation techniques include net present value by way of discounted cash flow models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, similar market products, foreign currency exchange rates and equity index prices. Critical judgement is applied by management in utilising unobservable inputs including expected price volatilities, expected mortality rates and prepayment rates, based on industry practice or historical observation. 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.

Transfers between levels

The Group makes transfers between the different levels of the fair value hierarchy where the inputs used to measure the fair value of the financial instruments in question no longer satisfy the conditions required to be classified in a certain level within the hierarchy. Any such transfer between different levels of the fair value hierarchy is made at the date the event in question that results in a change in circumstances occurs. There were no transfers between different levels of the fair value hierarchy during the year ended 31 December 2019 or the year ended 31 December 2018.

The following tables provide an analysis of financial assets and liabilities held within the Statement of Financial Position at fair value, grouped into Levels 1 to 3 of the fair value hierarchy.

Group	2019				2018			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Financial assets held at FVOCI:								
Debt securities	2,151.9	31.0	-	**2,182.9**	1,066.6	316.5	-	1,383.1
Financial assets at FVTPL:								
Equity share investments	0.2	-	1.3	**1.5**	0.1	-	0.7	0.8
Derivative financial instruments	-	38.4	0.1	**38.5**	-	71.2	1.1	72.3
Equity release portfolio	-	-	410.0	**410.0**	-	-	410.9	410.9
Loans and advances to customers	-	-	1.5	**1.5**	-	-	1.9	1.9
Contingent consideration	-	-	17.9	**17.9**	-	-	23.0	23.0
Share warrants	-	-	3.2	**3.2**	-	-	-	-
Other assets	-	-	3.2	**3.2**	-	-	-	-
	2,152.1	**69.4**	**437.2**	**2,658.7**	1,066.7	387.7	437.6	1,892.0
Financial liabilities								
Financial liabilities at FVTPL:								
Derivative financial instruments	-	150.4	210.7	**361.1**	-	63.9	215.5	279.4
Fair value of put option obligation	-	-	7.5	**7.5**	-	-	8.3	8.3
	-	**150.4**	**218.2**	**368.6**	-	63.9	223.8	287.7
	2,152.1	**(81.0)**	**219.0**	**2,290.1**	1,066.7	323.8	213.8	1,604.3

Society	2019				2018			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Financial assets held at FVOCI:								
Debt securities	1,965.5	31.0	-	1,996.5	961.4	301.5	-	1,262.9
Financial assets at FVTPL:								
Derivative financial instruments	-	46.6	-	46.6	-	68.1	0.1	68.2
Debt securities	36.0	-	-	36.0	82.0	-	-	82.0
Equity release portfolio	-	-	410.0	410.0	-	-	410.9	410.9
Loans and advances to customers	-	-	1.5	1.5	-	-	1.9	1.9
	2,001.5	**77.6**	**411.5**	**2,490.6**	1,043.4	369.6	412.9	1,825.9
Financial liabilities								
Financial liabilities at FVTPL:								
Derivative financial instruments	-	111.0	210.7	321.7	-	66.9	215.4	282.3
Amounts owed to credit institutions and other customers	-	-	150.1	150.1	-	-	324.9	324.9
	-	**111.0**	**360.8**	**471.8**	-	66.9	540.3	607.2
	2,001.5	**(33.4)**	**50.7**	**2,018.8**	1,043.4	302.7	(127.4)	1,218.7

The tables below analyse the movements in the Level 3 portfolio during the year:

Group	2019								
	Equity share invest-ments £m	Equity release portfolio £m	Loans and advances to customers £m	Derivative financial instruments £m	Fair value of put option obligation £m	Contingent consider-ation £m	Share warrants £m	Other assets £m	Total £m
At 1 January	0.7	410.9	1.9	(214.4)	(8.3)	23.0	-	-	**213.8**
(Loss) / gain recognised in Income Statement	-	(6.0)[1]	-	2.6[2]	-[3]	1.1[4]	-	-	**(2.3)**
Contingent consideration received	-	-	-	-	-	(6.2)	-	-	**(6.2)**
Revaluation of market values	-	-	-	-	0.2[5]	-	-	-	**0.2**
Accrued interest	-	9.3[6]	0.1[6]	1.2[6]	-	-	-	-	**10.6**
Repayments	-	(3.9)	(0.5)	-	-	-	-	-	**(4.4)**
Realised losses	-	(0.5)[6]	-	-	-	-	-	-	**(0.5)**
Exercise of put options by non-controlling shareholders	-	-	-	-	0.6	-	-	-	**0.6**
Additions / further advances	0.6	0.2	-	-	-	-	3.2	3.2	**7.2**
At 31 December	**1.3**	**410.0**	**1.5**	**(210.6)**	**(7.5)**	**17.9**	**3.2**	**3.2**	**219.0**

Notes
1. These are unrealised losses and are included in the 'Fair value gains / (losses) on equity release portfolio' line in the Income Statement.
2. These are unrealised gains and are included in the 'Fair value gains / (losses) on other derivatives' line in the Income Statement.
3. Included in the 'Interest payable and similar charges' line in the Income Statement and arises from the unwind of the liability and changes to exercise dates.
4. Included in the 'Profit on disposal of subsidiary undertakings' line in the Income Statement.
5. Included in the 'Interest payable and similar charges' line in the Income Statement and arises from changes to assumptions regarding the market value of the put options.
6. Included in the 'Interest receivable and similar income' line in the Income Statement.
7. Included in the 'Realised losses on equity release portfolio' line in the Income Statement.

Notes to the Accounts *(continued)*

39. Fair values *(continued)*

Group

				2018			
	Equity share investments	Equity release portfolio	Loans and advances to customers	Derivative financial instruments	Fair value of put option obligation	Contingent consideration	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January	0.4	426.6	-	(232.5)	(9.9)	25.1	209.7
(Loss) / gain recognised in Income Statement	(0.2)[1]	(17.1)[2]	-	18.1[3]	(0.2)[4]	3.3[5]	3.9
Transfer of engagements	-	-	1.7	-	-	-	1.7
Contingent consideration received	-	-	-	-	-	(5.4)	(5.4)
Revaluation of market values	-	-	-	-	1.5[6]	-	1.5
Accrued interest	-	8.0[7]	-	-	-	-	8.0
Repayments	-	(6.2)	(0.7)	-	-	-	(6.9)
Realised losses	-	(0.7)[8]	-	-	-	-	(0.7)
Exercise of put options by non-controlling shareholders	-	-	-	-	0.3	-	0.3
Additions / further advances	0.5	0.3	0.9	-	-	-	1.7
At 31 December	0.7	410.9	1.9	(214.4)	(8.3)	23.0	213.8

Notes
1. These are unrealised losses and are included in the ‘Fair value gains / (losses) on other financial instruments’ line in the Income Statement.
2. These are unrealised losses and are included in the ‘Fair value gains / (losses) on equity release portfolio’ line in the Income Statement.
3. These are unrealised gains and are included in the ‘Fair value gains / (losses) on other derivatives’ line in the Income Statement.
4. Included in the ‘Interest payable and similar charges’ line in the Income Statement and arises from the unwind of the liability and changes to exercise dates.
5. Included in the ‘Profit on disposal of subsidiary undertakings’ line in the Income Statement.
6. Included in the ‘Administrative expenses’ line in the Income Statement and arises from changes to assumptions regarding the market value of the put options.
7. Included in the ‘Interest receivable and similar income’ line in the Income Statement.
8. Included in the ‘Realised losses on equity release portfolio’ line in the Income Statement.

Society

			2019		
	Equity release portfolio	**Loans and advances to customers**	**Derivative financial instruments**	**Amounts owed to credit institutions and other customers**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
At 1 January	410.9	1.9	(215.3)	(324.9)	**(127.4)**
(Loss) / gain recognised in Income Statement	(6.0)[1]	-	3.4[2]	(1.0)[3]	**(3.6)**
Accrued interest	9.3[4]	0.1[4]	1.2[4]	-	**10.6**
Repayments	(3.9)	(0.5)	-	175.8	**171.4**
Realised losses	(0.5)[5]	-	-	-	**(0.5)**
Additions / further advances	0.2	-	-	-	**0.2**
At 31 December	**410.0**	**1.5**	**(210.7)**	**(150.1)**	**50.7**

Notes
1. Included in the ‘Fair value gains / (losses) on equity release portfolio’ line in the Income Statement.
2. £2.6m of this figure is included in the ‘Fair value gains / (losses) on other derivatives’ line in the Income Statement; the remaining £0.8m is included in the ‘Fair value gains / (losses) on hedging instruments and hedged items’ line in the Income Statement.
3. Included in the ‘Fair value gains / (losses) on deemed loans from subsidiary undertakings designated at FVTPL’ line in the Income Statement and relates to the fair value movements in the deemed loans repayable to the Group’s securitisation entities, as outlined in note 1c).
4. Included in the ‘Interest receivable and similar income’ line in the Income Statement.
5. Included in the ‘Realised losses on equity release portfolio’ line in the Income Statement.

Society

			2018		
	Equity release portfolio	Loans and advances to customers	Derivative financial instruments	Amounts owed to credit institutions and other customers	Total
	£m	£m	£m	£m	£m
At 1 January	426.6	-	(231.9)	(414.8)	(220.1)
(Loss) / gain recognised in Income Statement	(17.1)[1]	-	16.6[2]	1.4[3]	0.9
Transfer of engagements	-	1.7	-	-	1.7
Accrued interest	8.0[4]	-	-	-	8.0
Repayments	(6.2)	(0.7)	-	88.5	81.6
Realised losses	(0.7)[5]	-	-	-	(0.7)
Additions / further advances	0.3	0.9	-	-	1.2
At 31 December	410.9	1.9	(215.3)	(324.9)	(127.4)

Notes
1. Included in the ‘Fair value gains / (losses) on equity release portfolio’ line in the Income Statement.
2. £18.1m of this figure is included in the ‘Fair value gains / (losses) on other derivatives’ line in the Income Statement; the remaining £(1.5)m is included in the ‘Fair value gains / (losses) on hedging instruments and hedged items’ line in the Income Statement.
3. Included in the ‘Fair value (losses) / gains on deemed loans from subsidiary undertakings designated at FVTPL’ line in the Income Statement and relates to the fair value movements in the deemed loans repayable to the Group’s securitisation entities, as outlined in note 1c).
4. Included in the ‘Interest receivable and similar income’ line in the Income Statement.
5. Included in the ‘Realised losses on equity release portfolio’ line in the Income Statement.

Equity share investments

The valuation of unlisted investments is regarded as a Level 3 valuation technique as certain inputs are not market observable. Further details are found in note 17e).

Equity release portfolio

The valuation of the equity release portfolio is regarded as a Level 3 valuation technique as certain inputs into the valuation are not market observable. Further details on the valuation techniques used are found in note 1e). Further details on the inputs into the valuation and the impact of reasonably possible alternative assumptions of certain inputs into the valuation of the portfolio are found in note 1t).

Derivative financial instruments

The Level 3 derivative financial instruments included in the tables on pages 213 to 215 comprise derivatives which are used to hedge the Group’s interest rate risk and inflation risk arising from the equity release portfolio. The valuation of these derivatives is regarded as a Level 3 valuation technique as certain inputs into the valuation are not market observable. Further details on the inputs into the valuation and the impact of reasonably possible alternative assumptions of certain inputs into the valuation of these derivatives are found in note 1t).

Any change in fair value of the derivative liabilities is offset to some extent by a corresponding but opposite change in the value of the equity release portfolio. The characteristics and the valuation requirements differ slightly between the derivatives and the equity release portfolio resulting in the changes in fair value not offsetting completely. During the year the net impact to the Income Statement was a £3.4m charge (2018: £1.0m credit).

Loans and advances to customers

The valuation of these loans and advances to customers is regarded as a Level 3 valuation technique as certain inputs are not market observable. Further details are found in note 1e).

Contingent consideration

The valuation of contingent consideration is regarded as a Level 3 valuation technique as certain inputs into the valuation are not market observable. Further details are found in note 1e).

Share warrants and other assets

These assets relate to share warrants held in an unlisted entity and amounts recognised, where appropriate, for additional share warrants yet to be received. The valuation of these assets is regarded as a Level 3 valuation technique as certain inputs into the valuation are not market observable. Further details are found in note 1e).

Fair value of put option obligation

A key input into the calculation of the fair value of the put option obligation is the estimate of the market value of the non-controlling shareholding. As this input is based on the judgement of senior management, the valuation of the put option obligation is considered to be a Level 3 valuation technique.

39. Fair values *(continued)*

Amounts owed to credit institutions and other customers

These balances relate to deemed loans payable by the Society to the Group's SPVs. The amount represents the proceeds received by the Society for assets transferred to the SPVs less repayments to date. The valuation is regarded as a Level 3 valuation technique as certain inputs are not market observable. Further details are found in note 13.

c) Fair values of financial instruments not carried at fair value

The tables below summarise the carrying values and fair values of those financial assets and liabilities not presented within the Statement of Financial Position at fair value.

	Group 2019		Society 2019	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets:				
Cash in hand and balances with the Bank of England	1,793.1	1,793.1	1,793.1	1,793.1
Loans and advances to credit institutions	546.6	546.6	465.8	465.8
Loans and advances to customers	20,065.6	20,248.6	17,891.6	18,048.3
Trade receivables	30.7	30.7	1.4	1.4
Loans to subsidiary undertakings	-	-	777.9	777.9
	22,436.0	**22,619.0**	**20,929.8**	**21,086.5**
Financial liabilities:				
Shares	17,364.1	17,470.4	17,362.3	17,470.4
Amounts owed to credit institutions	1,678.3	1,678.3	1,743.6	1,743.6
Amounts owed to other customers	1,816.9	1,819.6	265.3	263.4
Debt securities in issue	2,302.6	2,310.8	2,194.9	2,209.1
Lease liabilities	66.6	66.6	12.5	12.5
Trade payables	6.7	6.7	2.5	2.5
Subscribed capital	41.6	73.4	41.6	73.4
	23,276.8	**23,425.8**	**21,622.7**	**21,774.9**

	Group 2018*		Society 2018*	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets:				
Cash in hand and balances with the Bank of England	2,395.7	2,395.7	2,395.7	2,395.7
Loans and advances to credit institutions	422.7	422.7	349.5	349.5
Loans and advances to customers	18,119.0	18,260.1	15,991.2	16,129.1
Trade receivables	31.3	31.3	1.8	1.8
Loans to subsidiary undertakings	-	-	854.4	854.4
	20,968.7	21,109.8	19,592.6	19,730.5
Financial liabilities:				
Shares	16,113.5	16,186.3	16,112.1	16,184.9
Amounts owed to credit institutions	1,878.0	1,878.9	1,999.9	2,000.8
Amounts owed to other customers	1,690.5	1,695.0	204.3	204.2
Debt securities in issue	1,420.3	1,410.3	1,194.4	1,188.1
Trade payables	5.4	5.4	1.8	1.8
Subscribed capital	41.6	69.0	41.6	69.0
	21,149.3	21,244.9	19,554.1	19,648.8

* Loans and advances to customers, shares and amounts owed to other customers are restated as outlined in note 1b).

Key considerations in the calculation of fair values of those financial assets and liabilities not presented within the Statement of Financial Position at fair value are set out below unless there is no significant difference between carrying value and fair value.

Loans and advances to customers

For fixed rate and tracker mortgage products, the Group has estimated the fair value of these products using discounted cash flows and has applied relevant current market product rates as discount rates in order to also incorporate an element of future expected credit losses. Incurred losses have also been included. Fixed rate and tracker mortgages have been discounted using current market product rates that are specific to the particular market to which they relate.

Market prices will generally have moved since the fixed or tracker rate was taken out, therefore the valuation of these products will change reflecting upwards or downwards movements in market rates. The valuation includes information and expectations regarding estimated redemption profiles which are regularly reviewed and updated in light of experience.

As these redemption profiles are not considered to be observable by the market, the fair value of loans and advances to customers is considered to be derived by using Level 3 valuation techniques.

For standard variable rate mortgage products, the interest rate on such products is equivalent to a current market product rate and as such the Group considers the fair value of these mortgages to be equal to their carrying value.

Shares

Savings products at variable rates are at current market rates and therefore the Group regards the fair value to be equal to the carrying value.

The fair value of fixed rate savings products has been determined using discounted cash flows, discounted using a combined yield curve of cash and swap term rates.

Changes in market prices since the product was taken out will result in increases or decreases in the fair value of the fixed rate savings products. Penalties for early withdrawal on notice accounts are such as to suggest a negligible early withdrawal rate and none has therefore been applied; as a result the valuation of shares is considered to be a Level 2 valuation technique.

Amounts owed to credit institutions and other customers

Balances in these categories are valued using discounted cash flows which use only observable market inputs consisting of the combined yield curve of cash and swap term rates. All inputs to this valuation technique are market observable and as such they are categorised within Level 2 of the fair value hierarchy.

Debt securities in issue

Where securities are actively traded in a recognised market, with readily available and quoted prices, these have been used to value the securities. These securities are therefore regarded as having Level 1 fair values. Where such prices are not available, discounted cash flows are used, again using only market observable inputs consisting of a combined yield curve of cash and swap term rates. As such, these securities are categorised as having Level 2 fair values.

Subscribed capital

Prices are quoted for these instruments in actively traded markets and, as a result, these instruments are categorised as having Level 1 fair values.

d) Fair values of non-financial assets and liabilities not carried at fair value

The fair value of investment property, which is a non-financial asset, is disclosed in these financial statements. Note 20 contains details of the valuation techniques used in estimating this fair value, together with the resulting categorisation of these valuation techniques within the fair value hierarchy.

40. Group segmental reporting

The Group's structure and reportable segments are outlined in the Strategic Report on pages 14 and 15.

Transactions between the segments are on normal commercial terms and conditions. The accounting policies of the reportable segments are consistent with the Group's accounting policies. The Group has not aggregated any of its operating segments for the purposes of financial reporting.

No geographical analysis is presented because substantially all of the Group's activities are conducted within the UK. Of the total external income, £33.6m (2018: £38.6m) was generated outside the UK.

A breakdown of the allocation of goodwill to each segmental area is included within note 21.

	2019				
	Mortgages and Savings	**Estate Agency**	**Investment Portfolio**	**Sundry incl. inter-divisional adjustments**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
Net interest income	226.9	0.1	2.1	9.0	**238.1**
Net non-interest income	29.7	441.1	26.9	(12.7)	**485.0**
Fair value gains on hedged items and derivatives	3.8	-	-	-	**3.8**
Fair value losses on equity release portfolio	(6.0)	-	-	-	**(6.0)**
Realised profits on treasury assets held at FVOCI	2.4	-	-	-	**2.4**
Profit on disposal of Group undertakings	-	-	-	1.1	**1.1**
Share of profits from joint ventures	-	1.7	-	-	**1.7**
Total income	**256.8**	**442.9**	**29.0**	**(2.6)**	**726.1**
Administrative expenses	(156.6)	(373.4)	(24.9)	0.9	**(554.0)**
Realised losses on equity release portfolio	(0.5)	-	-	-	**(0.5)**
Impairment and provisions for liabilities	1.1	(19.4)	(0.1)	-	**(18.4)**
Profit / (loss) before tax	**100.8**	**50.1**	**4.0**	**(1.7)**	**153.2**
Taxation	(20.2)	(11.3)	(0.4)	1.1	**(30.8)**
Profit / (loss) after tax	**80.6**	**38.8**	**3.6**	**(0.6)**	**122.4**
Total assets	**25,242.5**	**332.0**	**120.7**	**(205.8)**	**25,489.4**
Total liabilities	**23,785.5**	**174.2**	**113.5**	**(216.0)**	**23,857.2**

Total income can be analysed as follows:

	2019				
	Mortgages and Savings	**Estate Agency**	**Investment Portfolio**	**Sundry incl. inter-divisional adjustments**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
External income	255.0	430.3	30.4	10.4	**726.1**
Income from other segments	1.8	12.6	(1.4)	(13.0)	**-**
Total income	**256.8**	**442.9**	**29.0**	**(2.6)**	**726.1**

	2018 Restated*				
	Mortgages and Savings	Estate Agency	Investment Portfolio	Sundry incl. inter-divisional adjustments	Total
	£m	£m	£m	£m	£m
Net interest income	230.6	0.3	2.1	8.2	241.2
Net non-interest income	31.9	444.0	30.3	(13.7)	492.5
Fair value gains on hedged items and derivatives	20.1	-	-	-	20.1
Fair value losses on equity release portfolio	(17.1)	-	-	-	(17.1)
Fair value losses on other financial assets held at FVTPL	-	(0.3)	-	-	(0.3)
Profit on disposal of Group undertakings	-	-	-	3.3	3.3
Share of profits from joint ventures	-	0.8	-	-	0.8
Total income	265.5	444.8	32.4	(2.2)	740.5
Administrative expenses	(148.7)	(374.8)	(24.6)	11.6	(536.5)
Realised losses on equity release portfolio	(0.7)	-	-	-	(0.7)
Impairment losses and provisions for liabilities	(1.3)	(13.1)	(0.2)	-	(14.6)
Profit before tax	114.8	56.9	7.6	9.4	188.7
Taxation	(27.3)	(11.9)	(0.9)	(0.6)	(40.7)
Profit after tax	87.5	45.0	6.7	8.8	148.0
Total assets	22,995.5	263.8	104.4	(171.8)	23,191.9
Total liabilities	21,591.1	134.4	106.5	(156.7)	21,675.3

* Net non-interest income, fair value gains on hedged items and derivatives, administrative expenses, taxation, total assets and total liabilities are restated as outlined in note 1b).

Total income can be analysed as follows:

	2018 Restated*				
	Mortgages and Savings	Estate Agency	Investment Portfolio	Sundry incl. inter-divisional adjustments	Total
	£m	£m	£m	£m	£m
External income	263.7	433.5	33.6	9.7	740.5
Income from other segments	1.8	11.3	(1.2)	(11.9)	-
Total income	265.5	444.8	32.4	(2.2)	740.5

* The Mortgages and Savings and Estate Agency divisions have been restated resulting in an increase to external income of £0.5m and £15.5m respectively. For further details see note 1b).

Notes to the Accounts *(continued)*

41. Capital management

The components of the prudential group's capital and the associated regulatory framework are set out in the Strategic Report on pages 33 and 34, and this is followed by quantitative disclosure of the components of capital resources and capital requirements. The Group's capital management processes are set out in the Strategic Report on page 34. Throughout both the current year and the prior year, the Group complied with and maintained surplus capital above all externally imposed capital requirements.

42. Adoption of new and revised International Financial Reporting Standards

The Group adopted IFRS 16 *Leases* during the year, further details of which are provided in note 1b). In addition, the Group has early adopted in the year *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)*, further details of which are also provided in note 1b).

The Group also adopted during the year the following new interpretations and amendments to existing accounting standards, none of which had a material impact on these financial statements:

- IFRIC 23 *Uncertainty over Income Tax Treatments;*
- *Prepayment Features with Negative Compensation* (Amendments to IFRS 9);
- *Long-term Interests in Associates and Joint Ventures* (Amendments to IAS 28);
- *Plan Amendment, Curtailment or Settlement* (Amendments to IAS 19); and
- *Annual Improvements to IFRS Standards 2015-2017 Cycle* (various standards).

Standards issued but not yet effective

A number of new and amended accounting standards and interpretations will be effective for future reporting periods, none of which has been early adopted by the Group in preparing these consolidated financial statements. These new and amended standards and interpretations, details of which are set out below, are not expected to have a material impact on the Group's consolidated financial statements:

- *Amendments to References to the Conceptual Framework in IFRS Standards*;
- *Definition of a Business* (Amendments to IAS 3);
- *Definition of Material* (Amendments to IAS 1 and IAS 8);
- IFRS 17 *Insurance Contracts*;
- *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28); and
- IFRS 14 *Regulatory Deferral Accounts*.

43. Subsequent events

On 24 February 2020, the Group completed its fifth securitisation transaction through Darrowby No. 5 plc, raising £500m of wholesale funding.

There have been no other material subsequent events between 31 December 2019 and the date of approval of this Annual Report and Accounts by the Board.

4 Other Information

Country by Country Reporting

Nature of the Group's activities

The Skipton Building Society Group holds an investment in a number of subsidiary undertakings. The Society and the majority of its subsidiary undertakings are incorporated in the UK, with the exception of the entities listed below. For a full list of the principal trading subsidiaries in the Group and the nature of their activities, see note 17a) of the financial statements.

Name of subsidiary undertaking	Principal business activity	Country of incorporation	% ownership interest 31.12.19
Jade Software Corporation Limited	Provider of software development services	New Zealand	99.98
Northwest Investments NZ Limited	Provider of software development services	New Zealand	100.0
Skipton International Limited	Offshore deposit taker and lender	Guernsey	100.0

Jade Software Corporation Limited also holds a 100% ownership in the following trading subsidiary undertakings, all of which carry out the principal business activity of the Jade group of businesses.

Name of subsidiary undertaking	Country of incorporation
Jade Software Corporation (NZ) Limited	New Zealand
Jade Software Corporation Pty Limited	Australia
Jade Software Corporation UK Limited	UK
Jade Software Corporation USA	USA

In addition, the Group holds a non-controlling interest of 17.7% in Wynyard Group Limited, which entered liquidation in February 2017 and which is incorporated in New Zealand.

Country by country disclosures

An analysis of turnover, which is regarded as total income as defined below (and which excludes dividend income from subsidiaries), profit before tax, the current tax charge, corporation taxes paid, public subsidies received and the average number of employees on a full-time equivalent basis is set out below. The information presented is at a full Group level of consolidation. Total income is defined as net interest income plus fees and commissions receivable (net of fees and commissions payable), together with all other components of operating income. Total gross income and total gross profit before tax, for each country, represents consolidated income or profit before tax for that country.

2019 £m	UK	Australia	Guernsey	New Zealand	Jersey	USA	Total
Total income by country	681.4	3.6	28.9	12.2	-	0.5	726.6
Inter-country adjustments	(0.1)	-	0.1	(0.5)	-	-	(0.5)
Consolidated income	681.3	3.6	29.0	11.7	-	0.5	726.1
Profit before tax by country	132.0	0.4	21.2	(0.4)	-	-	153.2
Inter-country adjustments	0.3	0.7	0.7	(1.8)	-	0.1	-
Consolidated profit before tax	132.3	1.1	21.9	(2.2)	-	0.1	153.2

£m	UK	Australia	Guernsey	New Zealand	Jersey	USA	Total
Current tax expense	29.4	0.1	2.1	-	-	-	31.6
Corporation taxes paid	29.6	0.1	3.0	-	-	-	32.7
Public subsidies received*	-	-	-	0.2	-	-	0.2
Average number of employees	8,438	21	57	186	4	1	8,707

2018 £m	UK[1]	Australia	Guernsey[1]	New Zealand	Jersey	USA	Total[1]
Total income by country	692.6	4.1	26.9	16.9	-	0.5	741.0
Inter-country adjustments	0.2	0.9	0.2	(1.8)	-	-	(0.5)
Consolidated income	692.8	5.0	27.1	15.1	-	0.5	740.5
Profit before tax by country	164.9	0.3	20.0	3.5	-	-	188.7
Inter-country adjustments	0.1	1.3	0.8	(2.2)	-	-	-
Consolidated profit before tax	165.0	1.6	20.8	1.3	-	-	188.7

£m	UK[1]	Australia	Guernsey[1]	New Zealand	Jersey	USA	Total[1]
Current tax expense	38.1	0.1	1.8	-	-	-	40.0
Corporation taxes paid	38.3	0.1	2.0	-	-	-	40.4
Public subsidies received*	-	-	-	0.2	-	-	0.2
Average number of employees	8,512	26	48	190	4	2	8,782

* Public subsidies received relate to cash payments received from governments in the form of grants.

[1] Restated as described in note 1b).

Other Information

Annual Business Statement

1. Statutory percentages

	As at 31 December 2019 %	Statutory Limit %
Lending limit	**3.85**	25.00
Funding limit	**20.18**	50.00

These percentages form part of the audited Accounts.

Explanation

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986.

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property. Business assets are defined as the total assets of the Group plus provisions for impairment losses on loans and receivables, less liquid assets, intangible assets, property, plant and equipment, right-of-use assets and investment properties as shown within the Group Statement of Financial Position.

The funding limit measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. We have taken advantage of the relief set out in SI 2007/No 860, effective from April 2007, to exclude retail offshore deposits from the total of wholesale funds.

The statutory limits are as laid down under the Building Societies Act 1986 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. Other percentages

	2019 %	2018 Restated* %
As a percentage of shares and borrowings:		
(i) Gross capital	**7.23**	7.38
(ii) Free capital	**5.87**	6.19
(iii) Liquid assets	**19.53**	19.91
As a percentage of mean total assets:		
(i) Group profit after taxation	**0.50**	0.67
(ii) Group management expenses	**2.28**	2.43
(iii) Society management expenses	**0.65**	0.67
As a percentage of closing total assets:		
(i) Group profit after tax	**0.48**	0.64

* Restated as described in note 1b).

These percentages form part of the audited Accounts.

Explanation

The above percentages have been calculated from the Group and Society Income Statements and Statements of Financial Position.

Shares, deposits and borrowings represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and the fair value adjustments for hedged risk.

Gross capital represents the general reserve together with the fair value reserve, cash flow hedging reserve, cost of hedging reserve, translation reserve and subscribed capital, as shown within the Group Statement of Financial Position.

Free capital represents gross capital plus provisions for collective impairment losses on loans and advances to customers, less property, plant and equipment, right-of-use assets, investment properties and intangible assets as shown within the Group Statement of Financial Position.

Liquid assets represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities. Mean total assets are the average of the 2019 and 2018 total assets. Management expenses represent administrative expenses.

3. Information relating to Directors at 31 December 2019

The Board of Directors at 31 December 2019, their dates of birth and dates of appointment as a Director are as follows:

	Date of birth	Date of appointment
A P Bottomley*	12 July 1965	1 January 2016
A J Burton	3 January 1959	3 May 2016
J R Coates	26 September 1951	27 March 2017
D P Cockrem	15 November 1962	1 September 2015
I M Cornelius*	11 February 1969	11 June 2012
D J Cutter*	1 January 1962	1 January 2000
R D East	18 March 1960	29 November 2011
D A Hall	9 November 1955	27 March 2017
H L Jackson	23 August 1965	24 October 2018
M J Lund	1 July 1957	25 April 2016
R S D M Ndawula*	24 February 1974	23 February 2015
H C Stevenson	10 November 1960	1 March 2013

* Executive Directors

Documents may be served on any of the above named Directors at the following address: Addleshaw Goddard, 3 Sovereign Square, Sovereign Street, Leeds, LS1 4ER.

The Directors' business occupations and other directorships at 31 December 2019 were as follows:

A P Bottomley	Building Society Customer Director	Skipton Financial Services Limited Skipton Group Holdings Limited
A J Burton	Non-Executive Director	Battersea Dogs' and Cats' Home Bellmead Kennels Limited Connells Limited Countryside Properties Plc HSS Hire Group Plc Skipton Group Holdings Limited
J R Coates	Non-Executive Director	Skipton Group Holdings Limited TPT Retirement Solutions Ltd The Veterinary Defence Society Limited
D P Cockrem	Non-Executive Director	Ecclesiastical Group Healthcare Trustees Ltd Ecclesiastical Insurance Group PLC Ecclesiastical Insurance Office PLC Edentree Asset Management Limited Edentree Investment Management Limited Lycetts Holdings Limited Macintyre Acadamies Trust Skipton Group Holdings Limited
I M Cornelius	Building Society Commercial and Strategy Director	BCHT Development Company Ltd Giggleswick School Incommunities Group Limited Incommunities Treasury PLC Jade Software Corporation Limited Skipton Group Holdings Limited Skipton International Limited Skipton Trustees Limited

Other Information

Annual Business Statement *(continued)*

D J Cutter	Building Society Group Chief Executive	Bailey Computer Services Limited Connells Limited Craven Educational Trust Leeds Share Shop Limited Moorlands Learning Trust Northwest Investments NZ Limited Skipton Group Holdings Limited Skipton Group Limited Skipton Investments Limited Skipton Limited Skipton Mortgage Corporation Limited Skipton Mortgages Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Skipton Trustees Limited
R D East	Non-Executive Director & Chair	Hampshire Trust Bank Plc Provident Financial plc RCWJ Limited Skipton Group Holdings Limited Vanquis Bank Limited
D A Hall	Non-Executive Director	Cembra Money Bank Moneta Money Bank Skipton Group Holdings Limited
H L Jackson	Non-Executive Director	Ikano Bank AB JD Sports Fashion Plc Lookers Motor Group Limited Lookers PLC Skipton Group Holdings Limited
M J Lund	Non-Executive Director	Coutts & Company Equiniti Financial Services Limited MyCSP Limited MyCSP Trustee Company Limited Skipton Group Holdings Limited
R S D M Ndawula	Building Society Group Finance Director	Connells Limited Leeds Share Shop Limited Skipton Financial Services Limited Skipton Group Holdings Limited Skipton Group Limited Skipton Limited Skipton Mortgage Corporation Limited Skipton Mortgages Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Yorkshire Cancer Research
H C Stevenson	Non-Executive Director	Henley Business School Kin and Carta plc NHW Consultancy Limited Reach plc Skipton Group Holdings Limited The Wellington College International Limited XYZXYZ Limited

Messrs Bottomley, Cornelius, Cutter and Ndawula have service contracts entered into on 1 January 2016, 7 December 2012, 1 January 2000 and 25 February 2015 respectively which may be terminated by either party giving one year's notice.

4. Principal office

Skipton Building Society is a building society incorporated and domiciled in the United Kingdom. The address of the principal office is The Bailey, Skipton, North Yorkshire, BD23 1DN.

Glossary

Set out below are the definitions of terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue.
Asset backed securities (ABS)	An asset backed security is a security whose value and income payments are derived from and collateralised (or 'backed') by a specified pool of underlying assets. Typically these assets are pools of residential or commercial mortgages.
Buy-to-let mortgages	Mortgages offered to customers purchasing residential property to be rented to others to generate a rental income.
Common Equity Tier 1 capital	Common Equity Tier 1 (CET 1) capital primarily comprises internally generated capital from retained profits. An adjustment is made to deduct intangible assets and goodwill. CET 1 capital is fully loss absorbing.
Contractual maturity	The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets to be solely for the benefit of the holders of the covered bonds. The Group has established covered bonds as part of its funding activities. Covered bonds use retail / residential mortgages as the asset pool.
CRD IV	CRD IV is made up of the Capital Requirements Regulation (CRR), which is directly applicable to firms across the EU, and the Capital Requirements Directive (CRD), which must be implemented through national law. CRD IV became effective in the UK from 1 January 2014.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Derivative financial instruments	A derivative financial instrument is a type of financial instrument (or an agreement between two parties) that has a value based on the underlying asset, index or reference rate it is linked to. The Group uses derivative financial instruments to hedge its exposures to market risks such as interest rate risk and currency risk.
Effective interest rate (EIR) method	The method used to measure the carrying value of a financial asset or liability measured at amortised cost and to allocate associated interest income or expense over the relevant period.
Expected Credit Loss (ECL)	The present value of all cash shortfalls over the expected life of the financial instrument to determine impairment allowances under IFRS 9.
Exposure at default (EAD)	The expected outstanding balance of an asset at the time of default.
Fair value	Fair value is the amount for which an asset could be exchanged, or a liability settle¬d, between knowledgeable, willing parties in an arm's-length transaction.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry.
Forbearance strategies	Strategies to assist borrowers in financial difficulty, such as arrears capitalisation, a reduction in the monthly payment, a conversion to interest only or a mortgage term extension. Forbearance strategies aim, if possible, to avoid foreclosure or repossession.
Free capital	The aggregate of gross capital plus provisions for collective impairment losses on loans and advances to customers less property, plant and equipment, right-of-use assets, investment properties and intangible assets.

Glossary *(continued)*

Funding limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.
Goodwill	Goodwill arises on the acquisition of subsidiary undertakings, joint ventures, associates or other businesses and represents the excess of the fair value of consideration over the fair value of separately identifiable net assets acquired at the date of acquisition.
Gross capital	The aggregate of the general reserve, translation reserve, fair value reserve, cash flow hedging reserve, cost of hedging reserve, subscribed capital and non-controlling interests.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's own assessment, as part of regulatory requirements, of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Group's own assessment that current and projected levels of liquidity are sufficient and appropriate for the Group's plans, under a variety of stress scenarios. It also details the Group's compliance with the PRA's regulatory requirements.
Internal Ratings Based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under CRD IV. The IRB approach may only be used with permission from the PRA.
International Swaps and Derivatives Association (ISDA) Master Agreement	A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions.
Investment grade	The range of credit ratings from Aaa to Baa3, as measured by external credit rating agencies.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property. The calculation of the lending limit is explained in the Annual Business Statement.
Leverage ratio	The ratio of Tier 1 capital divided by total exposure, which includes on and off balance sheet assets, after netting derivatives.
Liquid assets	The total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.
Liquidity Coverage Ratio	A measure designed to ensure that financial institutions have sufficient high quality assets available to meet their liquidity needs for a 30 day liquidity stress scenario.
Liquidity ratio	Liquid assets as a percentage of shares, deposits and borrowings.
Loan-to-value ratio (LTV)	A ratio which expresses the balance of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTVs on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in a house price index).
Loans past due / past due loans	Loans on which payments are overdue including those on which partial payments are being made.
Loss given default (LGD)	An estimate of the loss that would be incurred should a borrower default on their credit obligations.
Management expenses	Management expenses represent administrative expenses. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Material Risk Takers (MRTs)	A group of employees to which the FCA's Remuneration Code applies. MRTs consist of Executive Directors, Non-Executive Directors and certain senior managers who could have a material impact on the firm's risk profile.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Medium term notes (MTN)	Corporate notes continuously offered by an entity to investors through a dealer.

Member	A person who has a share investment or a mortgage loan with the Society, or is the holder of a Permanent Interest Bearing Share in the Society.
Mortgage backed securities (MBS)	Assets which are backed by underlying mortgage collateral.
Net interest income	The difference between interest received on assets and interest paid on liabilities.
Net interest margin	Net interest income as a percentage of mean total assets.
Permanent Interest Bearing Shares (PIBS) or subscribed capital	Unsecured, deferred shares that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing members of Skipton Building Society.
Prime	Prime mortgages are those granted to the most credit worthy category of borrower.
Probability of Default (PD)	An estimate of the probability that a borrower will default on their credit obligations.
Put option	Where the Group acquires a majority shareholding in a subsidiary undertaking, but grants the non-controlling shareholders an option to sell their shares to the Group at some future date(s), a put option obligation exists.
Renegotiated loans	Loans are classed as renegotiated, with the customer's consent, when their terms have changed during the year. Loans and advances may be renegotiated whether or not the customer is experiencing financial difficulty in repaying their loan with the Group.
Repo / reverse repo	Short to medium term funding agreements which allow a borrower to sell a financial asset, such as an ABS or government bond, as security for cash. As part of the agreement the borrower agrees to repurchase the security at some later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo, which can typically be resold or repledged if desired.
Residential loans	Mortgage lending secured against residential property.
Residential mortgage backed securities (RMBS)	A category of ABS that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).
Risk appetite	The articulation of the level of risk that the Group is willing to take in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk weighted asset (RWA)	The value of assets, after adjustment, under CRD IV rules to reflect the degree of risk they represent.
Securitisation	A process by which a group of assets, usually loans, are aggregated into a pool which is used to back the issuance of new securities. A firm transfers these assets to a special purpose vehicle which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities. These securitisation structures use retail / residential mortgages as the asset pool.
Shares	Money deposited by non-corporate depositors in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares, deposits and borrowings	The total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and fair value adjustments for hedged risk.
Significant increase in credit risk	A significant increase in credit risk on a financial asset is judged to have occurred when an assessment using quantitative and qualitative factors identifies that the credit risk has increased significantly since the asset was originally recognised.
SPPI test	An assessment of whether the contractual terms of the financial asset give rise to cash flows that are in substance solely payments of principal and interest.
Stage 1 financial assets	Stage 1 financial assets are those which have not experienced a significant increase in credit risk since origination. 12 month ECLs are recognised and interest revenue is determined by the EIR on the gross carrying amount.

Glossary *(continued)*

Stage 2 financial assets	Stage 2 financial assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECLs are recognised and interest revenue is determined by the EIR on the gross carrying amount.
Stage 3 financial assets	Stage 3 financial assets are identified as in default and considered credit impaired. Lifetime ECLs are recognised and interest revenue is determined by the EIR on the net carrying amount.
Term Funding Scheme (TFS)	A scheme launched by the Bank of England in 2016 which allows qualifying financial institutions to borrow central Bank of England reserves in exchange for eligible collateral to provide access to cost effective funding to support lending to customers.
Tier 1 capital	A measure of financial strength. Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital comprises general reserves from retained profits. The book values of goodwill and other intangible assets are deducted from Common Equity Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as PIBS are included in other Tier 1 capital (i.e. not Common Equity Tier 1).
Tier 2 capital	Tier 2 capital comprises PIBS that have been transitioned out of additional Tier 1 capital – under CRD IV all of the Society's PIBS will be phased out of Tier 1 capital as they fail to satisfy the CRD IV requirements. However the Society's PIBS will continue to satisfy the criteria for Tier 2 capital and will therefore be phased into Tier 2.
Wholesale funding	Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue excluding balances deposited by offshore customers.

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