Annual Report & Accounts
2016

SKIPTON
BUILDING SOCIETY
For your life ahead

Contents

2016 Group Highlights

Key performance highlights

22,316 New customers
Society customer numbers increased by 22,316 to 860,403

£1.3bn Savings balances growth
Savings balances grew by £1.3bn to £14.1bn, an annual growth rate of 10.0% (2015: 11.9%)

£4.0bn Gross residential mortgage lending
Gross residential mortgage lending in the year up by 8.0% to £4.0bn (2015: £3.7bn)

£1.3bn Mortgage book growth
The mortgage book grew by £1.3bn to £15.5bn, an annual growth rate of 9.1% (2015: 11.9%)

£168.9m Total Group profit before tax
Total Group profit before tax (PBT) was £168.9m (2015: £146.9m)

£151.5m Underlying Group profit before tax
Underlying Group PBT (as defined on page 19) was £151.5m (2015: £153.3m)

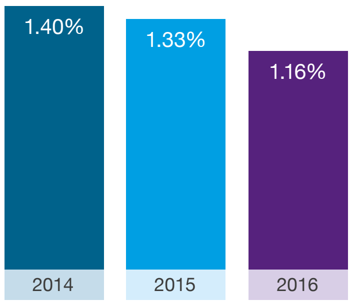
23.9% Group Common Equity Tier 1 ratio
Group Common Equity Tier 1 ratio was strong at 23.9% (2015: 16.8%)[1]

90% Net customer satisfaction
Society net customer satisfaction was 90% (2015: 88%)

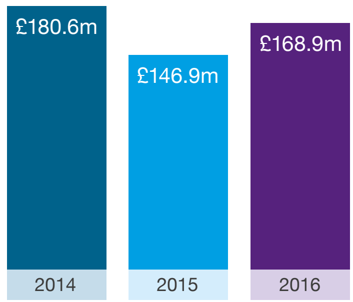
90% Employee engagement
Society employee engagement was maintained at 90% (2015: 90%)

[1] The 2016 Common Equity Tier 1 (CET 1) ratio is now calculated on an Internal Ratings Based (IRB) basis, rather than standardised as is the case for the comparative figure, following IRB status approval during 2016. Had the Society remained on the standardised approach its CET 1 ratio at 31 December 2016 would have been 17.3% (2015: 16.8%).

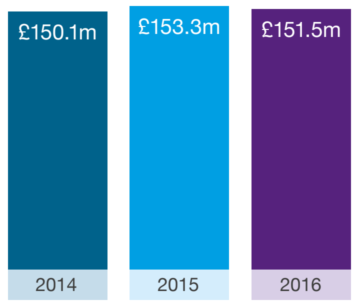
Three Year Financial Highlights
Year ended 31 December



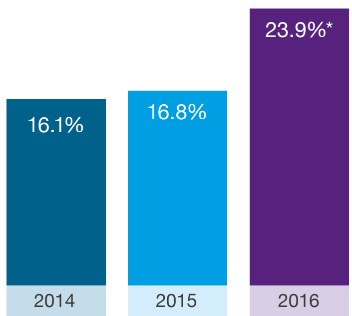
Net interest margin



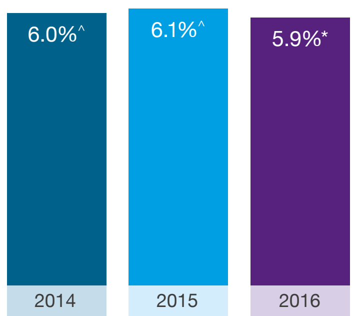
Total Group profit before tax



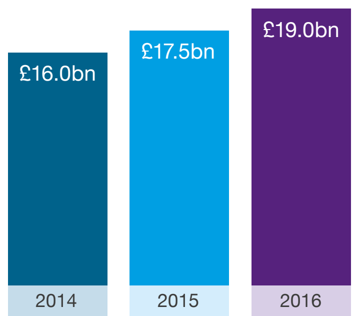
Underlying Group profit before tax (note 1)



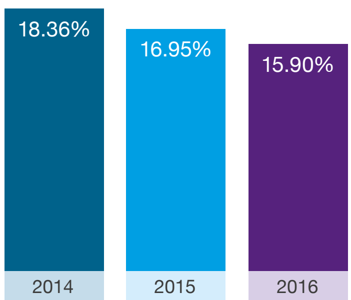
Group Common Equity Tier 1 ratio



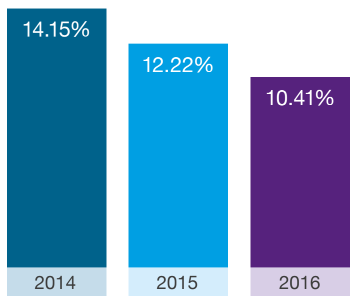
Leverage ratio



Total assets



Liquidity ratio



Wholesale funding ratio

* 2016 is calculated on an IRB basis, whereas comparative figures are calculated on a standardised basis, following IRB status approval during 2016. Further details can be found on pages 27 to 29.

^ The comparative figures have been restated to reflect a change to the way the leverage ratio exposure measure is calculated, reflecting a reduction in exposures for collateral the Society has provided against derivative liabilities, in accordance with CRD IV rules.

Note:

1. Underlying profit before tax excludes Financial Services Compensation Scheme charges, gains or losses on disposal of subsidiary, associate and equity share investments, and impairment of subsidiary, associate and equity share investments. Further details on underlying profit before tax are included on page 19.

Awards won

What Mortgage Awards – Best National Building Society 2016

Mortgage Finance Gazette Awards 2016 – Winner Customer Service/Treating Customers Fairly - Lenders

Business in the Community – Finalist with Retiresavvy

Your Money Direct Awards 2016 – Best Online Cash ISA Provider

Financial Adviser Service Awards 2016 – 5 Star Mortgage Provider (Skipton Intermediaries)

MoneySuperMarket 'Supers' Awards 2016 – Best Cash ISA Savings Provider and Best Savings Account Provider

Chairman's Statement

This is my sixth statement as the Chairman of the Society, which has seen significant change over the past six years. I will be retiring from the Board at the conclusion of the Annual General Meeting (AGM) on 24 April 2017, and have reflected on the progress the Society has made in recent years.

The Society's business model has been simplified and de-risked through the disposal or closure of a number of our subsidiaries during recent years. We are now focussed on our core mortgages and savings business and building a better society, with considerable support from our highly profitable estate agency, the Connells group.

Core business performance

During 2016, we integrated within the Society our financial advice service, previously undertaken by a separate subsidiary Skipton Financial Services Limited (SFS). We remain committed to providing financial advice for our customers and believe that the integration not only demonstrates this commitment, but also enables us to more efficiently and effectively deliver a seamless service, which includes advice on pensions and investments.

Our mortgages and savings business delivered another solid performance in 2016, despite the economic uncertainties and competitive pressures on our net interest margin. Group profit before tax (PBT) on a statutory basis was £168.9m (2015: £146.9m) and on an underlying basis (as defined on page 19) was lower at £151.5m compared to £153.3m in the previous year, mainly due to the lower net interest margin at 1.16% compared to 1.33% in 2015. We expect to see further margin pressure but are well placed to serve the needs of an increasing number of savings and mortgage customers.

Indeed, the Society is in a strong financial position as demonstrated by our Common Equity Tier 1 capital ratio of 23.9%. From 1 December 2016, we report our capital ratios using the Internal Ratings Based (IRB) approach for credit risk, which improves our understanding of the capital requirements and credit risks associated with our loan books, and better informs pricing and credit management decisions.

The financial strength of the Society was also recognised by an upgrade in our long term rating from Fitch Ratings to A-, with a stable outlook. This is further welcome news for the Society and our members, and follows a series of positive ratings appraisals over the past few years. Our long term rating from Moody's Investor Services is Baa2, with a positive outlook.

Focus on our members and customers

We constantly seek to balance the requirements of our savings and borrowing customers and in 2016 grew mortgage and retail savings balances by 9.1% and 10.0% respectively. This resulted in customer numbers for the Society increasing by 22,316 to 860,403. The Society's average savings rate for the 11 months to the end of November 2016 was 0.58% higher than the average paid by UK banks and building societies (source: CACI Savings Market Database).

Most importantly, net customer satisfaction remained high at 90%, due to the attractiveness of our products and the excellent service provided by our people. We are proud to report that employee engagement has been maintained at 90%, which is considerably higher than the benchmark for financial services (as measured by Willis Towers Watson).

We seek input from our customers regarding the products and services we provide in a number of different ways. Our customer panel has 3,847 members, and during the last year has helped us to answer questions on a range of topics. In addition, we hold customer forums in which small groups of customers can share their views in an informal discussion. Our most recent forum took place in Chelmsford to explore how our proposition resonated with customers outside of our heartland.

In 2016, we enhanced our digital services, introducing web chat for mortgage brokers and for customers using our online savings portal. We also introduced new features on our website skipton.co.uk, including our popular 'Life Goals' tool, and new apps available for our customers via our in-branch iPads. We improved the experience for our online savers by enhancing our customer portal. We topped the year by winning the FT Adviser *Online Innovation and Service Award* for our efforts in improving our eMortgage system – a platform used by mortgage brokers.

Skipton Direct continued to be a central port of call for our customers, handling over a million calls in 2016. Skipton Direct processed 2,879 mortgage applications, helped 8,900 mortgage customers change their mortgage deal, and 19,900 customers with financial advice needs were booked in with one of our financial advisers. We pride ourselves on the excellent service our people provide across the Society and Skipton Direct is no exception, with 88% of customers surveyed saying they were extremely or very satisfied with this service.

> "The Society has made significant progress in recent years, as is evident in another solid set of results for 2016, and is well set for the future despite the global uncertainties that currently exist."

2016 saw us continue to invest in our branch network, with six branch refurbishments including our Bingley, Bradford and Glasgow branches. We have also invested in our Guildford branch and relocated our St Annes branch to a more prominent site in the town. We're committed to investing in our branch network, and have further refurbishments planned in 2017.

The Society has some 2,100 employees dedicated to serving our customers, and I would like to pay tribute to their unstinting efforts to serve and delight our customers - with that friendly human touch that is the hallmark of the Society.

Community

It's never been more important to us to work together with our members in the community. Our award winning Grassroots Giving community funding programme has been supporting small groups since 2013. Over the past four years we have donated over £320,000 to 646 clubs, groups and organisations across the UK, together with offering help in promoting them in their local areas.

In 2016 the Society donated £150,000 to the Skipton Building Society Charitable Foundation, which enabled the Foundation to support a host of well deserving causes. From supporting the invaluable work of hospices, helping older people stay active and providing equipment for volunteers to run activities for young people, our Charitable Foundation continues to help those whose needs are greatest.

We don't just support our physical communities; Retiresavvy, our online community dedicated to helping people make the most of retirement, has gone from strength to strength. Over the past year, the site and its Facebook following have continued to grow, helping us learn invaluable lessons about how to engage with people online on a topic that will affect us all. Retiresavvy featured the Women Against State Pension Inequality campaign in an article that has been viewed almost 60,000 times and generated over 200 comments. To find out more about our pioneering retirement community, visit retiresavvy.co.uk.

Subsidiary performance

I would also like to draw out the contribution made by our principal subsidiaries.

Skipton International Limited (SIL) is our Guernsey based mortgage and savings subsidiary serving the needs of the Channel Islands and expatriates. SIL made a profit of £15.2m in 2016 (£13.7m in 2015), which is included in the profits of our core mortgages and savings business, and its deposit and mortgage balances now each exceed £1bn.

Our estate agency business, Connells, reported profit before tax of £73.4m, including £17.0m from the sale of part of its shareholding in Zoopla Property Group Plc. On an underlying basis, profits were down on the previous year as the housing market cooled following the EU referendum vote. Our estate agency operation trades under a number of different brands including Connells, William H Brown, Barnard Marcus, Sharman Quinney, Peter Alan and Gascoigne Halman. In 2016, Connells acquired the Rook Matthews Sayer estate agency and Andersons & Associates surveying business, and also acquired a number of other smaller businesses.

Board composition

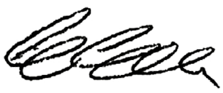
Turning to Board composition, there are a few changes in 2016 to report. As mentioned in last year's report, Cheryl Black and Nimble Thompson retired from the Board after the AGM in April 2016. Mark Lund joined the Board on the day of the 2016 AGM.

In May 2016 Amanda Burton joined the Board as a Non-Executive Director. Amanda is a lawyer by profession and is currently also a non-executive director of Countryside Properties, HSS Hire Group, Monitise plc and the Battersea Dogs and Cats Home.

Amanda will be standing for election to the Board at the 2017 AGM, as will all Directors seeking re-election to the Board.

As I mentioned earlier, I will be retiring from the Board following the AGM and, therefore, not seeking re-election. However, I am pleased to announce that the Board has appointed Robert East to succeed me as Chairman, subject to his re-election as a Non-Executive Director at the AGM. Robert has vast experience in financial services and a deep understanding of and commitment to the values of the Society. I commend him to all members as the new Chairman of the Society.

To conclude, the Society has made significant progress in recent years, as is evident in another solid set of results for 2016, and is well set for the future despite the global uncertainties that currently exist.



Mike Ellis
Chairman

28 February 2017

Group Chief Executive's Report

In my eight years as Chief Executive, 2016 was a year of UK economic and political change that I will not forget for some time. The country voted to leave the European Union, a new Prime Minister was appointed, and the Bank of England lowered Bank Base Rate to its lowest level in its 322 year history.

These national events created a higher level of economic uncertainty than in more normal times, but I'm delighted to report that in 2016 the Society once again delivered another solid performance.

As the UK's fourth largest building society, 2016 saw us continue to build on the strong performance seen in recent years. Group gross residential mortgage lending of £4.0bn was the highest in the Society's history, and our total assets rose to £19.0bn.

We also continued to grow our customer base, strengthen our capital position and deliver excellent customer service. Key highlights in 2016 included:

- A 22,316 increase in customers to 860,403;
- The mortgage book grew by £1.3bn to £15.5bn, a growth rate of 9.1% (2015: by £1.5bn, a growth rate of 11.9%);
- Savings balances grew by £1.3bn to £14.1bn, a growth rate of 10.0% (2015: by £1.4bn, a growth rate of 11.9%);
- Group total assets increased by 8.6% during the year to £19.0bn (2015: £17.5bn);
- Total Group profit before tax (PBT) increased by 15.0% to £168.9m (2015: £146.9m). This included £15.7m profit recognised in 2016 in relation to the disposal of Homeloan Management Limited (HML) in 2014, £17.0m profit on disposal of part of the Group's shareholding in Zoopla Property Group Plc and a £10.6m impairment charge in relation to the Group's shareholding in Wynyard Group Limited;
- Underlying Group PBT (as defined on page 19) decreased by 1.2% to £151.5m (2015: £153.3m);
- Group net interest margin reduced to 1.16% (2015: 1.33%) and net interest income amounted to £212.4m (2015: £223.3m), a reduction of £10.9m (or 4.9%);
- Group administrative expenses increased by £34.7m or 7.5% to £499.1m (2015: £464.4m), of which £337.7m relates to the Connells estate agency group (2015: £289.0m);
- Loan loss provisions continued to reduce, resulting in a net credit of £0.3m, from an £8.4m charge in 2015;
- Charges for provisions and liabilities reduced to £10.9m from £11.8m, and included a levy of £2.1m payable to the Financial Services Compensation Scheme (FSCS) (2015: £7.4m);
- The Society now reports its capital ratios using the Internal Ratings Based (IRB) approach and its Common Equity Tier 1 (CET 1) ratio at 31 December 2016 was 23.9%. Had the Society remained on the standardised approach, its CET 1 ratio as at 31 December 2016 would have been 17.3% (2015: 16.8%);
- The leverage ratio, calculated on an IRB basis, was strong at 5.9%, comfortably ahead of the regulator's expected minimum. On a standardised basis, the ratio would have been 6.3% at 31 December 2016 (2015: 6.1%); and
- In May 2016, the ratings agency Fitch upgraded the Society's long term rating to A- (from BBB+) with a stable outlook and its short term rating was upgraded to F1 (from F2). In October 2016, Moody's maintained its long and short term rating of Baa2 and P-2 respectively but changed its outlook from stable to positive.

Looking after people's savings and enabling home ownership is at the very heart of what Skipton does as a mutual building society. I firmly believe that our long term focus of being there to help people plan for their life ahead is resonating with our members.

Unwavering focus on our members and our people

During 2016 Skipton introduced a range of measures to ensure we continue to meet the evolving needs of our members, including the integration of Skipton Financial Services (SFS) into the building society. SFS was set up in 1988 after identifying a growing customer need for high

“Looking after people’s savings and enabling home ownership is at the very heart of what Skipton does as a mutual building society. I firmly believe that our long term focus of being there to help people plan for their life ahead is resonating with our members.”

quality, face-to-face financial planning. Nearly 30 years on, and in an increasingly complex financial world, I am convinced this need is greater than ever. So in 2016 we integrated our financial advice subsidiary into the Society and in doing so will make it easier and more cost effective to meet our customers’ changing needs. This enables us to offer a one-stop-shop for all financial planning matters through a seamless customer experience, without duplicating branding, digital and online investment.

In addition, in 2016 the Society also:

- Achieved a net customer satisfaction rating of 90% (2015: 88%);
- Saw 21% of customer complaints referred to the Financial Ombudsman Service changed in the customer’s favour compared with an average of 45% for the financial services industry;
- Achieved in June 2016 an employee engagement level of 90% (June 2015: 90%), significantly ahead of industry norms; and
- Was listed, for the third year running, in *The Sunday Times* 100 Best Companies to Work For.

Good performance in the Mortgages and Savings division

The Mortgages and Savings division comprises the Society, which provides mortgages, savings, investments and pensions advice, two mortgage portfolios in run-off, and a mortgage and savings provider based in Guernsey. The division produced a PBT of £96.6m compared to £103.1m in 2015, a reduction of £6.5m (or 6.3%).

The Group’s prudent approach to lending is demonstrated by the number of Group residential mortgages in arrears by three months or more. These represent only 0.73% of mortgage accounts (2015: 0.91%) and compares to an industry average of 1.00% (2015: 1.12%) of mortgages in arrears by more than three months (source: Council of Mortgage Lenders).

Further information on the performance of the Mortgages and Savings division can be found in the Strategic Report on page 23.

Enabling our members to achieve their life ahead aspirations

The Society helped 23,666 homeowners (2015: 23,094) to purchase or remortgage their properties in 2016, including 4,327 first time buyers (2015: 3,847) and 1,292 (2015: 618) through participation in the Government’s Help to Buy equity loan scheme.

This contributed to the Group mortgage book growing by £1.3bn to £15.5bn (2015: £14.2bn), an annual growth rate of 9.1% (2015: 11.9%). Our net residential UK mortgage lending accounted for 3.5% of the growth in the UK residential mortgage market, compared to our 1.1% share of UK residential mortgage balances (source: Bank of England statistics, December 2016). £588.0m of our gross lending in 2016 (14.8% of all lending in the year) was on buy-to-let mortgages (2015: £467.2m or 12.7%).

With regard to savings, our award-winning range of competitive savings products saw retail deposit balances grow by £1.3bn to £14.1bn, an annual growth rate of 10.0% (2015: 11.9%). The growth in the Society’s savings balances accounted for 1.6% of the growth in the UK deposit savings market (2015: 2.1%), compared to our market share of savings balances of 1.0%. Our average savings rate paid across all of our accounts reduced by 0.19% during the 12 month period, but nevertheless averaged 1.50% during the year, compared to an average Bank Base Rate during the period of 0.40%. And this in turn saw the Society pay on average 0.58% higher interest than the market average for banks and building societies during the 11 month period to 30 November 2016 (11 months to 30 November 2015: 0.49%), being the latest available comparable market data (source: CACI Savings Market Database).

Robust performance from Estate Agency in a challenging market

In 2016, Connells delivered another strong set of results in a more difficult market with PBT of £73.4m (2015: £62.5m), an increase of 17.4%. This included a £17.0m profit on the part disposal of shares in Zoopla Property Group Plc (2015: £0.3m). Excluding these gains, PBT in 2016 amounted to £56.4m, a 9.3% reduction compared to 2015. The UK housing market was adversely impacted around the date of the EU referendum but gradually improved in the second half of the year. Like-for-like second hand house sales (sold subject to contract), having been 12.3% higher in the first five months of 2016 compared to the same period in the previous year, were 7.9% lower in quarter 3 and 6.7% lower in quarter 4. The total number of properties (both second hand and new) that contracts were exchanged on during the whole of 2016 was 8% higher than in 2015 and was 1% higher on a like-for-like basis. Further information on the performance of the Estate Agency division can be found in the Strategic Report on pages 23 and 24.

Other subsidiaries

Looking at our other subsidiaries, Skipton Business Finance recorded a PBT of £3.3m (2015: £3.2m). Jade Software Corporation, the provider of the Society's core database and software development language and 56.4% owned by Skipton, recorded a loss before tax of £0.4m (2015: loss of £1.3m). The Group owns 17.7% of Wynyard Group Limited, a provider of software development services that was spun out of Jade Software Corporation and floated on the New Zealand stock exchange in July 2013. In October 2016, Wynyard was placed into voluntary administration, and subsequently entered liquidation in February 2017. The Group recognised a loss of £15.0m during 2016 on Wynyard related activities, including a £10.6m impairment charge against the whole of its investment.

In 2014, the Group sold its 100% shareholding in Homeloan Management Limited, a provider of mortgage services, for £56.6m with a right to contingent consideration based on performance. Although the performance period has not yet ended, in 2016 the Group recognised £9.9m of contingent consideration (2015: £nil) based on the Directors' best estimate of an element of the consideration that can be reliably estimated at this stage. In addition, the Group's reported profits for 2016 have benefitted by £5.8m following expiry of the indemnity period relating to the disposal (2015: £nil). Both of these items are excluded from underlying PBT.

Conclusion and outlook

2016 was another year of strong performance by the Society, with good growth in both mortgage and savings balances in excess of our market share.

Economic forecasters indicate that UK GDP growth in 2017 will be similar to that achieved in 2016, although inflation is expected to be higher, which will impact disposable income. There is no precedent for a country leaving the EU, which makes forecasting difficult. The Society conducts all of its trading activities within the UK but we are mindful of any potential secondary effects from parts of the wider economy that are impacted as a result of the EU referendum. The Society will continue with its naturally cautious approach and so its growth rate in 2017 is expected to moderate in comparison to recent years.

We are conscious of the continuing low interest rate environment and the impact it has on our savers, compounded during 2016 by a further reduction in Bank Base Rate to only 0.25%, and the introduction of the Government's Term Funding Scheme which has reduced banks and building societies' demand for retail funds. The rates payable to our savers are to a large extent driven by competitor pricing but the strong growth in the Society's retail balances relative to the market in 2016 once again demonstrates the attractiveness of our products. With Bank Base Rate remaining so low, and tax and pension reforms introducing more complexity, there is a need for financial advice and the Society is well placed to advise on the financial planning needs of its members for their life ahead. During 2017, the Society will launch a pensions decumulation advisory service.

The outlook for the Society remains healthy, although we remain vigilant to any uncertainties regarding the economy, new regulatory requirements to strengthen the resilience of the UK finance sector and changes in consumer behaviours, in particular their desire to engage with the Society via a number of channels of their choice.

We remain well placed to capitalise upon the opportunities that lie ahead as well as manage the risks that arise.

David Cutter
Group Chief Executive

28 February 2017

Strategic Report

Skipton Building Society was established 163 years ago, with the same purpose that we have today: to provide a secure place for our members to place and grow their savings and to lend to people of the community to enable homeownership. We remain committed to this core purpose and to achieving our vision of 'Building a better Society', by being here for our members, our people and the communities in which we operate.

This Strategic Report sets out the objectives we have put in place in order to achieve this vision. It sets out how we are committed to delivering excellence to our customers, by providing outstanding customer service through our people and allowing members to interact with us in the way they choose. It also sets out how we are building a sustainable business for our members by generating sufficient profits and maintaining capital strength. In addition, this report provides a review of the performance during the year against our strategic objectives.

Contents

The business model

Skipton Building Society is the fourth largest building society in the UK, with £19.0bn of assets, 860,403 customers and a national presence of 95 branches.

The Society is at the head of the Skipton Group, whose business model centres on providing a secure home for our growing number of customers' savings, which allows us to lend to borrowers, both directly and through mortgage brokers, to enable homeownership. The provision of high quality financial advice is also fundamental to our strategy to help guide customers to and through retirement. This is supported by maintaining a significant presence in estate agency through the Connells group, dividends from which help strengthen the Society's capital position for the benefit of our members. In addition, the Group holds interests in a small number of companies comprising the Investment Portfolio.

Mortgages & Savings Division

Principally the Society but also includes deposit taking and mortgage lending in the Channel Islands and the UK through Skipton International Limited (SIL). Our specialist mortgage businesses Amber Homeloans Limited (Amber) and North Yorkshire Mortgages Limited (NYM), which both ceased lending in 2008, are also part of the division, as are the Group's special purpose vehicles (SPVs), formed to acquire funds from the wholesale markets, and the intermediate holding company Skipton Group Holdings Limited (SGHL).

Funds raised by:

- Customer deposits
- Wholesale funding

Used to provide:

- Residential mortgages
- Buy-to-Let mortgages

Income generated by:

- Net interest income – the difference between the interest received from our borrowers and on our liquid assets and the interest paid to our savers and on our wholesale funding
- Other income generated from the provision of financial advice (including inheritance tax planning and retirement planning) and other financial products and services

Costs include:

- People costs
- Property and operating costs

Profits are used to:

- Build the Society's reserves to maintain capital strength
- Enable investment to support future growth and improved products and service for our customers
- Pay taxes

Reserves are the retained earnings from cumulative profits made by the Society and from dividends received from its subsidiaries, principally the Estate Agency division

Estate agency division (Connells group)

- Property sales
- Surveys and valuations
- Conveyancing
- Lettings
- Asset management
- Mortgage and insurance broking

Investment portfolio

- Invoice discounting and debt factoring through Skipton Business Finance Limited
- Provision of IT solutions to a range of industries through Jade Software Corporation Limited

On 1 August 2016, financial advice activities, previously carried out through Skipton Financial Services Limited (SFS) were integrated into the Society. Previously the performance of SFS was reported within the Financial Advice division and following the integration the Financial Advice division ceased to be a reportable segment. The performance of SFS prior to this integration, including prior year results, has been re-presented to be shown within the Mortgages and Savings division and, as such, where performance is reported by division throughout the Annual Report and Accounts, the Mortgages and Savings division's comparative figures have been re-presented accordingly.

The 2015 financial results reported for the Financial Advice division in this Annual Report and Accounts comprise the results of Pearson Jones plc up to the date of disposal by the Group in May 2015 together with the loss on disposal of £0.8m.

Strategy and objectives

We remain committed to mutuality because we believe that this is in the best long term interests of our members. Our mutual status provides us with the advantage that we do not need to make additional profits to pay shareholders. Instead, we focus on ensuring a balance exists in our measures of success: supporting our members, generating sufficient profit to maintain a strong balance sheet and taking long term decisions to invest in the development of the business for the benefit of our current and future members.

In order to achieve the objective of growing the business we remain focussed on defined medium term objectives 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.

In order to achieve this we continue to invest in developing a deep understanding of the needs of our customers through research, insight and feedback. We use this insight to continuously refine, develop and improve the products and services we offer.

Our target savings and investment customers are those planning for and moving through retirement. We focus on ensuring we have a compelling proposition to meet the needs of these target customers. We promote this to our customers under the strapline 'For Your Life Ahead' and will seek to further develop and promote this over the coming years.

We also focus on helping customers to own their own homes by providing good value mortgages, together with excellent personal service, to both our mortgage customers and intermediary partners. We also provide finance to customers seeking to invest in buy-to-let properties, which supports the growing rented housing sector.

Fundamental to the delivery of our customer strategy is the development of a truly customer centric culture across the Society. In 2016 we continued to develop and improve our internal capability and infrastructure to deliver an exceptional customer experience. Investment in enhanced digital capability is a particular area of focus to support and drive an improved customer experience. There has also been development of our Skipton-based contact centre, Skipton Direct, to introduce more ways for our customers to interact with us and to support our growing customer base. We have invested in our branch network with new concept branches in Leeds and Guildford to meet the changing needs and expectations of our customers, as well as carrying out a further six branch refurbishments and one branch relocation during the year.

A review of performance in the year against our customer strategy is set out on page 16.

Our People

Our strategy requires people who are able to deliver it and a culture that enables them to do so. Our people strategy is, therefore, to ensure we have the right people, with the right skills and knowledge, who are highly engaged and who perform well to deliver a great experience for our customers both now and in the future.

Our culture is the sum of all our behaviours and we know that it influences everything we do. We have a culture of high engagement which is key to the delivery of our strategy and achievement of our objectives. We all work hard to sustain high levels of employee engagement above the financial services industry benchmark and are committed to maintaining this. We manage, lead, influence and reinforce our desired culture in a proactive and purposeful way, using a variety of formal, informal, tangible and less tangible methods.

One of the things that sets our service apart for our customers is our human touch and we ensure that this focus on customers, people and relationships is part of our culture. We develop the skills of all our people to deliver our customer proposition, to have empathy and build relationships with our customers and with each other and to have the necessary knowledge and expertise to provide the support and advice our customers need.

(continued on next page)

Our People (continued)

Our values and behaviours provide the framework for ensuring our culture supports our strategy and they are built into every aspect of leading and managing people. We recruit, select, induct, train, coach, develop, support, reward and performance manage our people using those values and behaviours.

We develop leadership capability, to allow current and future leaders to grow and adapt their leadership skills. We offer a number of leadership initiatives to give them 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. Importantly, conduct risk (ensuring we always deliver a fair outcome for our customers) will remain at the forefront of our minds to ensure that any remuneration package relating to performance encourages the right behaviours and customer outcomes.

The way in which we work and the way in which the roles and structures in the Society are designed are an important part of delivering our strategy, improving efficiency, ensuring that our work is rewarding for our people and creating a great experience for our customers.

A review of performance in the year against our people strategy is set out on pages 16 and 17.

Our Proposition

We seek to provide good value products and consistently excellent service to our customers however they choose to interact with us.

Our proposition is based on continually striving to understand what is important to our customers, listening to their feedback and ensuring that the mortgage, savings, investment and pension products and services that we offer are aligned with their needs. We focus on meeting the needs of customers through our 'For Your Life Ahead' proposition. Our mortgage proposition 'Real Life Lending' focuses on building strong relationships with our mortgage customers and intermediary partners.

Our core services are mortgages, savings, investment and pension advice, complemented by protection, legacy and inheritance tax planning. 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 via phone and web-chat, or digitally, in order that they experience a high quality, empathetic and personalised service.

Investment in enhanced digital capability remains an important area of focus. Key digital initiatives in 2016 included further enhancing our online mortgage application system for our intermediary partners, launching an online 'Life Goals' tool, improving the online savings application process and launching web-chat for use by our savings customers and mortgage intermediaries. We expect this to continue going forward, with a strong focus on developing a seamless customer experience across all channels.

The provision of financial advice for our target market is a key differentiator and integral to the delivery of our 'For Your Life Ahead' customer proposition. To support the further development and expansion of our financial advice offering we integrated our financial advice subsidiary, SFS, into the Society in 2016. We are seeking to broaden our financial advice offering which is currently predominantly provided face-to-face in branch. In 2017 this will include piloting provision of advice by video conferencing as well as exploring opportunities to expand our advice offer through digital and telephone channels.

A review of performance in the year against our proposition strategy is set out on pages 17 and 18.

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 will do this by continuing to provide mortgage and savings products, supplemented by dividends principally from our estate agency business, balanced with controlled management of our cost base and a prudent approach to risk management.

The majority of the growth in lending will continue to be funded by retail balances and we will maintain an appropriate mix of wholesale and retail funding that allows us to grow our retail savings whilst ensuring the appropriate cost of funding in order to generate sufficient profits to maintain our capital strength. The Society has received a number of credit rating upgrades in recent years, including an upgrade by Fitch during 2016, whilst the Society's outlook was changed from stable to positive by Moody's during the year. We expect to make greater use of wholesale funding, whilst maintaining our commitment to members to offer competitive savings rates.

Our liquidity strategy is to ensure that liquidity is held in sufficient quantity and quality to support the Group's business plans and meet our liquidity risk appetite and regulatory requirements. Managing liquidity and capital will continue on a conservative basis, operating within limits that are defined by our low risk appetite, and using a variety of stress testing scenarios to demonstrate we would remain resilient even under an extreme environment.

During the year we achieved Internal Ratings Based (IRB) status for credit risk. Approved IRB status allows financial institutions to use their own calculated risk parameters for the purpose of calculating capital requirements for credit risk. Amongst other benefits, this allows us to continue to ensure effective pricing, loan impairment provisioning and use of capital, through the use of our IRB credit risk models.

Managing loan impairment losses in our mortgage portfolios remains a key priority and we monitor and manage mortgages that have fallen into arrears, supporting our customers wherever possible, and ensuring fair outcomes for our borrowers whilst protecting the business against financial losses for the benefit of all our members.

As part of our financial strategy we also closely monitor our cost base. We have made a significant investment in our people and systems over recent years to further ensure excellent service for our customers, which is a fundamental part of our strategy to grow our customer base. Given the current uncertainties in the marketplace and the continuing costs of increased regulatory compliance, it is now more pertinent than ever that we prudently manage our cost base, with a focus on ensuring efficiency and cost effectiveness across our business, whilst maintaining our commitment to delivering excellent customer service.

The Group's investment in 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 18 to 30.

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	2016	2015	2014
Our Customers				
Growth in customer numbers (Society only)	To ensure we are attracting and retaining customers	**22,316**	43,348	31,276
Increase in customer savings balances (Society only)	To help more customers save for their future	**£1,285m**	£1,367m	£1,196m
Group gross mortgage advances	To help us to meet our goal of enabling homeownership through prudent and controlled lending	**£3,968m**	£3,675m	£2,981m
Group net mortgage growth	To help us to meet our goal of enabling homeownership through prudent and controlled lending	**£1,298m**	£1,508m	£1,275m

A key measure of success of a mutual building society is the long term growth of its customer base and mortgage and savings balances. In 2016 Society customer numbers grew by 22,316 to take its total customer base to 860,403 and we grew savings balances by 10.0% (2015: 11.9%) compared to the UK savings market where net savings growth was 6.1% (source: Bank of England statistics, December 2016). The growth in customer numbers and customer savings balances, whilst not as significant as the growth experienced in 2015 as the economic environment impacted our ability to offer rates to attract the same level of new customers as seen in 2015, demonstrates our commitment to offering competitive rates for our savers in this tough financial climate, whilst maintaining high levels of customer service.

We paid on average 0.58% higher interest than the market average for banks and building societies during the 11 month period to 30 November 2016 (11 months to 30 November 2015: 0.49%), being the latest available comparable market data (source: CACI Savings Market Database).

Our attractive range of cash ISAs was a key driver in attracting new members to the Society; in April we took an 11.6% share of the new ISA market, well above our overall ISA market share of 2.4%. We aim to grow our customer base in a sustainable manner, bringing the benefits of membership to an increasing number of customers going forward.

We grew Group mortgage balances by 9.1% (2015: 11.9%), despite the continued run off of our specialist mortgage portfolios Amber and NYM which reduced by 10.7% during 2016. This mortgage growth, delivered within our prudent credit risk appetite, saw a slight fall from 2015 as competition across the mortgage market remains intense, however it was still significantly ahead of the UK residential mortgage market where net mortgage growth was 2.8% (source: Bank of England statistics, December 2016). This demonstrated our success in delivering mortgage products and services that are valued by both new and existing Skipton members.

Gross mortgage advances totalled £3,968m (2015: £3,675m) across the Group during 2016, representing an increase of 8.0% compared to 2015. During the year we helped a broad spectrum of homeowners, by also offering loans requiring only a 10% deposit for first and next-time buyers, a targeted range of new-build mortgages including 'Help to Buy' equity loans and a suite of buy-to-let loans.

Our People

Key Performance Indicator	Strategic Goal	2016	2015	2014
Our People				
Employee engagement (Society only) (note 1)	To ensure our people are passionate, loyal and committed	**90%**	90%	88%

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

The delivery of the Society's people strategy is primarily measured by employee engagement which remained at 90% when measured in June 2016. Sustaining high engagement (above 85%) is achieved through a range of activities reflecting all aspects of our people strategy including learning and development, recruitment and reward. The focus now will be on maintaining employee engagement above 85% over the coming years.

Our 'Building a better Society' workshops were experienced by 1,200 people, enabling them to strengthen the connection to the customer across the Society. We support the skills of our leaders through training and programmes such as 'Leading High Performance'.

To support the delivery of our strategy we have invested in attracting the right people with the right skills into the Society. In 2016 we recruited, welcomed and trained 432 (2015: 491) new people across the Society's teams. We also continue to offer an apprenticeship scheme, taking on eight apprentices during the year, and again achieved a place in *The Sunday Times* 100 Best Companies to Work For.

Employee equality and diversity

The Society remains committed to the principles of diversity. We aim to create an environment where our people feel valued and respected and that promotes dignity. We 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. For example, the number of employees of each gender employed in the Group as at 31 December 2016 is outlined below:

	Male	Female	Total
Directors (note 1)	8	4	**12**
Senior managers (note 2)	52	26	**78**
Other employees	4,021	5,412	**9,433**
	4,081	**5,442**	**9,523**

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.

The UK Government issued a consultation in February 2016 on draft regulations to introduce mandatory gender pay gap reporting for employers with more than 250 employees. This consultation recommends the first reporting date for the introduction of these reporting requirements as April 2017 with up to 12 months to comply. As such, enhanced reporting on diversity and pay by gender will be provided on our website later this year.

Our Proposition

Key Performance Indicator	Strategic Goal	2016	2015	2014
Our Proposition				
Society net customer satisfaction score (note 1)	To ensure we are putting the customer at the heart of our business	**90%**	88%	88%
Society Financial Ombudsman Service (FOS) complaints – change in outcome rate	To ensure we are treating customers fairly	**21%**	32%	16%

Note
1. As measured in an independent survey by a customer experience management services provider of 2,393 Society members. The net customer satisfaction score is calculated by subtracting dissatisfied customers (those scoring satisfaction with the Society as 1-3 on a scale of 1-7) from those who are satisfied (those scoring satisfaction as 5-7 on the same scale).

One of the ways in which we monitor the success of our proposition is by measuring net customer satisfaction. We do this quarterly, using an independent third party to ask our customers about their levels of satisfaction with the service they have received. In 2016 net customer satisfaction was 90% (2015: 88%), demonstrating the continued delivery of high quality products and services to our customers.

Given the strong customer satisfaction score seen during the year, it was disappointing that our ranking in the independent 2016 Customer Experience Excellence survey dropped from seventh to 33rd. This was out of 290 leading brands and so still shows that we continue to deliver a very good customer experience relative to other organisations. However, it also demonstrates that we cannot afford to be complacent and we remain committed to delivering consistently excellent customer service.

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, and we received 181 independent 'best-buy' mentions for our products in 2016 (2015: 541).

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 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 2016 was 21% (2015: 32%). This compared favourably with the financial services industry average of 45% for 2016 (source: FOS complaints data (resolved cases)).

Our Financial Strength

Key Performance Indicator	Strategic Goal	2016	2015	2014	Discussed further
Our Financial Strength					
Total Group profit before tax	To ensure we generate the necessary capital to enable the business to develop	**£168.9m**	£146.9m	£180.6m	Pages 22-23
Underlying Group profit before tax	To ensure we generate the necessary capital to enable the business to develop regardless of any costs or benefits not arising from the Group's ongoing trading operations	**£151.5m**	£153.3m	£150.1m	Pages 22-23
Group net interest margin (% of mean assets)	To manage the earnings of our core Mortgages and Savings division	**1.16%**	1.33%	1.40%	Page 20
Mortgages and Savings division cost income ratio	To maintain a manageable cost base to ensure the business is cost efficient	**57.3%**	53.3%*	49.3%*	Page 23
Mortgages and Savings division management expense ratio	To maintain a manageable cost base to ensure the business is cost efficient	**0.75%**	0.83%*	0.80%*	Page 23
Group residential mortgages in arrears by three months or more	To manage and monitor our arrears and credit risk management	**0.73%**	0.91%	1.20%	Page 25
Liquidity as a % of shares, deposits and borrowings	To ensure we hold sufficient levels of overall liquidity	**15.90%**	16.95%	18.36%	Page 26
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	**89.59%**	87.78%	85.85%	Page 26
Group Common Equity Tier 1 ratio	To ensure the Group remains financially strong by having a strong (risk weighted) capital base	**23.9%****	16.8%	16.1%	Page 28
Group Leverage ratio	To ensure the Group remains financially strong by having a strong (non risk weighted) capital base	**5.9%****	6.1%^	6.0%^	Page 29

* The comparative figures have been re-presented following the integration of financial advice activities (previously carried out through SFS) into the Society, resulting in the re-presentation of the 2015 and 2014 Mortgages and Savings division results.

** These figures are calculated on an Internal Ratings Based (IRB) basis, rather than standardised as is the case for the comparative figures, following IRB status approval during the year. Further details can be found on pages 27 to 29 of this report.

^ The comparative figures have been restated to reflect a reduction in exposures for collateral the Society has provided against derivative liabilities, in accordance with CRD IV rules.

Financial performance

The outcome of the EU referendum on 23 June 2016 has resulted in a more uncertain economic backdrop than this time last year.

The housing market was impacted around the time of the vote, with the market suffering a dip in housing transaction volumes as a result of reduced consumer confidence, however transaction levels started to pick up towards the end of the year. In addition, inflation increased in the second half of 2016 following the devaluation of Sterling and this has increased the valuation of the 'no negative equity guarantee' given to the customers within the Society's equity release mortgage portfolio, resulting in an additional charge to the Income Statement during the year. Further details are provided on page 21.

In August 2016 the Bank of England cut Bank Base Rate to a record low of 0.25% and this has contributed towards a reduction in net interest income during the year. The reduction in the Bank Base Rate has also led to a reduction in the discount rate used to discount the future liabilities within the Group's defined benefit pension schemes. As a consequence the schemes' combined deficits increased from £65.2m to £110.9m during 2016. Along with the reduction in the Bank Base Rate, the Bank of England announced the introduction of the Term Funding Scheme (TFS), and the Society has drawn down £300m of TFS funding during the year.

Although house prices and employment levels, which are two of the key drivers of the Group's loan impairment charge, have so far not been adversely impacted, the full consequences of the EU referendum result are still largely unknown and we continue to monitor the situation closely.

The Board monitors and reports profits at both a statutory level, governed by accounting standards and practices, and at an 'underlying' level. The measure of underlying profit reflects the Group's current strategy and business model and the majority of the items that are excluded from the statutory profit figure to arrive at underlying profit are generated from the Group's investments in other entities not considered to be part of the Group's current strategy. In addition, the Financial Services Compensation Scheme (FSCS) levy is added back to arrive at underlying profit as it is a cost borne by the Group as a result of the failure of a number of financial institutions in recent years and is not viewed as a long term ongoing cost to the Group. Underlying profit therefore provides greater transparency of the performance of the Group's ongoing trading activities.

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.

Underlying Group profit before tax for the year, as shown below, fell to £151.5m (2015: £153.3m).

	2016 £m	2015 £m
Total Group profit before tax	168.9	146.9
Less profit / add back loss on disposal of subsidiary undertakings	(15.8)	0.4
Less profit on full or part disposal of associate and equity share investments	(16.1)	(1.4)
Add back impairment of associate and equity share investments	12.4	-
Add back FSCS levy	2.1	7.4
Underlying Group profit before tax	151.5	153.3

For further details of profit / loss on disposal of subsidiary undertakings, associates and equity share investments, see page 20. For further details of impairment of associate and equity share investments, see pages 21 and 24.

A summary Group Income Statement is set out below:

	2016 £m	2015 £m
Net interest income	212.4	223.3
Net non-interest income	445.7	402.6
Fair value (losses) / gains on financial instruments	(3.7)	4.0
Profit on treasury assets	4.6	0.1
Share of (losses) / profits from joint ventures and associates	(0.6)	0.2
Dividend income from equity share investments	0.7	0.3
Profit / (loss) on disposal of subsidiary undertakings	15.8	(0.4)
(Loss) / profit on full or part disposal of associate	(0.9)	1.1
Profit on part disposal of equity share investments	17.0	0.3
Total income	691.0	631.5
Administrative expenses	(499.1)	(464.4)
Operating profit before impairment losses and provisions	191.9	167.1
Impairment credit / (charge) on loans and advances to customers	0.3	(8.4)
Impairment losses on associate	(1.1)	-
Impairment losses on equity share investments	(11.3)	-
Provisions for liabilities	(10.9)	(11.8)
Total Group profit before tax	168.9	146.9
Tax expense	(39.1)	(33.5)
Profit after tax	129.8	113.4

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

Net interest income

Net interest income, which is the main source of income for the Mortgages and Savings division, decreased by 4.9% across the Group to £212.4m (2015: £223.3m). The Group's net interest margin, one of our key measures of profitability and performance, measures net interest income as a percentage of mean total assets and was 1.16% (2015: 1.33%).

The reduction in the net interest margin was mainly the result of increased competition in the mortgage market and we expect the pressure on margins to continue for the foreseeable future. Despite passing on the 0.25% Bank Base Rate reduction to our existing mortgage customers through the reduction in our Mortgage Variable Rate (MVR) and Standard Variable Rate (SVR), the increased differential between fixed rates on new lending and the variable rates that these products ultimately revert to has resulted in a higher volume of customers switching to further fixed rate products at the end of their fixed term, rather than reverting to MVR or SVR. This has led to a reduction in interest income. In addition, returns on our liquidity portfolio have reduced as a result of the reduction in Bank Base Rate.

Net non-interest income

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

	2016	2015 Re-presented*
	£m	£m
Mortgages and Savings	30.1	33.1
Estate Agency	397.6	351.4
Financial Advice	-	3.5
Investment Portfolio	27.0	20.9
Inter-divisional adjustments^	(9.0)	(6.3)
	445.7	402.6

* The comparative figures have been re-presented following the integration of financial advice activities into the Society.

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

The majority of the Group's other income is generated by the Estate Agency division, which saw a 13.1% increase in other income in the year. This was due to a robust trading performance across the division, particularly during the first half of the year, with income in the first six months of the year up 18.6% on the same period in 2015. The second half of the year saw a slow down due to the uncertainty in the housing market following the EU referendum. The investment in Connells' lettings capabilities and acquisitions made during the year and previous years also contributed to the increase in income.

The Mortgages and Savings division's net non-interest income decreased by £3.0m in the year. This is partly as a result of a reduction in financial advice income due to a lower number of financial advisers in comparison to 2015, as well as an IT recharge from a former subsidiary no longer being recognised following this company's migration off the Group's IT service in 2015.

The Investment Portfolio saw a £6.1m increase in other income due to strong sales growth during the year in Jade Software Corporation.

Profit / loss on disposal of subsidiary undertakings, associates and equity share investments

The profit on disposal of subsidiary undertakings during the year was £15.8m (2015: £0.4m loss), of which £0.1m arose from the release of a provision in relation to the disposal of Pearson Jones in 2015 and £15.7m relates to the disposal of Homeloan Management Limited (HML) in 2014. The sale of HML included contingent consideration dependent on HML's performance over a period following the disposal. During the first half of 2016 Computershare Limited, the ultimate parent company of HML, announced that its UK subsidiary had been appointed by UK Asset Resolution to undertake its mortgage servicing activities. This will result in contingent consideration being receivable by the Group between 2018 and 2022. The amount recognised in the first six months of the year of £9.6m was based on the Directors' best estimate of the present value of an element of the contingent consideration that could be reliably estimated at that stage. Based on the information received by the Group subsequent to the half year, the Board believes an additional amount is likely to be recognised in future but at present the amount cannot be reliably estimated to provide a best estimate. The amount recognised for the full year was £9.9m (2015: £nil) which includes the unwind of the discount between 30 June 2016 and 31 December 2016. In addition, a further £5.8m profit on disposal (2015: £nil) was recognised during the year following the expiration of the indemnity period relating to this disposal. The above amounts are included in the 'Profit / (loss) on disposal of subsidiary undertakings' line in the Income Statement and are not included in underlying profit before tax.

In June 2016, we reclassified our holding in Wynyard Group Limited to an equity share investment (previously recognised as an associate investment) following the resignation of a senior manager of the Skipton Group from Wynyard's Board of Directors. This, and consideration of a number of other factors, led the Directors to conclude that the Group no longer held significant influence over Wynyard. This change in accounting treatment resulted in a loss of £0.9m recognised on the deemed disposal of the associate investment. This is shown in the '(Loss) / profit on full or part disposal of associate' line in the Income Statement and is not included in underlying profit before tax. The investment in Wynyard has subsequently been fully provided against; for further details see 'Impairment losses on equity share investments' on page 21.

In September 2016, Connells sold a third of its shareholding in Zoopla Property Group Plc, generating a profit of £17.0m (2015: £0.3m). This is shown in the 'Profit on part disposal of equity share investments' line in the Income Statement and is not included in underlying profit before tax.

Administrative expenses

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

	2016 £m	2015 Re-presented* £m
Mortgages and Savings	135.9	137.1
Estate Agency	337.7	289.0
Financial Advice	-	2.7
Investment Portfolio	25.8	20.9
Sundry incl. inter-divisional adjustments^	(0.3)	14.7
	499.1	464.4

* The comparative figures have been re-presented following the integration of financial advice activities into the Society.

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

Administrative expenses across the Group increased by 7.5% to £499.1m (2015: £464.4m).

During the year the Mortgages and Savings division's administrative expenses decreased by £1.2m. This is predominantly due to reduced costs associated with financial advice following the integration of financial advice activities previously carried out by SFS into the Society and due to increased focus on careful control of our cost base. This is partially offset by continued investment in our people and customer proposition to ensure ongoing excellent customer service.

Administrative expenses in the Estate Agency division increased by 16.9% during the year to £337.7m (2015: £289.0m). This increase is largely due to staff costs, which rose by £31.1m to £228.9m (2015: £197.8m), reflecting the division's continued investment in headcount to grow the business organically and through acquisitions.

The decrease in administrative expenses within sundry / inter-divisional adjustments is due to a decrease in the charge for the management incentive scheme in place for Connells' senior management; this decreased to £1.0m compared to £15.9m in 2015. The management incentive scheme cost is based on a number of assumptions relating to the Estate Agency division and is in place to retain the high performing management team at Connells in order to safeguard the future financial contribution this business will make to the Group. The decrease in the charge in the year is a result of an update to the assumptions in relation to the scheme, the details of which can be found in note 25 to the Accounts.

The Group management expense ratio has seen an improvement to 2.73% from 2.77%, representing the continued focus on cost efficiency across the Group in line with our strategic objectives; however, this measure is less comparable to that of our peers given the nature of our Group, particularly the Estate Agency division. The cost income ratio for the full Group saw a slight deterioration to 75.7% (2015: 73.7%), mainly due to the decrease seen in net interest income.

Impairment on loans and advances to customers

Impairment on loans and advances to customers for the Group was a £0.3m credit during the year (2015: £8.4m charge) and is broken down as follows:

	2016 £m	2015 £m
Residential mortgages	(2.7)	0.6
Equity release mortgages	3.8	6.5
Commercial mortgages*	(1.5)	1.3
Other loans	0.1	-
	(0.3)	8.4

* 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 impairment credit on the residential mortgage portfolio is due to the continued favourable economic landscape with falling unemployment, low interest rates and increasing house prices.

The equity release charge relates to the equity release portfolio acquired when the Society merged with Scarborough Building Society in 2009. The expected losses on this portfolio relate to the 'no negative equity guarantee' provided to customers (as described in note 15 to the Accounts) and are, inter alia, a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and the specific behaviour of this portfolio. During the year we have updated the associated key assumptions we expect to observe within this portfolio, resulting in a charge of £3.8m for the year (2015: £6.5m). Further details on the assumptions used in calculating the equity release impairment charge are found in note 37b) to the Accounts.

There was a net credit of £1.5m (2015: £1.3m charge) to the Income Statement during the year for the impairment provision on our commercial mortgages portfolio due to a number of specific cases where the provision requirement has fallen since 2015. The arrears levels within the commercial portfolio remain low.

Impairment losses on equity share investments

In October 2016, Wynyard Group Limited, which the Skipton Group holds a 17.7% shareholding in, entered into voluntary administration. Subsequently, Wynyard was placed into liquidation in February 2017. The Group fully impaired its investment in Wynyard in 2016 resulting in a £10.6m charge to the Income Statement. In addition a further £0.7m impairment loss was recognised during the year following the write down to £nil of the Group's 13.9% shareholding in Hearthstone Investments Limited. These amounts are not included in underlying profit before tax.

Provisions for liabilities

The Group's provisions for liabilities charge was £10.9m for the year (2015: £11.8m), £2.1m (2015: £7.4m) of which relates to the Group's share of the costs of the Financial Services Compensation Scheme levy. The levy is charged to the Society and other regulated deposit takers and compensates savers and investors for losses when financial institutions fail. In previous years the levy was made up of two elements, an interest levy and a capital levy, the latter of which was levied over a three year period. The final payment for the Society's share of the capital levy was recognised in 2015, and a provision is now required for the interest levy only, which accounts for the reduction in the provision seen during the year. Further details are found in note 26 to the Accounts.

Charges for other provisions of £8.8m (2015: £4.4m) relate mainly to professional indemnity claims made against Connells' survey and valuation business and commission and clawback rebates, which arise in the ordinary course of business. These rebates have increased since 2015 as a result of an increase in the volume of business written; this accounts for the majority of the year-on-year increase in the Group's provisions for liabilities charge.

Taxation

The Group's effective tax rate is 23.1% (2015: 22.8%) compared with the standard rate of UK Corporation tax of 20.00% (2015: 20.25%). 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 (including the impairment charge recognised on the Group's investment in Wynyard) 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 15.2% (2015: 15.7%). The major impact on the effective rate of tax is the non-taxable dividend income received of £57.6m (2015: £30.0m). This is partially offset by the impact of the 8% surcharge on taxable profits above £25m, which increased the tax charge by £4.5m (2015: £nil).

The table below shows the total UK tax contribution made by the Group in the year.

UK taxes borne in the year	2016 £m	2015 £m
Corporation tax	30.1	32.5
Taxes on property	8.2	8.0
Employment taxes	26.5	25.3
Irrecoverable VAT	5.1	6.6
	69.9	72.4

More detailed tax disclosures are provided in notes 10 and 27 to the Accounts and in the Country by Country Reporting section on pages 167 and 168.

Other comprehensive income

During the year the Group recorded a net expense of £29.9m through other comprehensive income (net of tax) (2015: £11.9m income). This mainly consisted of a £50.0m loss (before tax) from the remeasurement of retirement benefit obligations (2015: gain of £5.7m) due to large movements in the financial markets following the EU referendum result; further details on the valuation of the retirement benefit obligation can be found in note 28 to the Accounts.

An unrealised gain of £14.0m (2015: £7.3m) was recognised through other comprehensive income in the year, resulting from an increase in the fair value of the Group's shareholding in Zoopla Property Group Plc. The unrealised gain is based on the quoted share price as at 31 December 2016 and has been recognised in the available-for-sale reserve.

Various other movements in the Society's available-for-sale and cash flow hedging reserves account for the remainder of the overall movement in the Group's other comprehensive income, including an £8.9m unrealised gain as a result of fair value movements in the Society's cash flow hedging reserve.

Performance by division

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

	2016 £m	2015 Re-presented* £m
Mortgages and Savings	96.6	103.1
Estate Agency	73.4	62.5
Financial Advice	-	(0.1)
Investment Portfolio	(12.2)	1.4
Sundry incl. inter-divisional adjustments^	11.1	(20.0)
Profit before tax (PBT)	168.9	146.9

* The comparative figures have been re-presented following the integration of financial advice activities into the Society.
^ Sundry including inter-divisional adjustments relate primarily to the elimination of inter-divisional trading, the cost of the Connells management incentive scheme, and additional profit on disposal recognised in relation to the sale of HML in 2014.

The Group's total profit increased in the year to £168.9m from £146.9m. Contributing factors to the increase in total profits were the £17.0m gain (2015: £0.3m) arising in the Estate Agency division on the sale of part of the Group's shareholding in Zoopla and the recognition of £15.7m additional profit on disposal relating to the disposal of HML in 2014 (see page 20 for further details).

A £10.6m impairment charge arose in the Investment Portfolio in relation to the Group's investment in Wynyard Group Limited, following that company going into voluntary administration in October 2016 (see page 21 for further details).

The Group's underlying profit by division was as follows:

	2016 £m	2015 Re-presented* £m
Mortgages and Savings	98.7	110.5
Estate Agency	57.1	62.5
Financial Advice	-	0.7
Investment Portfolio	0.4	(0.4)
Sundry incl. inter-divisional adjustments^	(4.7)	(20.0)
Underlying profit before tax (PBT)	151.5	153.3

* The comparative figures have been re-presented following the integration of financial advice activities into the Society.

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

The Mortgages and Savings division saw a decrease in underlying profits during the year to £98.7m from £110.5m, following a decrease in net interest income, as outlined on page 20. Group mortgage and savings balances have seen good growth, of 9.1% and 10.0% respectively (2015: 11.9% and 11.9% respectively).

The Estate Agency underlying profits were down £5.4m during the year predominantly as a result of a slow down in the housing market during the second half of the year following the result of the EU referendum.

The Investment Portfolio delivered underlying profits of £0.4m (2015: £0.4m loss) due to the continued strong performance by Skipton Business Finance generating a profit of £3.3m (2015: £3.2m), partially offset by small losses elsewhere.

The reduction in sundry / inter-divisional charges during the year is predominantly as a result of a decrease in the Connells management incentive scheme charge. For further details on the decrease in the year refer to the administrative expenses section on page 21 of this report; and for details of the calculation of the liability and the assumptions used see note 25 to the Accounts.

Mortgages and Savings

The Mortgages and Savings division produced a solid performance during the year given the additional pressures from the economic environment witnessed over the last 12 months. Profits have fallen to £96.6m from £103.1m in 2015, due mainly to the reduction in net interest income, as discussed on page 20.

Despite the pressures on margin the division continued to increase mortgage balances, without extending our credit risk appetite or compromising the quality of our mortgage assets. Retail balances also increased in the year, to £14.1bn from £12.8bn at the end of 2015.

Financial advice generated £27.6m of income (2015: £29.7m), with funds under management totalling £3.1bn, up 9.4% on 2015. The integration of financial advice activities previously carried out by SFS into the Society allows us to deliver a more seamless customer journey for all financial advice matters which remains a key offering in our customer proposition.

The division saw an overall decrease in costs during the year of £1.2m to £135.9m predominantly due to reduced costs associated with financial advice following the integration and due to increased focus on careful control of our cost base. This is partially offset by continued investment in our people and customer proposition to ensure ongoing excellent customer service.

Impairment on loans and advances to customers for the division was a credit of £0.4m (2015: £8.4m charge) as discussed on page 21, and provisions for liabilities charges for the division reduced to £5.2m (2015: £8.4m), discussed on page 22 and in note 26 to the Accounts.

Despite the small decrease in costs, the pressures on margin outlined above resulted in the division's cost income ratio increasing from 53.3% to 57.3%.

The division's Channel Islands operation, SIL, again saw growth during the year, delivering profits of £15.2m (2015: £13.7m) as it grew both its mortgage and savings balances to £1.0bn and £1.2bn respectively (2015: £0.9bn and £1.1bn respectively). The quality of SIL's mortgage book is excellent with only a few cases in arrears.

Our specialist lending businesses, Amber and NYM, reported an aggregate profit before tax of £10.5m (2015: £8.8m). 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 completely. During the year the number of mortgages in arrears by three months or more improved to 5.4% (2015: 6.2%) and aggregate mortgage balances decreased in the year to £1.2bn from £1.3bn.

Estate Agency

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

	2016	2015
Total income*	£417.4m	£354.8m
Profit before tax	£73.4m	£62.5m
Movement in:		
Estate agency – house exchanges	+8%	+3%
Residential lettings properties under management	+23%	+17%
Number of mortgages arranged	+10%	+23%
Surveys and valuations completed	+8%	+12%
Number of conveyancing transactions arranged	+4%	+10%

* Total income is as defined in note 38 'Group segmental reporting'.

Connells' total profit before tax was £73.4m (2015: £62.5m); this included a £17.0m gain (2015: £0.3m) from the disposal of part of Connells' shareholding in Zoopla Property Group Plc.

Connells continues to invest in all parts of the business, including in the digital and online arena, and drives towards delivering an efficient, customer focussed proposition throughout the Connells group. It has also continued to expand through targeted acquisitions; notably, in February 2016 Connells acquired Rook Matthews Sayer, an established and successful 16 branch estate agency business in the North East; and in March 2016 Connells Survey & Valuation Limited acquired the business of Andersons & Associates, adding further depth to this successful part of the Connells group. A number of other acquisitions were also made during the year, each of which will complement and add to Connells' proposition.

Following a strong UK housing market during the second half of 2015, Connells entered 2016 with a residential sales pipeline 18% higher than the previous year. During the first quarter of 2016, sales activity was boosted by the impending stamp duty changes on second properties; however, as the UK moved towards the EU referendum in June, the market became more uncertain and the volume of sales fell below 2015 levels. Towards the end of the year, the market slowly improved and the number of properties that contracts were exchanged on during 2016 was 8% higher than in 2015 and was 1% higher on a like-for-like basis (i.e. excluding the impact of acquisitions of subsidiary undertakings in the current and prior year). The UK housing market still remains characterised by slowly rising property prices, but a lack of properties being brought onto the market limits the number of sales able to be made.

Whilst recent UK Government tax changes adversely impact landlords, the growth of the UK private rented sector still continues and looks set to expand further in the long term. Connells continues to seek to take advantage of this and invest in its lettings capability, opening a lettings business in 33 more branches during 2016 and acquiring several lettings portfolios. As a result, Connells has increased its number of properties under management by 23% during the year.

In financial services, Connells is now reaping the benefits of the investment made in its processes following the implementation of the Mortgage Market Review regulations during 2014 and it increased the number of mortgages it arranged by 10% year-on-year, generating £8.2bn worth of lending for UK mortgage providers. Investment continues in this area of business, ensuring that customers continue to receive a good experience and outcome.

Connells Survey & Valuation Limited continued to roll out new technology and process improvements. The number of qualified surveyors was 293 at the end of 2016. This part of the business continues to retain and win new panel management contracts with lenders, and the number of cases completed in-house during 2016 increased by 8%.

Income derived from conveyancing also increased during 2016 with the number of cases handled being up by 4%. The Connells group's conveyancing service is an important aspect of offering customers a smooth property buying experience in what can often be a stressful time for customers.

Investment Portfolio

Skipton Business Finance Limited (a provider of debt factoring and invoice discounting to small and medium-sized enterprises) performed well during the year, producing a pre-tax profit of £3.3m (2015: £3.2m). Jade Software Corporation (a software solutions provider based in New Zealand that specialises in digital solutions, large enterprise solutions and logistics) has delivered encouraging year-on-year sales growth, however continues to trade at a small loss of £0.4m (2015: £1.3m loss) as investment is made for future growth.

During the year the Group recognised a combined loss of £15.0m in relation to its holding in Wynyard Group. As detailed on page 20 of this report, the Group's holding in Wynyard was reclassified during the year from an associate holding to an equity share investment, resulting in a loss of £0.9m on the deemed disposal. The Group's share of Wynyard's losses, based on a publicly-available forecast, whilst held as an associate was £2.4m (share of losses for 2015: £2.3m). In addition, an impairment charge of £1.1m was recognised on the associate holding as a result of a deterioration in the share price leading to the market value of the Group's shareholding falling below the carrying value at the time. In October 2016, Wynyard entered voluntary administration; consequently an impairment charge of £10.6m was recognised in the 'Impairment losses on equity share investments' line in the Income Statement.

Sundry, including inter-divisional adjustments

Sundry, including inter-divisional adjustments of £11.1m income (2015: cost of £20.0m) relate primarily to the recognition of additional profit on disposal of £15.7m (2015: £nil) relating to the disposal of HML in 2014, as detailed on page 20 of this report.

The cost of the management incentive scheme for the senior managers at Connells Limited during the year was £1.0m (2015: £15.9m). For further details on the decrease in the charge for the management incentive scheme in the year refer to the administrative expenses section on page 21 of this report; and for details of the calculation of the liability and the assumptions used see note 25 to the Accounts.

Other inter-divisional adjustments during the period, which relate primarily to the elimination of inter-divisional trading between Group entities, amounted to a cost of £3.6m (2015: £4.1m).

Financial position

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

Loans and advances to customers

Lending to our customers is at the core of the Society's purpose and our lending activity focuses primarily on secured lending on residential properties through mortgage intermediaries. During the year the Group delivered another strong level of mortgage growth, with net mortgage lending totalling £1.3bn (2015: £1.5bn). The majority of the Group's new lending was in the form of residential mortgages, including buy-to-let mortgages, for the Society's customers, which amounted to £3.7bn (2015: £3.5bn).

The Group's overall loans and advances have increased by 9.1% to £15.5bn from £14.2bn at the end of 2015 as set out in the table below:

	2016 £m	2015 £m
Residential mortgages (including buy-to-let)	14,772.2	13,457.0
Equity release mortgages	274.3	273.0
Commercial mortgages	326.7	354.0
Other lending:		
Debt factoring loans	75.4	71.6
Other loans	49.0	44.5
Gross balances	15,497.6	14,200.1
Impairment provisions	(56.8)	(61.8)
Fair value adjustment for hedged risk	340.8	224.9
	15,781.6	14,363.2

The increase in lending has been achieved without extending our credit risk appetite. Our new lending remains prudent, with the mortgage book being well diversified by geographical location. The average loan-to-value (LTV) on new lending in the Society in 2016 was 64.3% (2015: 63.6%). The average LTV on the overall residential mortgage book remained low at 47.9% (2015: 48.5%).

Our well-managed spread of risk ensures that the quality of the Group's lending remains high and we carefully monitor and manage those mortgage accounts in arrears, with only 0.73% (2015: 0.91%) of our residential mortgage accounts in arrears by three months or more, compared to the industry average of 1.00% of mortgages in arrears by more than three months (source: Council of Mortgage Lenders).

Residential mortgages in arrears by three months or more	2016	2015
Society		
Number of cases	421	450
% of Society book	0.38%	0.44%
Impairment provision on residential mortgages (excluding equity release)	£5.0m	£6.8m
Amber Homeloans (Amber)		
Number of cases	336	415
% of Amber book	5.95%	6.64%
Impairment provision on residential mortgages	£10.9m	£13.4m
North Yorkshire Mortgages (NYM)		
Number of cases	138	198
% of NYM book	4.31%	5.54%
Impairment provision on residential mortgages	£3.3m	£5.0m
Skipton International (SIL)		
Number of cases	-	-
% of SIL book	-	-
Impairment provision on residential mortgages	-	-
Total		
Number of cases	895	1,063
% of total book	0.73%	0.91%
Impairment provision on residential mortgages (excluding equity release)	£19.2m	£25.2m

The mortgage balances of Amber and NYM continued to run off during the period and reduced by 10.7% to £1.2bn; these portfolios were closed to new lending in 2008. The average LTV of these portfolios reduced to 60.9% from 64.9%. 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, which was closed to new lending in 2008, reduced in the year by 7.7% to £326.7m as we continue to manage down these balances. The average LTV of this portfolio reduced to 54.1% from 56.1% and the number of accounts in arrears by three months or more in this portfolio remains low at 0.47% (2015: 0.22%).

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 36 to the Accounts.

Liquidity

The Group holds liquid assets of an appropriate quality to ensure it can meet its financial obligations as they fall due and to counter any economic uncertainty, which remains of paramount importance in the current economic climate. Whilst it is vital that the appropriate level of liquid assets is maintained at all times, holding excess liquidity can be costly and so maintaining the appropriate balance of high quality liquid assets is fundamental to the Group's strategy and liquidity management.

The Group's liquid assets increased slightly in the year to £2.7bn from £2.6bn at 31 December 2015. However, when measured as a percentage of shares, deposits and borrowings, the liquidity ratio reduced from 16.95% to 15.90%.

The Group's treasury investments are held to provide liquidity and 98.8% (2015: 99.9%) 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).

The Liquidity Coverage Ratio (LCR) is a new regulatory measure of liquidity introduced as part of the recent CRD IV regulatory changes, from which the Net Stable Funding Ratio (NSFR) is also expected to be enacted from 2018.

Our LCR, a measure designed to ensure that financial institutions have sufficient high quality liquid assets available to meet their liquidity needs for a 30 day liquidity stress scenario, was 170% at 31 December 2016 (2015: 201%), well above regulatory requirements.

The NSFR is a longer term stable funding metric, which measures the sustainability of the Group's long term funding and is expected to be implemented from 2018. The calculation of the NSFR is subject to change so there remains some uncertainty over its final definition. However, based on the Group's own calculation using the most up to date guidance, its NSFR is in excess of 100% and 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.

Funding

The Society continues to manage the mix of retail and wholesale funding in the best interests of our members and remains primarily funded by retail savings. Finding the right mix of retail and wholesale funding is essential to the Group achieving both its retail savings and lending growth objectives. At 31 December 2016 89.6% (2015: 87.8%) of our funding came from retail savings.

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 increases in retail savings balances during the year.

In addition to our UK retail funding, the Group also accepts deposits through our Channel Islands based subsidiary, SIL. SIL has again increased its funding base in the year, to £1.2bn (2015: £1.1bn). These balances are included in 'Amounts owed to other customers' within the Group Statement of Financial Position.

Wholesale funding

The Society accesses the remainder of its funding through the wholesale markets, as there are certain benefits that wholesale funding brings, such as the term of funding. At 31 December 2016, £1.5bn of our funding came from the wholesale markets as analysed below:

	2016 £m	2015 £m
Repo and other secured agreements	567.4	651.2
Deposits	395.9	393.0
Certificates of deposit	14.6	21.1
Medium term notes	-	0.1
Securitisation	519.6	587.6
	1,497.5	1,653.0

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

	2016 £m	2015 £m
Amounts owed to credit institutions	655.3	735.6
Amounts owed to other customers	1,493.2	1,389.5
Debt securities in issue	534.2	608.8
Less: SIL funding	(1,185.2)	(1,080.9)
	1,497.5	1,653.0

The Society has continued to make use of the benefits of the Government's Funding for Lending Scheme. During the year the Society has drawn down £100m (2015: £230m) of Treasury Bills and at 31 December 2016, the Society had drawn a total of £980m (2015: £880m) of Treasury Bills under the scheme. An additional Government scheme was introduced during the year, the Term Funding Scheme (TFS), 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. The Society has drawn down £300m during the year (2015: £nil).

During the year the Society raised an additional £300m of wholesale funding through Darrowby No. 4 plc, the Society's fourth securitisation transaction. Darrowby No. 1 plc, one of the Society's securitisation transaction vehicles, was liquidated during the year following the repayment of all its notes. The Society also repaid £300m of wholesale funding secured on a portfolio of residential mortgages, raised through a special purpose company, Beckindale No. 2 Limited.

The credit ratings of the Society are assigned by two major credit rating agencies, Fitch and Moody's. During the year our credit ratings were upgraded by Fitch and our outlook changed from stable to positive by Moody's. The Society's long and short term credit ratings as at 31 December 2016 were as follows:

	Long term	Short term	Outlook	Date of last rating action / confirmation
Fitch	A-	F1	Stable	26 May 2016
Moody's	Baa2	P-2	Positive	5 October 2016

The Class A Notes of our rated securitisation transactions (Darrowby No. 2 plc, Darrowby No. 3 plc and Darrowby No. 4 plc) remain Aaa rated by both agencies.

Capital

Capital comprises principally the general reserve, plus subscribed capital provided through Permanent Interest Bearing Shares (PIBS) and subordinated liabilities that meet the requirements set out in the Capital Requirements Regulation. Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses.

Capital is calculated under CRD IV. CRD IV was implemented on 1 January 2014 and introduced a number of changes to the capital framework. The impact of CRD IV in some areas was immediate, however for others, including the introduction of various capital buffers, the impact is being phased in under transitional arrangements up to 2022. Under CRD IV the key level at which we monitor our capital is at a prudential consolidation group level. 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. We currently satisfy all of the current capital requirements under CRD IV.

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.

During the year the Society obtained approval from the PRA to adopt the IRB approach to calculate the capital requirements for the residential mortgage exposures of the Society and its subsidiary companies Amber and NYM. The 2016 capital figures below have therefore been prepared by applying the IRB approach to credit risk. The comparative figures for 2015 have not been re-presented, however, a summary of the 2016 capital position under the standardised approach is shown on page 29 to provide a comparison to 2015.

The following table shows the composition of the prudential group's regulatory capital as at 31 December 2016 under CRD IV fully loaded and transitional rules based on the IRB approach.

	Fully Loaded[1] IRB 2016 £m	Transitional IRB 2016 £m	Fully Loaded[1] Standardised 2015 £m	Transitional Standardised 2015 £m
Common Equity Tier 1				
General reserve	1,171.7	1,171.7	1,062.7	1,062.7
Available-for-sale reserve	4.0	4.0	1.6	1.6
Cash flow hedging reserve	3.3	3.3	(3.2)	(3.2)
Total equity per balance sheet	1,179.0	1,179.0	1,061.1	1,061.1
Regulatory capital adjustments				
Fair value adjustments	(0.4)	(0.4)	(1.7)	(1.7)
Prudential adjustments (note 2)	(0.8)	(0.8)	(0.9)	(0.9)
Deductions from Common Equity Tier 1 capital (note 3)	(9.7)	(9.7)	(7.4)	(7.4)
Deduction of cash flow hedging reserve	(3.3)	(3.3)	3.2	3.2
Excess of expected loss over impairment provisions (note 4)	(28.2)	(28.2)	-	-
Total Common Equity Tier 1 capital	1,136.6	1,136.6	1,054.3	1,054.3
Additional Tier 1 capital – PIBS (note 5)	-	54.0	-	63.0
Total Tier 1 capital	1,136.6	1,190.6	1,054.3	1,117.3
Tier 2				
Subordinated liabilities (note 5)	0.4	30.4	2.4	32.4
PIBS (note 6)	40.0	36.0	40.0	27.0
Total Tier 2 capital	40.4	66.4	42.4	59.4
Total own funds	1,177.0	1,257.0	1,096.7	1,176.7
Risk weighted assets				
IRB approach				
Retail mortgages	2,721.0	2,721.0	-	-
Other assets (note 7)	407.0	407.0	-	-
Standardised approach				
Retail mortgages	430.3	430.3	4,941.7	4,941.7
Commercial mortgages	307.9	307.9	334.0	334.0
Treasury assets	290.4	290.4	332.9	332.9
Other assets (note 8)	239.3	239.3	321.5	321.5
Operational risk	367.3	367.3	346.3	346.3
Market risk	-	-	-	-
Total risk weighted assets	4,763.2	4,763.2	6,276.4	6,276.4
Capital ratios (note 9)				
Common Equity Tier 1 (CET 1) (%)	23.86	23.86	16.80	16.80
Tier 1 (%)	23.86	25.00	16.80	17.80
Total capital (%)	24.71	26.39	17.47	18.75

Notes
1. The key impact on ‘own funds’ of the CRD IV fully loaded rules are that existing additional Tier 1 and Tier 2 instruments that become ineligible as capital by 1 January 2022 are excluded in full.
2. Prudential adjustments include deductions to capital for deferred tax and an additional valuation adjustment (‘AVA’) on fair value assets. AVA has been applied to prudently provide for the downside of fair value exposures that are intrinsically subjective in nature.
3. Under PRA rules intangible assets (including goodwill) must be deducted from regulatory capital.
4. Under PRA rules for IRB the excess of expected loss over accounting impairment provisions is deducted from CET 1 capital.
5. Under PRA rules PIBS and subordinated liabilities are included in the solvency calculation in accordance with UK GAAP rather than IFRS. The PIBS and subordinated liabilities are disclosed at par value; therefore, the associated fair value adjustments for hedged risk are excluded. Subordinated liabilities with less than five years to maturity are amortised from a capital perspective.
6. 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 £40m of our PIBS will continue to satisfy the criteria for Tier 2 capital and will therefore be phased into Tier 2.
7. Other assets under IRB include the cost of investment in subsidiary companies outside the prudential group, property, plant and equipment and the fair value adjustment for IRB hedged assets.
8. Other assets under the standardised approach include capital required for debt factoring loans and other debtors and the fair value adjustment for hedged assets relating to exposures measured under the standardised approach.
9. Calculated as relevant capital divided by risk weighted assets.

The increase in own funds (total capital) during 2016 is due to profits accumulated during the year which are added to the general reserve.

During the year the Group has performed regular stress tests on its capital base and these tests have consistently demonstrated a capital surplus above requirements after allowing for severe stress scenarios.

Leverage ratio

The leverage ratio is defined as the ratio of Tier 1 capital to total exposure, i.e. total assets per the Statement of Financial Position (subject to some regulatory adjustments such as the deduction of intangible assets and an addition for commitments to lend where a mortgage has been offered but not yet advanced at the reporting date).

Fully loaded leverage ratio – prudential group	IRB 2016	Standardised 2015
Leverage ratio (%) (Tier 1 capital / leverage ratio exposure measure) (note 1)	5.9	6.1*

* The comparative figure has been restated to reflect a change to the way the leverage ratio exposure measure is calculated and reflects a reduction in exposures for collateral the Society has provided against derivative liabilities, in accordance with CRD IV rules as amended on 10 October 2014 by the European Commission delegated regulation on leverage ratio.

Note

1. Tier 1 capital is based on the fully loaded definition as set out in the CRR text. Under the standardised approach the leverage ratio would have been 6.3% at 31 December 2016.

Comparison under the standardised approach

The table below sets out the capital ratios for 2016 calculated under the standardised approach. As the Society is now an IRB firm for certain credit risk calculations, these ratios are reported for comparative purposes only.

	2016	2015
Capital ratios		
Fully Loaded Standardised		
Common Equity Tier 1 (CET 1) (%)	17.27	16.80
Tier 1 (%)	17.27	16.80
Total capital (%)	17.87	17.47
Transitional Standardised		
Common Equity Tier 1 (CET 1) (%)	17.27	16.80
Tier 1 (%)	18.07	17.80
Total capital (%)	19.05	18.75

Capital management

The Group conducts an Internal Capital Adequacy Assessment Process (ICAAP) at least annually, which is approved by the Board. This is used to assess the Group's capital adequacy and determine the levels of capital required to support the current and future risks in the business derived from the corporate plan. The ICAAP addresses all of the Group's material risks and includes Board-approved stress scenarios which are intended, as a minimum, to meet regulatory requirements. The ICAAP is reviewed by the PRA when setting the Group's Individual Capital Guidance (ICG) requirements.

The Group received approval from the PRA on 1 December 2016 to use a suite of IRB models for the assessment of the credit risk associated with the majority of our lending portfolios. The models are now in use and are used, inter alia, to inform our future capital requirements, mortgage pricing decisions and our collection strategies and form our assessment of our minimum regulatory requirement.

The Group adopts the following approaches to calculate its Pillar 1 minimum capital requirements:

IRB approach for:

- Residential mortgage exposures of the Society and its subsidiary companies Amber and NYM
- The cost of investment in subsidiary companies outside the prudential group
- Fair value adjustments for hedged assets associated with underlying exposures measured under the IRB approach
- Property, plant and equipment
- Cash in hand

Standardised approach for:

- Residential mortgage exposures of SIL
- Commercial mortgage exposures
- Equity release mortgage exposures
- Other assets including prepayments and fair value adjustments for hedged assets associated with underlying exposures measured under the standardised approach
- Operational risk
- Treasury portfolios

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 www.skipton.co.uk.

Pension funds

As described in note 28 to the Accounts, at the start of 2016 the Group managed three funded defined benefit pension schemes. On 31 January 2016 the Society and former Scarborough schemes were merged. At 31 December 2016 the two remaining schemes had a combined deficit of £110.9m (31 December 2015: £65.2m). The increase in the deficit was largely driven by a reduction in the discount rate applied to the scheme liabilities, which has been revised during the year from 3.83% at 31 December 2015 to 2.65% at 31 December 2016, reflecting market conditions at the balance sheet date.

We continue to take steps to manage the deficit and both schemes are closed to new members and to future accrual of benefit. Contributions totalling £24.8m 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 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.

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 55 to 59 and in notes 34 to 36 to the Accounts.

This Strategic Report was approved by the Board of Directors on 28 February 2017 and signed on behalf of the Board by:

Bobby Ndawula
Group Finance Director

Corporate Responsibility Report

Introduction

We understand the importance of our corporate responsibility, to our members, our people and to wider society. We continually support communities, across the UK, through a variety of community programmes, to make a difference to the lives of as many people as possible. In addition to charitable giving, and volunteering within our communities, 2016 saw the Society further reduce its environmental footprint – as we welcomed the introduction of better ways to save energy. We also increased the amount of waste we recycle and divert from landfill.

Our People

Employee engagement

We believe a great employee experience is really important to both our people and customers as we know that engaged people enjoy their work, perform well and provide excellent service.

Over the past six years, we have seen steady progress and sustained high levels of employee engagement, measured by our independent annual employee survey. Our people tell us that they feel committed as ever to our core values, with 97% of respondents saying they support them and 93% saying that they are proud to work for the Society.

Recognition of our efforts in ensuring that the Society is a good place to work is in being listed in *The Sunday Times* 100 Best Companies to Work For for the third year running.

THE SUNDAY TIMES 100 BEST COMPANIES TO WORK FOR 2017

As with our customers, we want to help our people plan for their own lives ahead. To help them, we have provided additional pension contributions and retirement workshops so that our people have the opportunity to plan for their future. The following table shows the significant increase in the number of our people increasing their pension contributions:

	2016	2015	2014
Percentage of our people aged 35 and above who are contributing 6% and above	89%	89%	60%
Percentage of our people contributing at 8% and above*	32%	26%	9%

* The Society increased its maximum employer contribution in 2015 from 8% to 10%.

Learning and development

We provide many opportunities for our people to develop both their skills and their talents through a range of learning opportunities. This investment enables us to provide the highest level of customer service both now and for the future.

We believe that great leaders are the key to supporting the performance and development of our colleagues. In 2016, we launched our new *Networked Leadership* programme, enabling them to work collaboratively on the future direction of the Society.

We are in the fifth year of our highly successful *Aspiring Leaders* programme. This programme is designed to develop our future leaders. Over the past five years, we have seen the majority of our 76 colleagues who took part in the programme move into their first leadership role.

Our 2016 Aspiring Leaders with David Cutter, our Group Chief Executive.

Apprenticeships and early careers

In 2015, we launched a new apprenticeship scheme, *Connecting our Future*, for existing and new colleagues. The scheme gives colleagues an opportunity to experience different business areas of the Society to understand the customer journey from different perspectives. These apprentices also work towards qualifications in both customer service and financial services. Now in its second year, our apprenticeship scheme has had 19 people enter the scheme since it began.

"The Connecting our Future programme has opened so many doors for me and I've met some great people along the way. I've found out more about how I like to work and I've learnt a lot about myself too. It's helped me find some real direction in my career with Skipton and I'm excited to see where I end up at the end of it." – Chloe Hanby-Roberts

Skipton & Ripon MP, Julian Smith, meeting the 2016 Connecting our Future apprentices.

Our Communities

We are committed to supporting communities locally and further afield. As one of the UK's biggest building societies, we feel that we should be both a responsible and considerate organisation. Therefore, one of our key priorities is to provide tangible support to community groups and charities across the UK, through a wide range of community support initiatives.

Our Distribution Customer Quality team doing some volunteering by gardening at the Sue Ryder Manorlands Hospice.

Volunteering

In 2014, we introduced our colleague volunteering scheme where our people can use two work days for volunteering every year.

Our people are encouraged to volunteer in the community both inside and outside of work. Significant team volunteering activity in the past year has included building a sensory garden at Brooklands School in Skipton, clearing litter from Blackpool beach and helping to renovate the Embsay & Bolton Abbey Steam Railway, as well as helping many local charity groups, particularly those supporting the elderly.

In 2016, the Society, our people and customers have raised or donated the following financial support to groups and charities:

Charitable Foundation	**£150,000**
Grassroots Giving	**£81,500**
Fundraising and Community activities	**£125,000**

As part of the £125,000, the Rotary Club of Skipton in 2016 raised in excess of £18,000 by managing our car park at the weekends and collecting parking fees.

Charitable Foundation

Our Charitable Foundation was established in 2000 and, to date, over £1.8m has been donated to 754 charities across the UK. The maximum donation available is £3,000.

Highlights from our Charitable Foundation in 2016 included:

- 174 applications received
- 89 donations made
- The average donation made was £1,563
- Gave £139,127 in total

Keighley Sea Cadets received £2,500 from our Charitable Foundation in 2016. They used the money to purchase a box trailer to carry their equipment and supplies when attending training weekends.

SKIPTON BUILDING SOCIETY CHARITABLE FOUNDATION

www.skiptoncharitablefoundation.co.uk

Grassroots Giving

Our award winning Grassroots Giving community funding programme has been supporting community groups and clubs since 2013. Over the past four years, over £320,000 has been donated to 646 small clubs, groups and organisations across the UK.

Grassroots Giving differs from most funding schemes in that it provides help to small community groups who struggle to receive funding elsewhere.

Grassroots Giving also helps raise awareness of community groups, both locally and nationally, as well as having access to the Project Dirt programme. Project Dirt (www.projectdirt.com/cluster/grassrootsgiving/) is the UK's most active social community network, where small local community groups can share ideas, resources and experiences. The Grassroots Giving cluster has details of 105 projects across the UK and provides handy advice, community events and shared ideas.

GRASSROOTS GIVING

www.skiptongrg.co.uk

Community fundraising activities

An important part of the Society's ethos in supporting our communities is the wide and diverse ways in which we work, together with our members, to raise money and awareness for both large and small community groups and charities across the country. Together we have raised £125,000 this year.

From Aberdeen to Plymouth and from Newcastle to Bristol, as well as at head office in the Yorkshire market town whose name we share, our people have shown their commitment to their communities, time and time again.

Some examples include:

Family Fun Day

The Society held its second Family Fun Day in July 2016. Over 400 colleagues and their families attended, raising £4,336 for local charities, which were the Sue Ryder Manorlands Hospice, Yorkshire Cancer Support and The Down Syndrome Training and Support Service.

Change for Wellies (UK Flood Support Appeal)

With the terrible scenes of flooding on our TV screens at the beginning of 2016, our people and customers decided that they could not sit back and watch. As well as accepting donations, we launched our *Change for Wellies* campaign where we sold wellington boot shaped keyrings in our branches and in our head office. This raised over £15,000, which we sent to five national flood charities. 11 branches in the most affected areas distributed some of the funds to the local flooding groups.

Our Crosshills branch donating money to Crosshills FC who suffered flood damage.

Our branches also continued to support their communities in other ways throughout the year:

- Our Taunton branch organised free sleeping bags and a soup kitchen for local homeless people;
- Our Yeadon branch has been selling second hand books for St. Gemma's Hospice for almost ten years. To date they have raised over £3,000;
- Our Edinburgh team defied their fear of heights and raised £700 for Alzheimer's Scotland by abseiling down the Forth Bridge;
- Our Northampton branch took part in the London Moonwalk to raise money for breast cancer support. They raised £800; and
- Our Ripon branch raised over £500 for the Yorkshire Air Ambulance with a host of activities including a three-legged walk around the town.

Corporate Responsibility Report (continued)

Many of our people have gone to extraordinary lengths to support their chosen charities - including fire walking, the Three Peaks Challenge, boxing and organising a golf day. They have again shown that our community ethos is not just words, it is put into action every day.

Cat Handford from our Marketing team set up the charity Wil's Wishes in memory of her twin brother who died of bowel cancer in 2015. With the support of colleagues across the Society, Cat has undertaken a number of fundraising activities, including the Three Peaks Challenge, and to date has raised in excess of £25,000. This money is being used to raise awareness of bowel cancer among young people. The Skipton Building Society Camerata's musical director, Ben Crick, joined in and helped, having organised walking trips across the Three Peaks for a number of years.

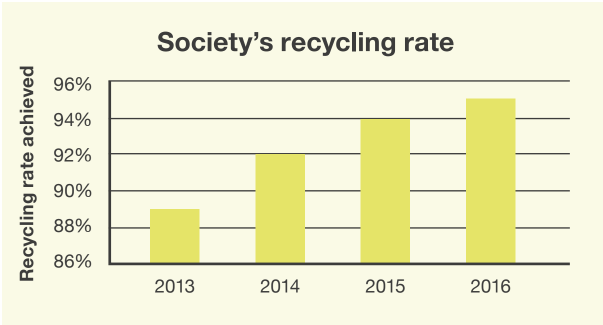
Cat Handford and a number of our people preparing to take on the Three Peaks Challenge.

Environment

2016 saw the Society continue with the drive to reduce our environmental impact.

The hosting of an environmental day at head office helped to encourage our people to think about the impact of our operations, and their personal lives, on the environment.

Below you can see how we are continually improving our recycling rates:



By constantly reviewing our operations and looking at new technology, we have been able to achieve the following reductions in 2016:

Head office electricity use down	Branch electricity use down	Head office gas use down	CO_2 emissions down
22%	9%	6%	11%

Additional activities to support our environment included our Commercial team doing a litter pick on Blackpool beach. We also organised a national litter pick across the UK, where our people spent time collecting rubbish in their local area. In Skipton alone, over 100 bags of rubbish were collected.

The Society remains committed to reducing the impact of our people travelling to work and continues to support cycle to work, car sharing and rail ticket schemes. Where appropriate, we also encourage our people to work from home, reducing our CO_2 impact further.

WINNER! Grassroots Giving photography competition

Sarah Peets with the winning photo in the 2016 Grassroots Giving photography competition which was open to amateur photographers and asked for photos demonstrating community groups in action.

The Board of Directors

Mike Ellis (65)

Chairman of the Board and the Nominations Committee

"I joined Skipton because it stands out for its excellent customer service and supports the local communities it serves. It's important to me that we provide financial security for our customers and are known for being an organisation that really cares. I understand the financial services industry and how we can work together to make Skipton the best it can be."

During 30 years in financial services, Mike held various senior executive positions with Halifax Building Society, its successor Halifax plc and HBOS plc. He was a Board member of Halifax plc between 1997-2001 and its successor HBOS plc. He retired at the end of 2004 but returned to HBOS plc in late 2007 and became Group Finance Director from January 2008 until January 2009. Mike joined the Board in 2011. His other directorships are M H Ellis Consulting Limited and Leeds Theatre Trust Limited.

Mike retires from the Board following the conclusion of the AGM on 24 April 2017 and, therefore, is not standing for re-election to the Board.

David Cutter (55)

Group Chief Executive, Chairman of the Executive and Retail Credit Committees and member of the Asset & Liability Committee

"I've been with Skipton for over 20 years and I still enjoy learning something new every day and seeing the culture of continual improvement we've developed over the years. Skipton is a trusted business, which aspires to consistently provide excellent service and build strong relationships with its customers. It's 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."

A chartered accountant, David has had more than 20 years' experience working 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. Other directorships are as a council member of the Building Societies Association and a trustee of The Craven Educational Trust.

Andrew Bottomley (51)

Distribution and Financial Services Director and a member of the Executive Committee

"Having worked in financial services for many years, I was keen to join an organisation that cares for both its customers and colleagues. I thrive on a challenge and an action-orientated environment where the team has strong values that won't be compromised. I've dealt with many cultures and segments of the financial services industry and I'm keen to develop people and help them grow. I also have wide experience in conduct risk and change management and ensure there's a rigorous customer focus. I'm pragmatic and bring energy and a clear set of values to work every day."

Andrew has more than 30 years' tenure in building societies and banking, plus wide experience in change management, distribution strategy and conduct risk. Andrew has previously served as Mortgage and Bancassurance Director at Lloyds Bank, in various senior roles at the Halifax encompassing branches, mortgages and head office positions, and was Chairman of Halifax Sharedealing. He joined the Board in 2016.

The Board of Directors (continued)

Amanda Burton (58)

A member of the Remuneration and Nominations Committees

"I'm 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 and legal background in a number of diverse industries and enjoy learning about new sectors and the challenges they face."

Amanda joined the Board in 2016, bringing more than 15 years' non-executive director experience. Until 2014 she held the role of Global Chief Operating Officer of Clifford Chance LLP, and was previously General Counsel at Meyer International, Ratners Group and Tiphook.

Her other directorships are Senior Independent Director and Chair of the Remuneration Committee at HSS Hire Group plc and Monitise plc respectively and Non-Executive Director and Chair of the Remuneration Committee at Countryside Properties plc. She is also Chair of Battersea Dogs and Cats Home.

Marisa Cassoni (65)

Chairman of the Audit Committee and member of the Nominations Committee

"Skipton has a strong and unique culture and brings important diversity to the marketplace. I believe businesses are about people. By employing the right ones, then nurturing and challenging them, you ensure success. As a former Finance Director with many years of practical experience, I can relate to what the people I interact with are trying to do and offer a wider perspective which will help them to achieve their goals."

A chartered accountant, Marisa has more than 40 years' experience as a financial professional. This includes 20 as an executive board member across various customer-facing industries, including financial services, plus 15 as a pension fund trustee with nine years as chair. Her previous roles include Group Finance Director of John Lewis Partnership, Royal Mail Group, Britannic Assurance Group and Prudential UK Group. She joined the Board in 2012.

She was a member of the Accounting Standards Board 2005-11 and the CBI Economics Committee 2001-12. She also held non-executive directorships of listed companies in the UK and USA for 15 years. She's been chair, director trustee and governor of a number of UK charity and pension funds. She holds other directorships including as Non-Executive Director of AO World plc, The People's Operator plc, Enterprise Inns plc and is a member of the Competition and Markets Commission.

Denise Cockrem (54)

A member of the Audit, Remuneration and Nominations Committees

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

Denise joined the Board in 2015, bringing more than 20 years' experience in financial services from roles at Barclays, RBS, Direct Line and RSA Insurance. She's currently also CFO for Good Energy plc, the AIM-listed renewable energy supplier with a strong tradition of customer share ownership, and the national charity MacIntyre, which supports people with learning disabilities. She has a passion for delivering excellent customer service and developing people.

Ian Cornelius (48)

Commercial Director, member of the Executive, Retail Credit and Asset & Liability Committees, and Chairman of the Skipton International Limited Board

"I joined Skipton because it has strong values that resonate with my own and a great reputation for looking after its customers. I see my role as building on the heritage and reputation that Skipton already has, with the aim of becoming the very best place to go to for financial help and advice 'for your life ahead' for both current and future generations."

A member of the Board since 2012, Ian has brought a strong, clear focus on understanding and meeting the needs of our customers, and ensuring we continually improve the products and services we offer. Previously Commercial Director of Homeloan Management Limited, he also held senior roles at Virgin Money, Bradford & Bingley, Capital One and Boots. He is also a Non-Executive Director of Incommunities Group Ltd.

Robert East (56)

Chairman of the Risk Committee and a member of the Remuneration and Nominations Committees

"In 1976, I joined a branch of Barclays in South East London first as the office junior and then as a cashier. Since then, I have worked in many varied roles in financial services, seeing some of the best and some of the worst practices. This time has taught me that well-led and motivated people will give great service to, and do the right thing for, their customers. I really believe in this. I joined Skipton because I saw a business with the same ambition and one where I could use my experience to help it deliver that ambition both now and in the future."

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. During his 32 years at Barclays Bank he was Chief Risk Officer of Absa South Africa among other roles. He's also had other leadership roles in retail and commercial banking, and took leadership of Cattles Limited's restructuring from 2009 and became its Chief Executive in 2010 until completion of its wind down in 2016. Other directorships are Welcome Financial Services Limited and Interim Chairman of Hampshire Trust plc.

Robert is the Chairman Designate of the Society and, subject to being re-elected, will become Chairman after the conclusion of the AGM.

Mark Lund (59)

A member of the Risk and Nominations Committees

"I was delighted to join the Society's Board in 2016 following a number of years as a non-executive director with Skipton's financial advice business. I've got to know the broader business of the Society well and, importantly, what it stands for – especially in terms of serving customers who are at the heart of everything we do. My personal goal is to continue to play my part in ensuring we continue to really understand our customers' needs and provide them with the right solutions."

Mark brings 30 years' experience in commercial and financial services. He's operated at director / CEO level for the last 15 years in plc and private businesses in the UK and internationally, including as CEO of St James's Place plc, CEO of Virgin Direct (secondment) and as Director of Henderson Investors plc. He joined the Board in 2016.

In 2012, he was appointed by the Cabinet Office to chair the Employee Benefit Trust of My CSP Limited. He's also a board member and acting Chairman of My CSP Limited, a pensions administration mutual company, Vice Chairman at British Ski and Snowboard Limited, Non-Executive Director of Coutts & Co and Chairman of Equiniti Financial Services Limited.

The Board of Directors (continued)

Bobby Ndawula (43)

Group Finance Director, Chairman of Asset & Liability Committee, member of Executive, Retail Credit and Model Governance Committees, and Chairman of our subsidiaries Amber and NYM

"Being part of an organisation which is values-led and has its members at the heart of everything it does, keeps me highly motivated to do my best each and every day. I enjoy leading teams that look to 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 provide more opportunities for people to save for their futures and buy their own homes."

A chartered accountant, Bobby held a number of senior positions in Group Finance and Financial Risk. With almost 20 years of experience in IT, finance and risk he has a desire to ensure the Society's customers' financial and service interests are safeguarded. He joined the Board in 2015.

Graham Picken (67)

Deputy Chairman, a member of the Audit, Risk and Nominations Committees and a Non-Executive Director of Connells Limited

"My executive career was largely in retail banking but when I moved to non-executive duties I was attracted by Skipton's mutual ethos which demands and encourages a clear focus on the interests of customers. I gain the greatest satisfaction from being part of, and contributing to, a growing and successful business and Skipton has more than fulfilled my expectations.

Financial services never stands still and there will be new opportunities and challenges ahead. I would like to believe that by sharing my knowledge and experience of the wider industry with the Society, Skipton will maintain the momentum that has enabled it to prosper and serve its customers well."

Graham joined the Board in 2012, bringing broad experience of financial services and business management. He had previously held various senior positions, including at HSBC (including Executive Chairman of First Direct and Chief Executive of Forward Trust Group) and Derbyshire Building Society (Non-Executive Director then Chief Executive 2005-9). Other former directorships include Chairman of the FTSE listed HICL Infrastructure Company Limited and Non-Executive Chairman of Hampshire Trust plc.

Helen Stevenson (56)

Chairman of the Remuneration Committee and a member of the Risk and Nominations Committees

"I joined Skipton because I believe the mutual model serves financial services customers particularly well and Skipton is well placed to continue to strengthen both its excellent customer service and financial stability. I'm interested in creating a powerful connection between customers and our business. I have deep experience of building strategies for businesses so that they make the right choices and continue to thrive in the context of a changing marketplace."

Helen joined the Board in 2013. She'd spent 19 years with Mars Inc, was Group Marketing Director of Lloyds TSB from 2003-6 and Chief Marketing Officer of Yell Group 2006-11. Her other directorships are Non-Executive Director of St Ives plc, Non-Executive Director of Trinity Mirror Group plc and member of the Henley Business School Advisory Board. She brings a strong customer focus to the Board as well as being an experienced Non-Executive Director and Remuneration Committee Chair.

Directors' Report

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2016.

The financial information given in this Directors' Report is taken from the statutory Accounts on pages 78 to 168 prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). Further unaudited information which allows comparison between 2016 and 2015 is set out on pages 16 to 30 of the Strategic Report.

Business objectives

The business objectives of the Group are set out on pages 13 to 15 of the Strategic Report.

Business review and future developments

The Chairman's Statement set out on pages 6 and 7, the Group Chief Executive's Report set out on pages 8 to 10 and the Strategic Report set out on pages 11 to 30 report on the performance of the business and its future objectives.

Profits and capital

Group profit before tax was £168.9m (2015: £146.9m). Total profit after tax transferred to the general reserve was £129.8m (2015: £113.4m).

Total Group reserves at 31 December 2016 were £1,278.5m (2015: £1,179.2m) including the available-for-sale reserve of £32.0m (2015: £31.7m) and the cash flow hedging reserve of £3.3m (2015: £(3.2)m).

Gross capital at 31 December 2016 was £1,447.3m (2015: £1,349.6m) including £77.2m (2015: £78.5m) of subordinated liabilities and £92.6m (2015: £93.5m) of subscribed capital. The ratio of gross capital as a percentage of shares, deposits and borrowings at 31 December 2016 was 8.60% (2015: 8.67%) and the free capital ratio was 7.28% (2015: 7.39%). The Annual Business Statement on pages 169 to 172 gives an explanation of these ratios.

Mortgage arrears

Group mortgage balances at 31 December 2016 included 144 cases (2015: 198) either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £29.0m (2015: £31.0m). The total amount of arrears on these loans was £2.2m (2015: £2.3m).

Charitable donations

During the year the Group made charitable donations of £0.2m (2015: £0.3m), primarily to the Skipton Building Society Charitable Foundation. No contributions were made for political purposes (2015: £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 creditor days as at 31 December 2016 for the Group was 13 days (2015: 12 days).

Principal risks and uncertainties

The principal risks and uncertainties are set out on pages 55 to 59 of the Risk Management Report and in notes 34 to 36.

The risk management objectives and policies of the Group are also referenced in the Risk Management Report.

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 53 to 59 of the Risk Management Report and in notes 34 to 36.

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 that their employees are effectively managed.

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 book value. 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 Accounts

This statement, which should be read in conjunction with the Independent Auditor's Report on pages 74 to 77, 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 Article 4 of the International Accounting Standards (IAS) Regulation 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 states that references to IFRS accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing these Annual Accounts, the Directors are required to:

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

In addition to the Annual Accounts, the Act requires the Directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Group. The Annual Business Statement can be found on pages 169 to 172.

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 16 to 30 of the Strategic Report, and a description of the principal risks and uncertainties facing the Group which is set out on pages 55 to 59 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 this 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 167 and 168.

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 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 financial statements 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 11 to 30 of the Strategic Report and on pages 53 to 59 of the Risk Management Report. In addition, notes 33 to 36 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).

Directors' statement of longer term viability

In accordance with the UK Corporate Governance Code, the Directors have assessed the viability of the Group until the end of 2021. 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 reflects the Group's five year corporate planning horizon and also the period for which associated stress testing is performed.

The Directors performed a robust assessment of the principal risks facing the Group over the next five years (until the end of 2021), which are outlined in the Risk Management Report on pages 55 to 59. Specifically, the Directors took account of those risks that could threaten the Group's business model, future performance, solvency and liquidity, including the economic, regulatory and political environments. In arriving at their conclusion, the Directors considered the following:

- The Group's business plans to the end of 2021, as well as stress testing carried out on these 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 house prices of 39% and unemployment reaching 12% during the five year period, each of which would adversely impact on the level of losses experienced within the Group's loan portfolios.
- 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 Risk Management Report, which includes the principal risks impacting the Group, and describes how these are mitigated and managed.
- 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.

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. However, there is some degree of uncertainty surrounding the outer years of this financial planning period due to the inherent limitations of preparing longer term budgets.

Directors

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

Mr M H Ellis	(Chairman)
Mr P J S Thompson	(Deputy Chairman – retired 25 April 2016)
Mr G E Picken	(Deputy Chairman – from 26 April 2016)
Mrs C Black	(retired 25 April 2016)
Mr A P Bottomley*	(appointed 1 January 2016)
Ms A J Burton	(appointed 3 May 2016)
Ms M Cassoni	
Mrs D P Cockrem	
Mr I M Cornelius*	
Mr D J Cutter*	(Group Chief Executive)
Mr R D East	
Mr M J Lund	(appointed 25 April 2016)
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 45. No Director of the Society had any interest in the shares of any Group undertaking as at 31 December 2016.

Auditor

In accordance with Section 77 of the Building Societies Act 1986, a resolution for the re-appointment of KPMG LLP will be put to the forthcoming AGM of the Society.

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 reference to the principal risks and uncertainties they face.

We consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides 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

Mike Ellis
Chairman

28 February 2017

Directors’ Report on Corporate Governance

The Board views good governance as being the heart of a well-run business and is committed to complying with prevailing best practice. This report sets out the framework of how the Society operates and conducts its business in a prudent and well organised manner, thereby maintaining high standards of governance for the benefit of its 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 prevailing version of the Code (published in April 2016), which is applicable to entities with accounting periods commencing on or after 17 June 2016, however we have elected to apply the new principles and provisions of the Code for the current reporting period. A copy of the Code is available at www.frc.org.uk.

The Board’s philosophy is to comply with the Code and the guidance issued by the Building Societies Association on it, to the extent that it is relevant to a building society. Section E of the Code requires the Chairman 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.

During 2016 the Board believes that the Society complied with the guidance issued by the Building Societies Association on the Code.

Governance framework

The 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 numerous legal entities, some of which are also regulated by the FCA.

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
- 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, which comprises the Executive Directors and other senior Society executives, and which he chairs.

Each principal subsidiary of the Group is governed by a board, which normally contains at least two Society executives as shareholder Directors (appointed by the Society) and the business’ own executive management. In addition, Mr Picken, a Society Non-Executive Director, is also a Non-Executive Director of Connells Limited. These boards are responsible for the prudent management of the business, within delegated authorities, to meet the strategic and operational objectives as defined in their corporate plans.

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, supervision 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 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 the integrity of reporting, the adequacy of the control framework 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 senior executives and the Board of material changes to the risk profile of the Society or any of its divisions 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 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.

The Board has agreed a formal schedule of matters which are reserved to it and has also delegated authority in other matters to a number of Board Committees, as described on page 46 of this report. The Board has set clear terms of reference for each of these Committees and has established an organisational structure with clearly defined and documented delegated authority to Executive management, together with reporting systems for financial results, risk exposure and control assessment.

Board meetings

The Board meets at least 10 times per year and the Non-Executive Directors also meet, without Executive Directors present, at least once a year. The attendance record of each Director at these meetings and each Committee member at relevant Board Committee meetings is set out on page 46.

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 Chairman 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 being an integral part of the reporting. This is normally issued several days before 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 relevant Executive Director or senior Society executive highlights appropriate matters including the performance of particular aspects of the business against targets.

The Board agenda also includes the following:

- Minutes of Board Committee meetings held before the previous Board meeting and verbal updates from the chairmen of Board Committees on the main issues discussed and matters agreed at recent meetings for which minutes are not available. This ensures that all Board members are kept up to date on the key discussions and decisions made by the Committees;
- Reports from both the Chairman and Group Chief Executive;
- 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 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 Committee structure which develops their understanding of the business while allowing the management teams to benefit from their experience and fully understand the non-executive perspective on particular issues.

Board composition

The Society's rules 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 2016 the Board comprised 12 Directors, being four Executive Directors and eight Non-Executive Directors. Details of the Directors are set out on pages 35 to 38. 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. None have previously been employed by the Group, 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, Directors or senior employees.

The Chairman regularly reviews the size and composition of the Board and its Committees and these 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. The Board Composition Policy is available on our website. 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, without the Executive Directors present, at least annually to discuss relevant matters, including the performance of the Executive team.

Mr Picken (Deputy Chairman) 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 Chairman, Group Chief Executive or Group Finance Director. The Senior Independent Director also provides a sounding board for the Chairman and serves as a trusted intermediary for other members of the Board, if necessary, and meets with the other Non-Executive Directors, without the Chairman present, annually, in order to appraise the performance of the Chairman.

One of the criteria which the Board takes into consideration when recruiting a Non-Executive Director is his or her 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 letters of appointment to Non-Executive Directors give 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 Chairman this will usually involve an average of two days per week. The letters of appointment also identify the key responsibilities of the Non-Executive Directors in relation to:

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

Copies of the letters of appointment of each of the Non-Executive Directors are available for inspection on request from the Group Secretary.

Chairman and Group Chief Executive

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

The Chairman is responsible for leading the Board and for ensuring the Board acts effectively, promoting high standards of corporate governance. The Chairman is also responsible for communicating with the Society's members on behalf of the Board. He is independent and has no conflicting relationships or circumstances that might affect his judgement.

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

The Board elects its Chairman and Deputy Chairman 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 and is chaired by the Society Chairman, 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 (including diversity) 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 longer term strategy in light of its strategic priorities and changing customer behaviours.

In addition, appointments to the sub-committees of the Board (see page 46 for details) are made by the Board on the recommendation of the Nominations Committee, in consultation with the relevant committee's chairman. Both the Nominations Committee and the Board have regard to ensuring a range of skills, experience, knowledge and professional qualifications exist on each sub-committee to enable the sub-committees to fulfil their duties effectively.

The Nominations Committee also 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.

2016 saw new additions to the Board. Andrew Bottomley joined as Distribution and Financial Services Director whilst Mark Lund and Amanda Burton joined as Non-Executive Directors.

In addition, the Deputy Chairman and Senior Independent Director led the process for appointing a new Chairman following the planned retirement of the current Chairman, Mike Ellis, at the conclusion of the AGM on 24 April 2017. Robert East has been appointed Chairman Designate and, subject to his re-election, will succeed Mike Ellis after the AGM.

During 2016, to support it in the appointment of Directors, the Committee has used the services of two external recruitment agencies, Warren Partners and Korn Ferry, which are independent of the Society.

Induction and professional development

On appointment, new Directors receive a comprehensive and tailored induction programme on 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-accounting background are provided with specific training on the capital and liquidity regime that governs the Society's operations. Non-Executive Directors are encouraged to contact individual members of the Executive team to discuss any queries they may have and to undertake subsidiary, branch and department visits on an ad-hoc basis.

Directors have access to the advice and services of the Group 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 Group 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 diversity

The Board considers all aspects of diversity, including age, experience and gender, when reviewing its composition. It has a composition policy which seeks to ensure that at least 25% of its composition will be male or female. All appointments to the Board are made on merit.

The Hampton-Alexander review issued in November 2016 recommended that FTSE 350 boards should endeavour to comprise at least 33% female directors by 2020. At 31 December 2016, four members (33%) of the Society's Board were female.

Performance evaluation

The Board undertakes an annual evaluation of its performance and effectiveness, and also of 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 late 2016 the Board engaged Praesta Partners LLP, who have no other connection with the Society, to undertake an external performance evaluation of the Board and its sub-committees with the results reviewed by the Board at its February 2017 meeting. The review concluded that the Board is effective with the skills, experience and knowledge to oversee the Society and guide its future. The review also identified how Directors might engage more effectively, both formally and informally and during and between meetings, to enhance the Board's guidance of the Society's future.

Individual Non-Executive Directors are evaluated on a one-to-one basis by the Chairman. Executive Directors are evaluated by the Group Chief Executive against agreed performance targets for their areas of responsibility and their own personal performance. The Chairman evaluates the Group Chief Executive's performance while the Deputy Chairman and Senior Independent Director leads the Board evaluation of the Chairman's performance, which also takes into account the views of Executive Directors.

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 were amended to require that Directors stand for re-election every year. Generally, Non-Executive Directors are initially appointed for a period of three years and, although not expected to serve more than six years, this may be extended to nine years in total.

Remuneration

Details relating to Directors' remuneration are contained in the Directors' Remuneration Report on pages 60 to 73.

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 this Annual Report and Accounts, 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. Further details on how this conclusion has been arrived at can be found on pages 49 and 50 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 40 and 41.

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 53 to 59, together with an explanation of the framework adopted by the Group for managing risk.

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

- Regular reports to the Board by the chairmen of the various Board Committees (see below);
- Presentations to the Board by divisional leaders relating to the strategy and performance of business 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 has direct access to the Chairman of the Audit Committee and reports directly to the Audit Committee;
- Regular reports to the Board, through the Board Risk Committee, from the risk functions on the principal conduct, operational, credit, market and regulatory risks facing the Group and the strength of the controls in place to mitigate such risks; and
- Reports to the Board on a quarterly basis presented by the Chief Conduct Risk Officer and Secretary and the Chief Financial Risk Officer.

The Society has a comprehensive system for reporting financial results to the Board. Each of the divisions prepares monthly results with comparisons against budget. The Board reviews these for the Group as a whole and challenges management, 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, that establish and monitor the implementation of business 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, regulatory compliance, control and governance processes. 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 adequately devoted to all areas of risk, the Society operates two discrete risk functions headed by the Chief Financial Risk 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 53 to 59.

The Board is satisfied that during 2016 the Society 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 Board Committees in order that they can be considered in more detail.

The Committee structure includes:

- The **Audit Committee** – details are contained in the Audit Committee Report on pages 48 to 52;
- The **Board Risk Committee** – details are contained in the Risk Management Report on pages 53 to 59;
- The **Remuneration Committee** and **Non-Executive Directors' Remuneration Committee** – details are contained in the Directors' Remuneration Report on pages 60 to 73; and
- The **Nominations Committee** – details are contained in the section on 'Appointments to the Board' on page 44 of this report.

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

Board and Committee membership attendance record

The attendance of Directors at scheduled Board meetings and attendance of those who are also members of the Audit Committee, Nominations Committee, Remuneration Committee and Board Risk Committee at Committee meetings during the year is set out below:

	Board	Audit Committee	Nominations Committee	Remuneration Committee	Board Risk Committee
Mr M H Ellis	10/10	-	2/2	-	-
Mr G E Picken	10/10	5/5	2/2	-	5/5
Mrs C Black	3/3	3/3	-	3/3	-
Mr A P Bottomley	9/10	-	-	-	-
Ms A J Burton	4/6	-	1/1	-	-
Ms M Cassoni	10/10	5/5	2/2	-	-
Mrs D P Cockrem	10/10	5/5	2/2	3/3	-
Mr I M Cornelius	10/10	-	-	-	-
Mr D J Cutter	10/10	-	-	-	-
Mr R D East	10/10	-	2/2	3/3	5/5
Mr M J Lund	7/7	-	1/2	-	1/1
Mr R S D M Ndawula	10/10	-	-	-	-
Ms H C Stevenson	10/10	-	2/2	5/5	5/5
Mr P J S Thompson	3/3	3/3	-	3/3	-

Note: Where Directors were not available to attend meetings, due mainly to commitments made prior to their appointment, they nonetheless received all papers and provided feedback as appropriate.

The Annual General Meeting (AGM)

Each year the Society gives all eligible members at least 21 days' notice of the AGM. At the meeting, the Chairman 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 and the voting form includes a 'vote withheld' option. Members can vote either by post, in any of our branches, online at www.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.

Copies of this Annual Report and Accounts 2016 are available online at www.skipton.co.uk or on request in branches or by post.

In addition, the Summary Financial Statement is included as part of the AGM magazine, the format of which is aimed at making it informative and easy to read.

Relations with members and other investors

The Society's membership comprises its savers, 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 the Society's activities and seeks to respond quickly to all enquiries received.

We conduct regular market research with members to evaluate their experience of dealing with the Society and how satisfied they are with their relationship with us. We carry out these interviews with members each year to help us understand how we can improve the service we provide to them. We also engage with members in numerous other ways, including through our Customer Forums. These consist of face-to-face sessions with customers to get their feedback on our strategies and initiatives. Small groups of customers attend each session along with Society representatives. In addition to this, we have a members' Customer Panel which we use to gather feedback on a wide range of topics including new product and proposition development.

Finally, the Society's 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 queries.

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

On behalf of the Board

Mike Ellis
Chairman

28 February 2017

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:

Ms M Cassoni	Non-Executive Director (Committee Chairman)
Mrs C Black	Non-Executive Director (resigned 25 April 2016)
Mrs D P Cockrem	Non-Executive Director
Mr G E Picken	Non-Executive Director
Mr P J S Thompson	Non-Executive Director (resigned 25 April 2016)

The Committee met five times during 2016 and the attendance of its members at these meetings is set out on page 46 in the Directors' Report on Corporate Governance. We also held private discussions during the year with the external auditor, KPMG LLP ('KPMG'), the Chief Conduct Risk Officer and Secretary, the Chief Financial Risk Officer, the Group Finance Director, the Finance Director of Connells and the Chief Internal Auditor, 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 Chief Financial Risk Officer, the Head of Compliance Monitoring, external audit representatives, the Chief Internal Auditor and the Deputy Chief Internal Auditor regularly attend meetings, by invitation.

The Committee is comprised of at least three members, all of whom are independent Non-Executive Directors. Consideration has been 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 Directors with recent, relevant financial experience to provide appropriate challenge to management. As Chairman of the Committee, I am a Chartered Accountant who has held senior finance appointments with a number of large organisations, most recently as Group Finance Director at the John Lewis Group prior to retirement in 2012. Mrs Cockrem is currently Chief Financial Officer at the Good Energy Group and has also held senior finance positions at RSA Group and Direct Line. Mr Picken has wide experience within the financial services industry and is currently a Non-Executive Director of Connells Limited.

In terms of good governance and to ensure holistic oversight, Mr Picken is also a member of the Board Risk Committee. The chairmen of the Board Risk and Board Audit committees also attended at least one of the other committee's meetings during the year.

As part of my role as Chairman of the Audit Committee, I also attended meetings of the Remuneration Committee and 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 www.skipton.co.uk/about-us/governance/board-committees. These are in line with the provisions of the Financial Reporting Council's 'Guidance on Audit Committees' which was last 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 significant reporting judgements and reporting how these were addressed;
- To provide advice to the Board on whether the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides 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 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 instigate 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, as Chairman of the Committee, I provide a verbal report to the next Board meeting after each meeting of the Committee.

Activities of the Committee during the year

During 2016 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 53 to 59.

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 2016 provided assurance that there were no material breaches of control and that the Group maintained an adequate internal control framework that met the principles of the UK Corporate Governance Code.

Internal Audit is supported by external advisers who are able to provide specialist technical support in connection with matters such as Treasury, Information Technology and Credit Risk. The Chief Internal Auditor reports to me, and as a Committee we are responsible for ensuring that Internal Audit retains adequate skills and resource levels that are sufficient to provide the level of assurance required. The Committee is satisfied that, throughout 2016, 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 agreeing 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 also has oversight responsibility for the Group's Compliance Monitoring function which provides second line assurance on activities regulated by the Financial Conduct Authority across the Group. A programme of conduct risk customer outcome testing is performed by the Compliance Monitoring function which includes, inter alia, investment, insurance and protection advice, complaint handling and will sales. 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.

During the year, the main areas of internal control which were reviewed were as follows:

- the governance framework surrounding the further embedding of credit risk models to support the Society's strategy to move to a more advanced credit risk approach (the Internal Ratings Based approach);
- Information Technology and cyber security 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;
- the governance framework and key controls associated with the introduction of pension advice services;
- 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
- the internal controls and governance within the Connells group.

The Committee also 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.

As part of the external audit process, KPMG also provide us with internal control reports. During the year, they did not highlight any material control weaknesses.

The Committee requires an external effectiveness review of Internal Audit at least every five years, which considers the quality, experience and expertise of the function. As outlined in the 2014 Annual Report, a review was carried out during 2014 by an external firm appointed by the Committee and that review concluded that the Internal Audit function was operating effectively. An action plan to address the areas recommended for further improvement was developed and has been monitored by the Committee. All actions from the 2014 effectiveness review have been completed, with the exception of the implementation of specialist audit and compliance monitoring software, which remains in progress.

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 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 2016 Annual Report was fair, balanced and understandable and whether it 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:

- the Chairman, Group Chief Executive and Group Finance Director were involved from an early stage in agreeing the overall tone and content of the Annual Report;
- members of the Executive Committee and the Board have been involved in reviewing and commenting on various drafts of the Accounts, to help ensure that the final draft is

fair, balanced and understandable; and

- robust verification by the Financial Reporting team took place to ensure there was appropriate supporting evidence for the content of the Annual Report.

The Committee is satisfied that, taken as a whole, the 2016 Annual Report and Accounts is fair, balanced and understandable and includes the necessary information as set out above. It has confirmed this to the Board, whose statement in this regard is set out on page 41 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 management. The key areas of estimate and judgement that we considered in reviewing the 2016 Annual Report and Accounts are set out below:

- We have again reviewed the adoption of the going concern assumption for the Interim and 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 on pages 40 and 41 in the Directors' Report, 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 thus threaten the Group's longer term viability. Based on this review, we concluded that the longer term viability statement on pages 40 and 41 is appropriate.
- 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.
- The Committee continues to monitor loan impairment provisions and has considered the impact of forbearance adopted in the Group's mortgage portfolios, as well as various other key assumptions contained in the Group's loan impairment model (such as house prices) on the level of provisions made and the relevant disclosure in the Accounts. We have examined and challenged the assumptions adopted and, by requesting and scrutinising reports produced by management, are satisfied with the models used to calculate loan impairment provisions for both the residential and commercial mortgage portfolios. We have also reviewed the carrying value of treasury assets by scrutinising reports produced by the Market & Liquidity Risk function and consider these to be appropriate.
- Interest income on the Group's mortgages is measured under the effective interest method, as explained in note 1s) to the Accounts. This method includes an estimation of mortgage product lives which is based on observed historical data and Directors' judgement. During the year, the Group's estimate of mortgage lives has been updated to reflect changes in market conditions and customer behaviours. In accordance with accounting standards, the impact of this change in assumption on expected future cashflows is recognised immediately in the Group's Income Statement.

  In August 2016, the Bank Base Rate was reduced from 0.5% to 0.25%. In response to this, the Group adjusted the variable rates of interest applied to its mortgages. In accordance with accounting standards, the impact of this change in interest rates on expected future cashflows will be recognised in the Group's Income Statement over the expected life of the mortgage assets.

  The Committee has examined papers prepared by management in support of the above changes, including evidence for revised mortgage life estimates, and is satisfied that the estimates and accounting treatment are appropriate.
- The Group holds an equity release mortgage book, closed to new business, and, as outlined in note 15 to the Accounts, a 'no negative equity guarantee' is given to customers under the terms and conditions of the mortgages in this book. This guarantee is accounted for as an embedded derivative and held at fair value within 'Loans and advances to customers' in the Statement of Financial Position. The valuation is determined by, inter alia, a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and, as a result, judgement is required in determining the appropriate set of assumptions to derive the valuation of the embedded derivative within the Accounts.

  During the year, a number of changes were made to the model inputs. These included updates to customer information and mortality data. In addition, there were updates to certain assumptions, including house price inflation and retail price inflation. At 31 December 2016 the embedded derivative was valued at £27.7m (31 December 2015: £24.0m). The Committee has scrutinised papers prepared by management which provide evidence that, taking into account the specific characteristics of this portfolio and also general macro-economic indicators, the revised inputs and assumptions are appropriate, and the valuation is appropriate. As a result, we have satisfied ourselves on the valuation of the embedded derivative and hence the carrying value of this portfolio in the Accounts.

  As outlined in note 37b), the Group hedges the interest rate risk arising from its equity release mortgage book 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, which is not always offset by the value of the underlying hedged item within the Statement of Financial Position; therefore income statement volatility can arise. The Committee has reviewed papers prepared by management that support the assumptions used and outline the control framework management has in place, and has satisfied itself that the amounts recognised in the Income Statement are fairly stated and that the valuations of these derivatives are appropriate.

- During the first half of 2016, Computershare Limited, the ultimate parent company of Homeloan Management Limited (a former subsidiary of the Group, sold in 2014), announced that its UK subsidiary had been appointed by UK Asset Resolution to undertake its mortgage servicing activities. This will result in contingent consideration being receivable by the Group between 2018 and 2022. The Committee considered whether a further amount of deferred consideration should be recognised in the second half of the year based upon the information presented to it by management. The Committee stated that although it is likely that ultimately further amounts would be due above and beyond the £9.9m recognised in the Accounts, there was not sufficient certainty to be able to reliably provide a best estimate of the final amount at this stage.
- Following 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 considered whether the Board's decision, in 2010, to remove the ceiling on the Society's Standard Variable Rate ('SVR') could result in future cash outflows, and concluded that the probability of this remains remote.
- The Group manages two funded defined benefit pension schemes which at 31 December 2016 had a combined deficit of £110.9m (31 December 2015: £65.2m). The increase in the deficit was largely driven by a reduction in the discount rate that is applied to the scheme liabilities, which has been revised during the year from 3.83% at 31 December 2015 to 2.65% at 31 December 2016, reflecting market conditions at the balance sheet date. The Committee has examined and challenged the pension scheme assumptions and is satisfied that these are reasonable and appropriate.
- The Committee has considered the other risks identified by the external auditor within the external audit report on pages 74 to 77 relating to provisions for liabilities and hedge accounting and we are comfortable that these have been appropriately considered within the Accounts.

External auditor

The Committee assesses the effectiveness and independence of the external auditor annually, following the 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, whilst at the same meeting the Committee also requested and considered feedback obtained from a survey that had been carried out by KPMG of key business contacts involved with the statutory audit process. The Committee scrutinised these reports and, together with its own experience, formed an opinion as to the effectiveness of the external auditor. During the year, we concluded that the relationship with the external auditor continues to work well and we are satisfied with their effectiveness and independence.

The Committee regularly monitors the Group's relationship with the external auditor and has adopted a framework for ensuring auditor independence and objectivity. This framework defines prohibited non-audit assignments (which include most 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 undertook a number of non-audit related assignments for the Group during 2016. These were conducted in accordance with the framework and are consistent with the professional and ethical standards expected of the external auditor. Details of the fees paid to the external auditor for audit and non-audit services are set out in note 6 to the Annual Accounts and during the year non-audit fees represented 81% of the total Group audit fee (2015: 76%). Non-audit assignments undertaken during the year included services provided by KPMG Nunwood, who provide our Commercial teams with customer feedback analysis and insights for management's consideration. Our engagement with Nunwood pre-dates KPMG's acquisition of Nunwood in 2015 and the Committee concluded that KPMG Nunwood remain the appropriate provider of this service. The Group is monitoring the non-audit services ratio in preparation for changes to EU rules which will limit this percentage to 70% and we intend to comply with these rules once they become effective for the Group in 2020.

The Committee also reviews auditor independence by considering regular rotation of the key external audit partner. The audit partner was most recently rotated in 2014, following a five year term as responsible partner. The current audit partner is Jonathan Holt and he has held the role since 2014.

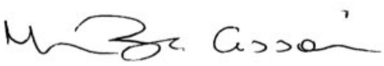
KPMG LLP, or its predecessor firm, has been the Society's auditor since the 1980s. The Corporate Governance Code recommends FTSE 350 companies put their external audit out to tender at least every 10 years. The Society most recently put its audit out to tender in the second half of 2014, as a result of which the Committee decided that KPMG is the most appropriate firm at this time to be the Society's external auditor. The Committee will continue to assess the need for a competitive process on an annual basis as part of its review of the external auditor's effectiveness. In accordance with EU legislation, KPMG will be required to rotate off the audit following the audit of the 2019 financial statements.

The Committee has also agreed a policy for the employment, by the Group, of former employees of the auditor which is designed to further maintain the auditor's independence.

Effectiveness of the Audit Committee

The effectiveness of the Committee is assessed 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 45. In 2016 the Committee was subject to an externally facilitated effectiveness review as part of the wider Board evaluation; this found the Committee to be effective in fulfilling its duties.

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.



Marisa Cassoni
Chairman of the Audit Committee

28 February 2017

Risk Management Report

Foreword

As Chairman of the Board Risk Committee, I am pleased to present the 2016 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.

This year we have witnessed a number of milestones, not least the outcome of the EU referendum and a further reduction in Bank Base Rate to a new historical low. 12 months ago the likelihood of either outcome appeared distant which, along with continuing global uncertainty, emphasises the need to maintain a forward looking focus and run appropriately severe scenarios to test the Group's resilience to risk. The 'Financial performance' section of the Strategic Report on page 19 discusses the initial impact of the outcome of the EU referendum on the Society as well as the uncertainties that still exist.

The Group has paid particular attention to economic developments since the decision was made to leave the EU and the impact that this may have 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 begins the exit process, the changing economic environment could have an impact on some of the principal risks discussed in this report. The Directors are monitoring developments closely and the Group is well placed to react to any developments accordingly.

At Skipton we have maintained focus on the external environment and 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 exercised and the prudential strength of the Group to be maintained.

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

- 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 growth plans do not increase the risk profile outside appetite);
- Cyber risk (to ensure that the Group has appropriate controls in place to reduce the likelihood of a successful attack);
- Mortgage and financial advice and will writing services (to ensure training and competence standards are appropriate, customers receive good advice and documentation standards substantiate this); and
- Risk appetite (to ensure that this remained appropriate against a changing business and economic backdrop).

The Committee receives regular reports from the Chief Financial Risk Officer and Chief Conduct Risk Officer and Secretary. These reports direct the Committee's attention to those matters which the risk officers believe warrant further consideration, enabling a challenge of first line management on the actions being taken to mitigate the risks.

Risk overview

Day-to-day operation of the business naturally involves exposure of 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. Central to operating within this appetite is a management culture which promotes awareness of actual and potential risk exposures and an understanding of their impact 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.

Membership and attendees

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

Mr R D East	Non-Executive Director (Committee Chairman)
Mr M J Lund	Non-Executive Director (appointed 1 October 2016)
Mr G E Picken	Non-Executive Director
Ms H C Stevenson	Non-Executive Director

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.

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:

Risk Management Report *(continued)*

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 and these reviews are reported to the Board Risk Committee.

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 which, 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 four sub-committees of the Board Risk Committee described above which are responsible for recommending and monitoring the Group's adherence to policy. The independent risk functions are represented on each of these sub-committees. The Board Risk Committee Chairman 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, the management of conduct and operational risks are key to the ongoing success of the Group. Central to managing these risks are maintenance of a robust product governance framework to ensure that we develop and market products and services designed to meet the needs of our target market, maintain effective control over the provision of advice and have efficient administration services.

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 Funding for Lending Scheme and more recently the Term Funding Scheme. These initiatives have provided market liquidity and have dampened competition for retail savings.

Whilst levels of mortgage arrears have continued to fall throughout 2016, a general downturn in the economy, an 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 slow down 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. The changes proposed by the Government in the 2016 Autumn Statement on the payment of lettings fees may impact Connells' revenue flows.

The Group continues to monitor closely the impact of the referendum result to leave the EU. Whilst this had an immediate adverse impact on house sales and mortgage completions, the market stabilised and improved during the second half of the year, although house sales in Connells for the second half of the year as a whole were below the same period last year. Such factors combine to underline the need to continue to operate within robust risk policy parameters.

The Group is also monitoring the impact of changes to stamp duty, tax changes in the buy-to-let market and house price levels generally, but particularly in London and South East England.

Principal risks and uncertainties

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 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. In addition, the Group includes specialist lending businesses Amber and NYM which were also closed to new lending in 2008. 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.

Risk	Risk mitigation and management
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. To diversify our funding sources, additional funding is provided by accessing longer term wholesale funding markets. In addition, funding has been accessed from the Bank of England's Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS). We have also maintained the quality of the Group's liquidity portfolio, with 45% of total liquidity comprising cash held at the Bank of England. We also hold a portfolio of high quality but less liquid assets held for liquidity management purposes. As at 31 December 2016, the proportion of total liquid assets rated A3 or above was 98.8% (2015: 99.9%).
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. 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.
Equity risk	
This is the risk of loss due to adverse movements in equity markets.	The Group has a shareholding in Zoopla Property Group Plc, owning 2.7% of its shares at 31 December 2016. The value of equity investments can fluctuate and therefore the Group holds capital to absorb such fluctuations in order to protect its regulatory capital position. The Board also regularly reviews the strategy for its investments to ensure that members' interests are protected. The market value of the Group's shareholding in Zoopla, based on the share price at 31 December 2016, is £36.0m.

Risk	Risk mitigation and management
Conduct risk	
Conduct risk is the risk of delivering poor or inappropriate outcomes for customers.	The framework to control this area is maintained and overseen by the Conduct and Operational Risk Committee. ***Mortgage advice*** - Likely to be the largest financial commitment undertaken by borrowers, the need for reliable mortgage advice is paramount. The Society provides advice directly and through its Estate Agency division, Connells. In an environment of strong house price inflation there is risk of customers stretching their ability to meet their mortgage commitments. Rigorous quality checking and compliance monitoring are operated by the Society and Connells. The Society also operates rigorous affordability assessments as part of its 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 announced by the Government in 2015 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. ***Will writing*** - The Society offered a will writing service to customers until the end of 2016. Since then, provision of the service has been outsourced to another Group company, Redstone Wills, which specialises in this area. This followed a review which concluded that the commercial return generated by the service did not justify the risks involved in the Society offering a will writing service directly.
Operational risk	
Operational risk is the risk of financial loss or reputational damage arising from inadequate or failed internal processes, systems or human error.	***Change management*** - The scale and pace of regulatory change has been significant in recent years and shows little sign of abating. 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 which is inadequately managed can 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, implementation of a 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 provision 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. *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 care. The Society is aware of the 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 in the event of a disaster.

Risk Management Report *(continued)*

Risk	Risk mitigation and management
Reputational risk	
Reputational risk is the risk to earnings, liquidity or capital arising from negative market or public opinion.	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; and • working within the risk management framework which has reputational risk as a key consideration.
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 managing and assessing model risk in the Society, ensuring that all material models: • go through a formal review and approval process; • have a strict change control process; • undergo a consistent model, development and validation process; • are monitored routinely and reviewed periodically in line with a risk based timetable; and • undergo a pre-determined model development and validation process.
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 pensions legislation.	The Group had, as at 31 December 2016, funding obligations for two defined benefit schemes which carried funding deficits. The schemes were closed to new entrants and to future accrual of benefit by 31 December 2009. To manage the Group's exposure to pension obligation risk: • The Board regularly reviews the Group's pension risk strategy; • The Board and the pension scheme Trustee receive professional advice from different actuarial advisers; • The pension scheme Trustee meets 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 Trustee also monitors 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.
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.	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. 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.

Risk	Risk mitigation and management
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 conducts an Internal Capital Adequacy Assessment Process (ICAAP) at least annually to assess the Group's current and projected capital adequacy required 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 Group's Individual Capital Guidance (ICG) requirements. From 1 December 2016, the Group has adopted the following approaches to calculate its Pillar 1 minimum capital requirements: • IRB approach for mortgage exposures of the Society, Amber and NYM; • Standardised approach for other lending exposures; • Standardised approach for treasury portfolios; and • Standardised approach for operational risk. During the year the Group received approval from the PRA to adopt the use of its internally developed suite of Internal Ratings Based (IRB) models for the assessment of the credit risk associated with the Society, Amber and NYM mortgage portfolios. This is a significant milestone reflecting confidence in our credit risk modelling and associated model governance. The Capital Requirements Directive IV (CRD IV) regulatory framework came into force on 1 January 2014. Whilst many of the proposed changes have been implemented, further material changes are anticipated, such as the requirement to hold Minimum Required Eligible Liabilities, initiated by the regulators in response to the previous banking crisis. The Society will assess the emerging implications for its future capital requirement, which will be required to be implemented by 2022. The Society satisfies all of the current capital requirements under CRD IV.

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 www.skipton.co.uk.

Conclusion

The challenges facing financial services businesses are extensive and very real. I am confident that the risk management framework operated by the 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.

Robert East
Chairman of Board Risk Committee
28 February 2017

Directors' Remuneration Report

Annual statement from the Chairman of the Remuneration Committee

Dear Member,

As we explained in the 2015 Annual Report and Accounts, further changes in the regulations relating to remuneration and the growth in asset size of the Society prompted a review of our 2016 remuneration policy for Executive Directors. This year, we have focussed our efforts on implementing the remuneration policy changes and aligning the supporting policies, processes and remuneration schemes to meet the increased regulatory requirements.

The Remuneration Committee has also had a period of change in 2016. Earlier this year, I took over as Chairman of the Committee from Nimble Thompson who, together with Cheryl Black, resigned from the Committee in April 2016. I would like to thank them both personally for their significant contribution, particularly with regard to the policy changes we have implemented this year. I am delighted, however, that Robert East (Chair of the Board Risk Committee) has resumed his former role on the Remuneration Committee and we have been joined by Denise Cockrem, newly appointed to the Committee in April 2016. From 1 January 2017, Amanda Burton has also joined the Committee and will bring her valuable expertise to bear.

The members of the Remuneration Committee during the period were:

Ms H C Stevenson	Non-Executive Director (Chairman of the Committee from 26 April 2016)
Mr P J S Thompson	Non-Executive Director (Chairman of the Committee until 25 April 2016)
Mrs C Black	Non-Executive Director (resigned 25 April 2016)
Mrs D P Cockrem	Non-Executive Director (appointed 25 April 2016)
Mr R D East	Non-Executive Director (appointed 25 April 2016)

As the newly appointed Chairman of the Committee, I am pleased to present the Remuneration Committee's report which sets out details of the pay, incentive payments and benefits for the Directors for the year ended 31 December 2016. We constantly strive to maintain the highest standards of transparency and governance in relation to Directors' remuneration and have again this year incorporated the requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 to the extent to which they are relevant to building societies.

This Directors' Remuneration Report is presented in two sections:

- An overview of the Remuneration Policy, which was set out in detail in the Society's 2015 Annual Report and Accounts and approved at the Annual General Meeting (AGM) in April 2016. This policy is unchanged and the overview on pages 62 to 65 serves as a reminder of the key elements of the Directors' remuneration policy.
- The Annual Report on Remuneration on pages 66 to 72 which explains how we put our existing policy into practice in 2016 and aligned it with other key policies.

A summary of this report will be sent to members, together with the Summary Financial Statement, ahead of the AGM in April 2017.

Remuneration policy for 2016

A reminder of the key elements of our 2016 policy for the Society's Executive Committee is set out below with a more detailed overview included in the policy section of the report:

- Replacement of the separate short term and medium term incentive arrangements with a single variable pay arrangement;
- The long term focus of the scheme is maintained by a requirement that at least 50% of any variable pay awarded from the scheme is deferred and will vest pro-rata over a period of five or seven years;
- 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 sustained;
- The ratio between fixed and variable pay was re-balanced by reducing the overall variable pay opportunity for Executive Directors from 100% of salary to 50% of salary whilst at the same time increasing base salaries by around 15%. The overall impact of this change for Executive Directors is that the net present value of on-target remuneration is broadly the same, but the maximum opportunity is significantly reduced in the longer term.

The new Remuneration Policy and the Annual Report on Remuneration were put to two advisory votes at our AGM in April 2016 and received majority votes in favour. Details of the votes are included in the final section of this report ('Statement of voting at the 2016 AGM').

Remuneration in respect of 2016

In the context of increasing competition in the mortgage market and pressure on our net interest margin, the Society's performance has remained solid.

Statutory Group profit before tax (PBT) was £168.9m (2015: £146.9m) and the core Mortgages and Savings division PBT was £96.6m (2015: £103.1m). Despite the increased market and economic pressures, mortgage and savings balances have seen good growth (9.1% and 10.0% respectively) and the Common Equity Tier 1 (CET 1) ratio, as measured under IRB this year, was strong at 23.9% (2015: 16.8% under the standardised approach).

Key decisions taken

- Taking into account the market competition, economic factors, our acceptable risk profile and our continued solid performance, the Committee made awards under the Society's Single Variable Pay Arrangement (SVPA) scheme with respect to the 2016 outturn. The average award payable to the Executive Directors is 33.1% (2015: 36.4%) of base salary (as at 31 December 2016) out of a possible maximum 50% (2015: 50%). Other Executive Committee members also participating in the short term incentive scheme received an average award of 28.5% of base salary (2015: 30.8%) out of a possible maximum of 40%. The average award made to senior managers in the Senior Leadership Team incentive scheme is 21.6% (2015: 21.4%) of base salary.

- The annual incentive scheme for the remainder of our people in the Society resulted in an average payment of 5.0% (2015: 5.4%) of base salary for eligible, full year participants rated as ‘achieving’ or above.
- The three year performance cycle for the 2014/2016 Medium Term Incentive (MTI) scheme, put in place in January 2014, came to an end in December 2016. Having reviewed the cumulative performance to December 2016, the Committee made an overall award of 39.3% (of salary on commencement of the scheme), half of which is paid in 2017 followed by a quarter in 2018 and a quarter in 2019. Payments for the 2015/2017 performance period will be made, in the same proportions, in 2018, 2019 and 2020 subject to performance. As signalled in the 2015 Directors’ Remuneration Report, a new MTI scheme was not put in place for 2016 to 2018 as the SVPA replaced the short and medium term schemes that were in place in 2015.
- From 2016, regulations mean that the Group Chief Executive and any other Material Risk Takers (as defined on page 72) receiving more than certain earnings limits in the performance year will have their awards made partly in the form of ‘instruments’. For listed organisations, this might typically be a share award but for the Society, as a mutual organisation, the instrument is a contingent cash award which is payable subject to the capital position of the Society. The instrument developed requires that, in addition to the required deferral period, the part of the award payable in instruments will be subject to a further six month retention period following vesting and all payments will be subject to write down if CET 1 capital falls below the agreed level. As this is a new requirement for the Society from 2016, the Remuneration Committee has overseen the development of the instrument and the rules around how it will work in practice.
- While the Remuneration Committee has always been focussed on managing risk in its remuneration schemes, we took the opportunity in 2016 to review and enhance our risk adjustment arrangements.
- In 2017, the Committee will continue its work in this area and will also consider how new regulations such as gender pay reporting and the UK Government’s focus on executive pay might influence our remuneration policy and practices going forward.

Conclusion

On behalf of the Committee, I hope that this report will give you a clear view of how we have implemented the policy in 2016. The Committee recommends that members vote in favour of the 2016 Annual Remuneration Report at the forthcoming AGM.

Helen Stevenson
Chairman of the Remuneration Committee

28 February 2017

Directors' Remuneration Policy 2016

The Directors' Remuneration Report in the 2015 Annual Report and Accounts (available on our website at www.skipton.co.uk/financialresults) explained fully our policy on Executive Directors' remuneration. To provide context and to enhance understanding of our 2016 report, we have set out below the key elements of our Executive and Non-Executive Directors' remuneration and how each element links to our overall business strategy.

Overview of Remuneration Policy for Executive Directors

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 for 2016 received a majority vote from members at the Annual General Meeting held on 25 April 2016.

Development of policy

In establishing, implementing and maintaining the remuneration policy, the Committee applies a set of general 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 additional requirements for those firms regulated by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), which include the Society, and the general principles for these firms are set out below. The full remuneration principles are available on request from the Secretary.

In addition to these general principles, the Committee sets out requirements for the operation of variable pay, setting appropriate rules and limits around incentive related payments. Further requirements on deferral and performance adjustment apply specifically to Material Risk Takers. The principles are reviewed annually and are supported by key policies.

General principles of remuneration for 2016

a. A total rewards approach to remuneration is taken which encompasses the key elements deployed to attract, engage and retain employees, namely compensation (base and variable), benefits and the 'work experience'. The 'work experience' includes but is not restricted to culture/environment, work/life balance, career development and recognition.

b. Remuneration at the Skipton Group encourages a high level of stewardship and corporate governance. Senior management and those responsible for drafting remuneration schemes are expected to have an understanding of the relevant prevailing regulation and to incorporate this into remuneration policy and scheme design. All schemes must comply, where applicable, with the PRA and FCA remuneration codes and guidance.

c. Remuneration policies, procedures and practices reflect sound, effective risk management and do not encourage risk taking which falls outside any of the stated Board risk appetites or the scope of Board policies. Remuneration practices are reviewed at least annually by the risk functions to ensure they do not encourage inappropriate risk taking behaviour or present conflicts of interest which may result in poor outcomes for our customers.

d. Remuneration should be competitive and sufficient to secure and retain the services of talented individuals from other companies or mutual organisations with the key skills, knowledge and expertise necessary to run Group businesses effectively, recognising the diverse nature of the Group and the nature of its stakeholders.

e. All employees will be 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.

f. Remuneration should recognise the appropriate level of Group/Society and individual performance which will create a strong and sustainable business, aligning with our values, strategic objectives and the long term interests of our members.

g. Where remuneration is performance related, it will be based on the assessment of the individual/team, the business unit and overall Group performance (if appropriate). In assessing individual performance, a balance of financial and non-financial criteria will be taken into account.

h. Remuneration arrangements are transparent, consistent and fair, reflecting individual responsibilities and performance. Base compensation will reflect the core role and responsibilities of the individual whereas variable compensation will reflect the achievement of agreed targets, or objectives which are over and above business as usual activities.

i. Remuneration policies, practices and procedures (including performance appraisal) should be cost effective, free from conflicts of interest, clearly documented and straightforward to understand, communicate and administer.

j. The Remuneration Committee will review and approve remuneration for executives with salaries in excess of £200,000. Recommendations for salary review and bonus payments must be submitted to the Remuneration Committee prior to confirmation.

k. The Committee is to be 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.

l. The calculation of termination payments should take account of an employee's performance over the duration of their period of service with the Group and shall be calculated in a way that is fair to both the employee and the Skipton Group and should not reward failure or misconduct.

The table below shows the key elements of remuneration for Executive Directors, the reasons for their inclusion and the way they operate with effect from 1 January 2016.

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.
Single Variable Pay Arrangement (SVPA) (from 2016) • 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 or seven years 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), 50% of the SVPA will be delivered in the form of an 'instrument' which will be subject to a further holding period (currently six 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	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; • Mortgages and Savings division profit; • 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

Element How element supports our strategy	Operation	Maximum potential value	Performance conditions and assessment
SVPA (continued)	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 or 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.		year as determined by the Committee.
Medium Term Incentive (MTI) 2014 and 2015 Schemes (discontinued in 2016) • Encourages the right behaviours in respect of long term, sustainable performance that supports the achievement of strategic goals; and • Provides a balance between long and short term rewards in the overall remuneration package for those senior executives eligible to participate.	Payments are based on performance (as determined by performance against agreed corporate plan targets) over rolling three year cycles. The corporate plan targets for each three year performance period are reviewed and agreed by the Board annually. The performance for each three year cycle is based on cumulative performance against the annual targets for the three year cycle. Payments are made over three years so that: • 50% of the incentive earned is paid immediately following completion of the three year performance period; • 25% is deferred for one year; and • 25% is deferred for two years. The Committee may reduce or withdraw the payment of a deferred amount in certain circumstances and has the power to reduce or cancel payments due under the MTI if it believes in extreme circumstances that 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 MTI has been discontinued in 2016. The current MTI schemes for 2014/2016 and 2015/2017 continue until completion of the performance period and will be paid as per scheme rules. The maximum incentive which may be earned for any year from the MTI scheme is 50% of salary. For each performance measure, the Committee determines a threshold, target and maximum level of performance. No MTI 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 MTI of 60% of the maximum.	50% of the award is based on Group profit and 50% of the award is based on customer measures. The measures are assessed independently. Any payment from the MTI is subject to reduction, up to and including the whole payment, based on CET 1 capital levels at the end of each three year cycle. Any payment from the MTI is subject to satisfactory individual performance.

Notes to the table

Base salary
In light of the additional regulatory requirements relating to remuneration for the Society in 2016, a review has been carried out as to the most appropriate structure for remuneration. As a consequence, a change to the ratio between fixed and variable pay was made which reduces the overall remuneration opportunity for each Executive, reduces the maximum variable pay to 50% and increases fixed pay by an average of 15% as explained in the section 'Annual Report on Remuneration in 2016'.

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 financial year to which they relate.
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 2017 are outlined in the 'Statement of implementation of Remuneration Policy in 2017' section of this report.

Changes from remuneration arrangements operated in 2015
In 2016, the MTI and Short Term Incentive (STI) schemes were replaced by the SVPA. The payments from the SVPA scheme (based on performance in the year ended 31 December 2016) are made in 2017 but are subject to the new deferral arrangements set out in the table above. Payments from the 2014/2016 and 2015/2017 MTI schemes will continue to be made (subject to performance and risk adjustment) together with any deferred incentive payments from prior performance year STI schemes.

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.

How the policy supports the Society's strategy

The table below shows how the variable elements of the 2016 remuneration policy support the Society's strategy.

	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 features				
Group profit	●			
Mortgages and Savings division profit	●			
Efficiency measures	●	●	●	
Customers (growth and satisfaction)	●		●	
Risk and governance		●	●	●
People			●	
Personal objectives including strategy development and implementation		●		
Risk adjustment		●	●	●
Deferral of at least 50% of incentive		●		●
Discretion to reduce / defer / recover payments		●	●	●

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 chairmanship 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 Chairman's fee while the fees of the other Non-Executive Directors are determined by the Non-Executive Directors' Remuneration Committee. Newly appointed Non-Executive Directors will receive fees in line with the policy outlined above. Non-Executive Directors do not have service contracts.

Annual Report on Remuneration in 2016

Executive Directors' remuneration

The total remuneration for Executive Directors in 2016 is set out in the table below:

2016 Audited	Mr D J Cutter £000	Mr A P Bottomley[9] £000	Mr I M Cornelius £000	Mr R S D M Ndawula £000	Total £000
Salary	490	283	287	299	**1,359**
Benefits[1]	15	12	12	12	**51**
2016 annual performance award (SVPA)[2]	161	94	96	101	**452**
MTI (2014/2016)[3]	157	96	88	81	**422**
Other[4]	-	180	-	-	**180**
Pension[5]	98	42	29	30	**199**
Total remuneration in respect of performance periods ending in 2016	**921**	**707**	**512**	**523**	**2,663**
Total 2016 performance pay deferred[6]	(175)	(95)	(92)	(91)	**(453)**
Prior years' deferred performance pay now released[7]	85	-	21	-	**106**
Total paid in 2016 or payable in 2017[8]	**831**	**612**	**441**	**432**	**2,316**

Notes

1. Benefits comprise the provision of a car or car allowance and private medical insurance contributions.
2. £96,747 (60%) of the 2016 SVPA award for Mr Cutter will be deferred for a period of seven years (2015: £59,718, deferred for three years). Half of the initial up-front award (i.e. 20% of the total) will be paid in March 2017 and the remaining half will be retained for a further six month period and paid subject to CET 1 capital remaining at or above the agreed level in September 2017.
3. The full outturn relating to the 2014/2016 MTI scheme (awarded in 2014) is included in this row. Only 50% of this award is paid in 2017 and the remaining portion is paid 25% in 2018 and 25% in 2019.
   No payments for the 2015/2017 MTI are included in the above figures, as payments will be based on performance in the stated periods and are not due to commence until 2018. A total of £219,567 has been accrued to 31 December 2016 in respect of the Executive Directors. This represents two thirds of the estimated payment for the 2015/2017 MTI based on current and expected performance. The accrual is reviewed at the end of each qualifying year and is adjusted, as required, based on that year's performance.
4. £180,000 was paid to Mr Bottomley as a one-off award to compensate him for remuneration he forfeited on leaving his previous employer.
5. Mr Cutter's 2016 pension figure includes the additional value earned in the defined benefit scheme during 2016 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.
6. These are amounts which have vested in respect of the performance periods ending in December 2016 (from the 2016 SVPA scheme and 2014/2016 MTI scheme) which are due to be paid in future years in line with the scheme rules.
7. These are deferred amounts from the 2013 – 2015 STI schemes which are payable in 2017.
8. Total payable is salary, benefits, pension and other payments which have been paid in 2016 and payments from variable pay schemes to be made in 2017.
9. Mr Bottomley joined the Society and was appointed to the Board on 1 January 2016. For further details of Mr Bottomley's remuneration in 2016, please see the section below 'Joining arrangements for Andrew Bottomley'.

2015 Audited	Mr D J Cutter £000	Mr I M Cornelius £000	Mr R S D M Ndawula[2] £000	Total £000
Salary	418	244	221	883
Benefits	15	12	10	37
2015 annual performance award	149	91	93	333
Pension	84	21	19	124
Total remuneration in respect of performance period ending in 2015	666	368	343	1,377
Total 2015 performance pay deferred	(60)	-	-	(60)
Prior years' deferred performance pay now released	90	21	-	111
Total paid in 2015 or payable in 2016[1]	696	389	343	1,428

Notes

1. Total payable includes salary, benefits and pension which were paid in 2015 and payments from variable pay schemes made in 2016.
2. Mr Ndawula was appointed as Group Finance Director on 23 February 2015.

Joining arrangements for Andrew Bottomley

Andrew Bottomley joined the Society and was appointed to the Board on 1 January 2016 as Distribution and Financial Services Director. His base salary on appointment was £245,000. Following the approval of our revised remuneration policy by members at the 2016 AGM, this was increased to £282,500 and backdated to the start of the year in line with the treatment of all Executive Directors as described in the section on base salary below. He receives a cash allowance in lieu of pension contributions of 15% of base salary and is provided with the Society's standard package of benefits for Executive Directors including a car or car allowance and private medical insurance.

For the 2016 performance year he participated in the standard SVPA arrangement for Executive Directors with a target award of 30% of base salary (maximum 50% of base salary).

In addition, Andrew received various one-off awards to compensate him for remuneration he forfeited when he left his previous employer. The Committee carefully considered the form, timing and level of these benefits, balancing the long term interests of members and the need to treat Andrew fairly. The Committee determined that Andrew would be entitled to:

- A cash sum of £180,000 paid in January 2016; and
- Participation in the Society's 2014/2016 and 2015/2017 MTI arrangements based on a maximum for each cycle of 50% of his base salary on appointment, awarded in respect of forfeited long term share awards.

Base salary

As part of the review of Executive remuneration in 2015, the Remuneration Committee agreed (with a vote in favour of our overall policy from 89.76% of members at the 2016 AGM) to increase base salaries by 15% with effect from 1 January 2016. This was to compensate the Executive Directors for the significant reduction in their variable pay opportunity and will mean that, in the longer term, the value of their on-target total remuneration should remain broadly the same as the levels projected under the STI and MTI schemes in operation in 2014 and 2015.

Our annual salary review process for Executive Directors takes place in April each year and the following further adjustments were made to the Executive Directors' base salaries following a benchmarking exercise conducted by PwC in the first quarter of 2016 and taking into account increases awarded in the wider Society. The increases were effective from 1 April 2016:

Director	% increase	April 2016	January 2016	April 2015
Mr D J Cutter	1.5%	£492,275	£485,000	£420,250
Mr A P Bottomley (note 1)	-	£282,500	£282,500	N/A
Mr I M Cornelius	1.6%	£288,000	£283,500	£245,790
Mr R S D M Ndawula (note 2)	5.0%	£303,000	£288,500	£250,000

Notes

1. As Mr Bottomley joined on 1 January 2016 and had a salary adjustment of 15% in line with the other Executive Directors, he was not eligible for a further increase in April 2016.
2. Mr Ndawula was appointed to his position as Group Finance Director on 23 February 2015 on a salary of £250,000. The further adjustment applied in April 2016 was to reflect his increasing experience and therefore align his salary with the appropriate market rate for his role.

Directors’ Remuneration Report *(continued)*

Variable pay

Single Variable Pay Arrangement (SVPA)

The measures, weightings and the final payments from the 2016 SVPA scheme are set out below. Taking into account the PVA adjustment as required by the PRA, the final awards were as follows:

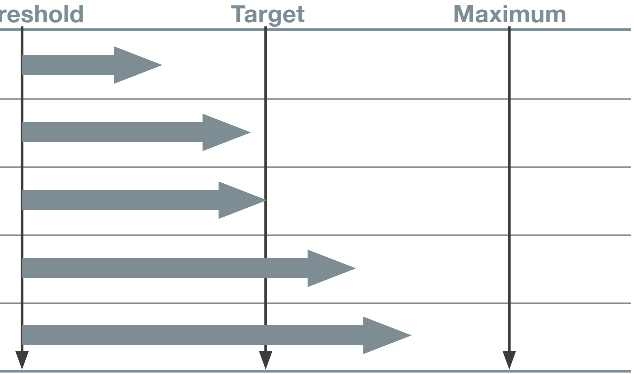
Director			Weighting					SVPA award	
	Target bonus opportunity (% of salary)	Maximum bonus opportunity (% of salary)	Group profit	Mortgages and Savings division profit	Management expense ratio	Team KPIs[1]	Personal objectives	% of salary	£000
Mr D J Cutter	30%	50%	10%	30%	10%	30%	20%	32.8%	161
Mr A P Bottomley	30%	50%	10%	30%	10%	30%	20%	33.3%	94
Mr I M Cornelius	30%	50%	10%	30%	10%	30%	20%	33.3%	96
Mr R S D M Ndawula	30%	50%	10%	30%	10%	30%	20%	33.3%	101

Note

1. Team KPIs include the measures for customer growth, customer satisfaction, risk and governance, and people as set out in the policy table.

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

Measure	Weight	Performance achieved		
		Threshold	Target	Maximum
Group profit	10%			
Mortgages and Savings division profit	30%			
Mortgages and Savings division management expense ratio	10%			
Team KPIs	30%			
Personal objectives (average)	20%			



Deferral arrangements for 2016

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 instruments, but for ourselves as a mutual organisation this means that 50% of the award payable in each year will be retained for a further six months and will only be paid subject to meeting agreed capital levels. The retained amount cannot increase or attract interest payments during the retention or deferral periods.

The deferral period increases to seven years if the Director is classified as a ‘Senior Manager’ under the PRA Senior Managers Regime and remuneration exceeds the de minimis level.

The total remuneration awarded to Mr Cutter in 2016 exceeded the threshold and therefore 60% of his SVPA award will be deferred for a period of seven years. This means that in 2017, Mr Cutter will receive payments of £32,249 in March and September, and he will receive a payment of £9,675 in both March and September each year from 2020 to 2024 subject to capital remaining at or above the agreed level. 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.

None of the other Executive Directors exceeded the threshold for the year and therefore 50% of their SVPA awards will be deferred over a five year period. In the case of Mr Bottomley the test against the threshold is based only on remuneration awarded in respect of the 2016 performance year and does not include the amounts awarded to compensate him in respect of remuneration he forfeited on leaving his previous employer.

Risk considerations

As part of approving incentive outcomes for 2016, the Committee reviewed a report from the Board Risk Committee outlining how the Society and Executive Directors had performed in relation to the risk objectives and appetites set for 2016, taking into account the context and impact of operational decisions. The Committee also considered the Board Risk and Audit Committees' views on whether there were any material issues to consider, e.g. a significant risk failing, regulatory breach or material error which may trigger malus or an adjustment to the outcome of the SVPA.

Having taken into consideration the information provided by each committee the Remuneration Committee decided that no adjustment to current year or deferred amounts of variable pay was required.

Medium Term Incentive (MTI) 2014 and 2015 schemes

2014 scheme

The three year performance period for the 2014/2016 MTI scheme concluded on 31 December 2016. The measures, weightings and the final payments from the 2014/2016 MTI scheme were as follows:

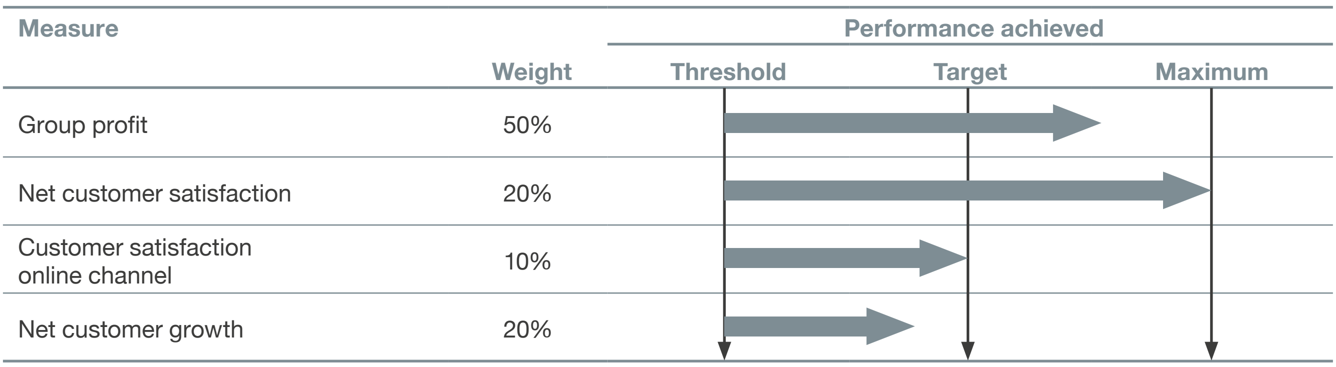
Director	Target MTI (% of salary)	Maximum MTI (% of salary)	Weighting				MTI award	
			Group profit	Net customer satisfaction	Customer satisfaction online channel	Net customer growth	(% of salary)(1)	£000
Mr D J Cutter	30%	50%	50%	20%	10%	20%	39.3%	157
Mr A P Bottomley(2)	30%	50%	50%	20%	10%	20%	39.3%	96
Mr I M Cornelius	30%	50%	50%	20%	10%	20%	39.3%	88
Mr R S D M Ndawula(3)	30%	50%	50%	20%	10%	20%	37.5%	81

Notes
1. The MTI % is based on the Director's salary at the point they started participating in the scheme.
2. At the discretion of the Remuneration Committee, Mr Bottomley was invited to participate in the 2014/2016 and 2015/2017 MTI schemes from the outset to replace the participation in such schemes that he has lost as a result of leaving his previous employer. His MTI award is based on his salary as at 1 January 2016 when he commenced employment with the Society.
3. Mr Ndawula participated in the scheme on a pro rata basis, one year as Chief Financial Risk Officer on a maximum of 40% of salary and two years in his capacity as Group Finance Director on a maximum of 50% of salary. The above percentage represents the combined outcome.

The MTI award can be reduced or not awarded at all if the CET 1 capital ratio falls below certain levels. As the CET 1 capital ratio was 23.9% in 2016, no reductions were made to the award in this respect for the 2014/2016 scheme.

As outlined above, 50% of the 2014/2016 MTI award is paid in March 2017 with the remaining 50% paid in equal instalments in 2018 and 2019.

The table below summarises the outcome against the various measures underlying the 2014/2016 MTI:



The MTI payments made in 2017 to Messrs Cutter, Cornelius and Ndawula were awarded in 2014 prior to the introduction of PRA regulations on extended deferral. As such, their payments are phased, in line with the original scheme arrangements over a three year period commencing in 2017.

2015 scheme

Awards from the 2015/2017 scheme are based on a three year performance period commencing January 2015 and ending December 2017 with the first payments due in March 2018. Payments are determined based on whether the performance objectives have been achieved and consideration of any risk adjustment measures which may need to be applied. The remuneration disclosed for the Executive Directors in 2016 does not include any amount for the 2015/2017 MTI scheme as the performance period has not yet been completed. The measures and weightings for the 2015/2017 scheme are unchanged from the 2014/2016 scheme.

Current expectations of performance against objectives for the 2015/2017 scheme are between threshold and target, but any future payments will depend on actual performance in 2017. Based on performance to date and the latest expectations of 2017 performance, the payment due would equate to 28.8% of base salary, half of which would be paid in 2018, one quarter in 2019 and one quarter in 2020 at which point the legacy MTI schemes will be concluded.

Directors' pension benefits

Mr Cutter is a deferred member of the Skipton Building Society (2015) Group Pension Scheme (and before merger a member of the Skipton Building Society Pension & Life Assurance 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 2016	Normal retirement date	Member's contribution for the year ended 31 December 2016 £000	Accrued pension entitlement at 31 December 2015 £000 pa	Accrued pension entitlement at 31 December 2016 £000 pa	Value of remuneration for the year ended 31 December 2016 £000
Mr D J Cutter	1 January 2027	-	89	89	-

Audited 2015	Normal retirement date	Member's contribution for the year ended 31 December 2015 £000	Accrued pension entitlement at 31 December 2014 £000 pa	Accrued pension entitlement at 31 December 2015 £000 pa	Value of remuneration for the year ended 31 December 2015 £000
Mr D J Cutter	1 January 2027	-	88	89	-

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.

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.

Payments to former Directors

Mr Fleet left the Society on 31 December 2014. A deferred payment of £22,705 will be paid to Mr Fleet in March 2017 in respect of the 2013 STI scheme. Mr Twigg, who transferred to Connells Limited in April 2014, is also due a final deferred payment of £27,474 from the 2013 scheme. These represent the final deferred payments due and will be paid in full. No payments are due from the 2014/2016 MTI scheme.

Non-Executive Directors' remuneration

Non-Executive Directors' fees (excluding those of the Chairman) 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 2016 recommended that the basic Non-Executive Director fee and Deputy Chairman fee should be increased by £1,000 to £49,000 and £54,000 respectively with effect from 1 August 2016. The fees for chairing the Audit and Board Risk Committees were held at £13,000 per annum and the fee for the chair of the Remuneration Committee was similarly held at £11,000 per annum.

The Chairman's fees are reviewed and approved by the Remuneration Committee. Mr Ellis' fee was reviewed by the Remuneration Committee in 2015 and increased to £165,000 with effect from 1 August 2015. No change was made to the Chairman's fee in 2016.

Audited		2016				2015			
	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 M H Ellis (Chairman)		165	-	5	170	162	-	5	167
Mr G E Picken (Deputy Chairman)	2	77	-	4	81	72	-	4	76
Mrs C Black	3	16	-	2	18	47	-	4	51
Ms A J Burton	4	32	-	1	33	-	-	-	-
Ms M Cassoni	5	48	13	5	66	47	13	5	65
Mrs D P Cockrem	6	48	-	7	55	16	-	2	18
Mr R D East	7	48	13	1	62	47	13	1	61
Mr P R Hales	8	-	-	-	-	12	-	-	12
Mr M J Lund	9	32	-	3	35	-	-	-	-
Ms H C Stevenson	10	48	7	4	59	47	-	3	50
Mr P J S Thompson	11	18	4	1	23	52	10	2	64
		532	37	33	602	502	36	26	564

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 Mr Picken, who is also a Non-Executive Director of Connells, Connells' head office), including for attendance at Board and Committee meetings.
2. Mr Picken was appointed Deputy Chairman on 26 April 2016 and is also a Non-Executive Director of Connells Limited for which he receives an annual fee of £25,000 included in the table above.
3. Mrs Black retired from the Board on 25 April 2016.
4. Ms Burton was appointed to the Board on 3 May 2016.
5. Ms Cassoni is the Chairman of the Audit Committee.
6. Mrs Cockrem was appointed to the Board on 1 September 2015.
7. Mr East is the Chairman of the Board Risk Committee.
8. Mr Hales retired from the Board on 31 March 2015.
9. Mr Lund was appointed to the Board on 25 April 2016.
10. Ms Stevenson was appointed Chairman of the Remuneration Committee on 26 April 2016.
11. Mr Thompson retired from the Board on 25 April 2016.

Directors' Remuneration Report *(continued)*

History of Group Chief Executive's remuneration

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

Year	Total remuneration(1)	SVPA/STI as % of maximum	MTI as % of maximum(2)
2016	£921,000	66%	79%
2015	£666,000	71%	N/A
2014	£699,000	95%	N/A
2013	£751,000	94%	N/A
2012	£617,000	60%	N/A
2011	£482,000	18%	N/A
2010	£463,000	25%	N/A
2009	£380,000	0%	N/A

Notes

1. Total remuneration includes base pay, allowances, benefits and short term incentive pay and, for 2016, medium term incentive pay for the 2014/2016 scheme (see Executive Directors' remuneration table on page 66 for the breakdown).
   No amounts relating to the 2015/2017 MTI are included in the above figures as payments will be based on performance in the stated periods and are not due to commence until 2018. A total of £78,636 has been accrued to 31 December 2016. This represents two thirds of the estimated payment for the 2015/2017 scheme based on current and expected performance.
2. The first MTI payments will commence in 2017 in respect of the 2014/2016 performance period.

Comparison to the remuneration of other employees

As outlined earlier in the report, the Group Chief Executive's base salary increased in April 2016 by 1.5%. This compares to an annual average pay review award in 2016 of 3.3% of base salary for all other Society employees. The Society 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 Chief Executive's award under the Society's SVPA scheme in respect of 2016 represented 32.8% of his base salary (2015: 35.5%). This compares to the average amount awarded to the Executive Directors of 33.1% (2015: 36.4%) and other Executive Committee members of 28.5% (2015: 30.8%). The average amount awarded to the Senior Leadership Team was 21.6% (2015: 21.4%) and to the remainder of our people in the Society was 5.0% (2015: 5.4%).

Statement of implementation of Remuneration Policy in 2017

Given the extensive review of Executive remuneration in preparation for 2016, we anticipate that the implementation of our Remuneration Policy in 2017 will be unchanged from 2016.

The SVPA for 2017 will continue to be based on a balanced scorecard of financial and non-financial measures. The financial measures include Group profit, Mortgages and Savings division profit and efficiency measures. The efficiency measures in 2017 will include a new target for the cost income ratio in addition to the management expense ratio. These will be weighted 5% each.

The non-financial measures include customer growth and satisfaction scores, risk and governance and people measures. The weighting will continue to be 50% based on financial measures, 30% on non-financial measures and 20% on personal objectives which include an element for strategy development and implementation. The maximum opportunity will remain as 50% of base salary and 30% at target.

The Committee will continue to embed the new scheme and the updated risk adjustment policy, ensuring that remuneration decisions fully reflect the Society's position on risk and the scheme delivers the intended outcomes for our members. The Committee will also maintain close links with the Board Risk and Audit Committees to ensure full compliance with the new guidelines from the European Banking Authority (EBA) which are effective from January 2017.

On a broader level, the Society will continue to respond to regulatory changes introduced by the UK Government and will, for the first time in 2017, be reporting on the gender pay gap.

Similarly, as outlined in our Annual Statement, we will be monitoring progress of the Government's green paper on executive pay and corporate governance to see how we might need to adapt our remuneration policy and practices from 2017 onwards.

Material Risk Takers (MRTs)

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.

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 2016 are included in the Pillar 3 document which is available at www.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 and to:

- 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;
- Maintain policies that are compliant with governing laws and regulations;
- Ensure that remuneration arrangements support and encourage desired behaviours and culture; and
- Ensure appropriate governance of remuneration practices across the Society and its subsidiary companies and exercise effective oversight of these.

Amongst its other duties, the Committee specifically:

- Determines and agrees, on behalf of the Board, the Society's Remuneration Principles and Policy and its associated costs;
- Determines and agrees remuneration for the Chairman of the Society Board and Society Executive Directors;
- Receives recommendations from the Group Chief Executive for approval of the remuneration for Senior Executives;
- Determines the policy, term, objectives and content of Society Executive Directors and Society Senior Executive service contracts; and
- Reviews and approves new remuneration policies for senior managers who have a material impact on the Society's risk profile ('MRTs').

The Committee has established clear remuneration principles for the Society and its subsidiaries. For the PRA and FCA regulated businesses, the principles, which are reviewed annually, set appropriate standards for remuneration governance, risk management, variable pay structures (and the link to performance) and remuneration for MRTs. The Committee receives annual reports from the Group Remuneration Oversight Committee and from the Chief Conduct Risk Officer and Secretary on the implications of the remuneration policies within the Group on risk management and compliance with the principles.

The full terms of reference of the Remuneration Committee and the remuneration principles are available on request from the Group Secretary. The terms of reference are also available online at www.skipton.co.uk.

The Remuneration Committee met five times during 2016. 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.

The Committee currently comprises four Non-Executive Directors, as listed on page 60. The Chairman, the Group Chief Executive, the Chief Conduct Risk Officer and Secretary and the Chief Human Resources Officer regularly attend meetings by invitation and external advisers are invited to attend meetings as and when appropriate.

PwC has continued to support the Committee in 2016 and has received £74,360 (net of VAT) in fees in respect of remuneration services provided.

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

Statement of voting at the 2016 AGM

At the 2016 AGM the Directors' Remuneration Report was subject to an advisory vote of members, the results of which were as follows:

		Votes	
	For	Against	Withheld
2016 remuneration policy	61,163 (89.76%)	6,981 (10.24%)	1,778
2015 remuneration report	61,682 (90.35%)	6,586 (9.65%)	1,652

Helen Stevenson
Chairman of the Remuneration Committee

28 February 2017

Independent auditor's report to the members of Skipton Building Society only

Opinions and conclusions arising from our audit

1. Our opinion on the Annual Accounts is unmodified

We have audited the Group and Society Annual Accounts of Skipton Building Society for the year ended 31 December 2016 set out on pages 78 to 168. In our opinion the Annual Accounts:

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

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the Annual Accounts, the risks of material misstatement that had the greatest effect on our audit, in decreasing order of audit significance, were as follows:

Impairment of loans and advances to customers £29.1m (2015: £37.8m) (excluding equity release mortgages) Risk vs. 2015: ◀▶

Refer to page 50 (Audit Committee Report), notes 1f) and 1s) (accounting policy) and notes 15 and 36 (financial disclosures).

The risk

Impairment of loans and advances to customers is estimated by the Directors. Historical information on the Group's loss experience is analysed and adjusted to reflect current circumstances which requires a high degree of judgement. The volume of data and assumptions input into the model presents an inherent risk of error. Due to the significance of loans and advances to customers and the related estimation uncertainty, this is considered a key audit risk.

Our response

Our audit procedures included testing the design, implementation and operating effectiveness of key controls over the underwriting, recording and monitoring of loans and advances through various procedures including the consideration of relevant reconciliations and segregation of duties.

We also tested the methodologies, inputs and assumptions used by the Group in calculating collectively assessed impairments and assessing impairment allowances for individually assessed loans and advances to customers.

We tested whether the Group's impairment models were operating as expected in terms of data extraction, calculation methodology and mathematical accuracy. We also reviewed any further changes made to these models during the current year. Where appropriate we used our model review specialists to assess the integrity of the models.

For both collective and individual impairment allowances, we compared the Group's assumptions to externally available industry, financial and economic data and our own assessments in relation to key inputs such as historical default rates, recovery rates, emergence periods, collateral valuation and economic factors, and considered the sensitivity of these inputs on the assessment of impairment.

For a sample of exposures that were subject to an individual impairment assessment, and focussing on those with the most significant potential impact on the financial statements, we specifically challenged the Group's assumptions on the expected future cash flows, including the value of realisable collateral based on our own industry experience and review of the latest correspondence and valuations.

We also assessed whether the Annual Accounts disclosures adequately reflect the Group's exposure to credit risk.

Equity release no negative equity guarantee £27.7m (2015: £24.0m) Risk vs. 2015: ◀▶

Refer to page 50 (Audit Committee Report), notes 1d) and 1s) (accounting policy) and note 37b) (financial disclosures).

The risk

Included in loans and advances to customers are equity release mortgage portfolios which carry a no negative equity guarantee, which limits the Group's maximum return to the value of the relevant customer's property on redemption. As explained in accounting policy note 1f) this guarantee is accounted for as a separable embedded derivative, with fair value movements recorded in the Income Statement. The Directors assess the fair value of the guarantee by considering key input assumptions including house price movements, house price volatility, the retail price index, mortality, early voluntary redemption rates and the discount factor.

Particularly given the anticipated longevity of the portfolio, there is significant uncertainty in these fair value calculations. Given the subjectivity and sensitivity of underlying assumptions, in particular long term house prices and house price volatility, this is considered to be a key audit risk.

Our response

Our audit procedures included testing the inputs and methodologies used by the Group in estimating the fair value of the no negative equity guarantee, as well as critically assessing the judgemental assumptions.

Key assumptions which we considered within our assessment were the volatility of, and long term expectation of, house prices, the retail price index, and the discount factor. We also considered the reasonableness of the Group's mortality tables using our actuarial specialists and assessed the prepayment assumptions against historical performance.

We compared the Group's assumptions to externally available industry, financial and economic data and our own assessments in relation to key inputs such as property valuations and economic factors, and considered the sensitivity of these inputs on the assessment of the carrying value of the no negative equity guarantee.

We also assessed whether the Annual Accounts disclosures adequately reflect the sensitivities of the fair value of the no negative equity guarantee to the assumptions used.

Provisions for liabilities £23.3m (2015: £26.5m) Risk vs. 2015: ◀▶

Refer to note 1s) (accounting policy) and notes 26 and 32 (financial disclosures).

The risk

Regulatory focus continues to be high within the sector and providing a wide range of customer offerings across the Group heightens the risk of compliance issues and of operational litigation and claims emerging. Due to the potential significance of provisions and the difficulty and significant judgement in assessing and measuring obligations resulting from operational, legal and regulatory judgements, this is considered a key audit risk.

Our response

Our audit procedures included testing the design, implementation and operating effectiveness of key controls, including review of complaints and evidence of consideration at relevant committees, over the identification, evaluation and measurement of potential obligations arising from conduct and operational issues.

We considered the Group's assessment of the nature and status of claims and litigation and discussed them with the Group's senior management including in-house legal and insurance teams, in the context of our wider industry experience. We assessed the relevant external legal advice and correspondence with regulators received in connection with legal proceedings, investigations or regulatory matters which the Group is party to.

For all provisions made (see note 26), we critically assessed the underlying assumptions used within the provisioning models. For those underlying assumptions based on historical experience, we assessed whether these remained appropriate for the latest assessment and the basis for any adjustments.

We also considered whether the Annual Accounts disclosures of the application of judgement in estimating provisions and contingent liabilities adequately reflected the information that is currently available given the inherent uncertainty as to the outcome of litigation and regulatory claims.

Revenue recognised based on the effective interest method £473.7m (2015: £472.0m) Risk vs. 2015: ◀▶

Refer to notes 1d) and 1s) (accounting policy) and note 2 (financial disclosures).

The risk

The Group's mortgages are held at amortised cost and interest income is recognised using the effective interest method as explained in note 1d). The key assumption relates to the estimation of mortgage lives, which is based on observed historical data and Directors' judgement. Due to the significance of the numbers involved, the inherent risk of error in the model calculations and the estimation uncertainty, this is considered a key audit risk.

Our response

Our audit procedures included testing the methodologies, inputs and assumptions used by the Group in respect of the effective interest method calculation and the expected life estimation. We used our model review specialists to perform review procedures over the model to assess integrity of the model calculation.

We challenged the appropriateness of expected future cash flows. In particular, we assessed the key assumption of expected mortgage lives within the model by comparing these to historical trends experienced in the Group, our own expectations based on our knowledge of the Group and the wider industry. We also assessed whether the Annual Accounts disclosures adequately reflect the sensitivities of the assumptions used.

Hedge accounting (new risk)

Refer to note 1d) (accounting policy) and note 33 (financial disclosures).

The risk

Hedge accounting is a technically complex area of financial reporting, and continues to receive significant industry focus.

The Society continues to increase the number and type of different hedge relationships. There is a risk that the hedge relationships are not established appropriately. Should a hedge relationship be set up or calculated incorrectly, it could lead to misstatements in the hedge accounting adjustments.

For complex derivatives, such as those used to hedge the interest rate risk on the equity release portfolio, inaccurate fair valuations driven by inappropriate assumptions could lead to misstatements in the measurement of hedge ineffectiveness.

Independent auditor's report to the members of Skipton Building Society only *(continued)*

Our response

Our audit procedures included reviewing the hedge documentation, testing on a sample basis the calculations, inputs and assumptions (for example market rates and customer behaviour) relating to the effectiveness of the hedge relationships across the Group. We also reviewed the posting of relevant hedge accounting adjustments at the reporting date. We used our own valuation specialists to test management's valuations of the derivatives used within hedge relationships.

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

The materiality for the Group Annual Accounts as a whole was set at £7.5m (2015: £7.5m), determined with reference to a benchmark of Group profit before tax, of which it represents 4.4% (2015: 5.0%). We report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.4m (2015: £0.4m) in addition to other identified misstatements that warranted reporting on qualitative grounds.

The Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. Audits for Group reporting purposes were performed by component auditors at 62 reporting components in three countries covering all of the components of the Group, including its joint ventures, so accounting for 100% of Group total income, Group profit before tax and total Group assets. The Group audit team approved the component materialities, which ranged from £0.2m to £4.1m, having regard to the mix of size and risk profile of the Group across the components.

Detailed Group audit instructions were sent to the auditors of all the components. These instructions covered the significant audit areas that should be covered by these audits (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported back to the Group audit team. The Group audit team also organised a planning meeting and regular telephone meetings with the majority of the component audit teams.

As well as drawing up the scope, Group audit instructions and exercising overall oversight, the Group audit team performed the audit of the Society itself including work for certain subsidiaries on impairment of loans and advances, valuation of financial instruments and disposal of subsidiaries and investments.

4. Our opinion on other matters prescribed by the Building Societies Act 1986 is unmodified

In our opinion:

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

5. We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the Directors' statement of longer term viability on pages 40 and 41, concerning the principal risks, their management, and, based on that, the Directors' assessment and expectations of the Group's continuing in operation over the five years to 2021; or
- the disclosures in note 1 of the Annual Accounts concerning the use of the going concern basis of accounting.

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

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the Annual Accounts, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the Annual Report and Annual Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the Group's and Society's position and performance, business model and strategy; or
- the Audit Committee Report does not appropriately address matters communicated by us to the Audit Committee.

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

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

We have nothing to report in respect of the above responsibilities.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on pages 40 and 41, the Directors are responsible for the preparation of Annual Accounts which give a true and fair view. Our responsibility is to audit, and express an opinion on, the Annual Accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of an audit of annual accounts performed in accordance with ISAs (UK and Ireland)

A description of the scope of an audit of annual accounts is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made subject to important explanations regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeother2014, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

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

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

Jonathan Holt (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

Leeds

28 February 2017

Income Statements

For the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Interest receivable and similar income	2	427.0	439.5	387.5	400.5
Interest payable and similar charges	3	(214.6)	(216.2)	(219.1)	(218.1)
Net interest receivable		212.4	223.3	168.4	182.4
Fees and commissions receivable	4	452.9	409.1	20.3	10.9
Fees and commissions payable		(9.6)	(10.1)	(1.7)	(1.6)
Fair value (losses) / gains on financial instruments		(3.7)	4.0	(4.3)	4.3
Profit on treasury assets		4.6	0.1	4.6	0.8
Income from shares in subsidiary undertakings		-	-	57.6	30.0
Profit / (loss) on disposal of subsidiary undertakings	16b)	15.8	(0.4)	-	-
(Loss) / profit on full or part disposal of associate	16d)	(0.9)	1.1	-	-
Profit on part disposal of equity share investments	16e)	17.0	0.3	-	-
Dividend income from equity share investments		0.7	0.3	-	-
Share of profits from joint ventures		1.8	2.5	-	-
Share of losses from associate	16d)	(2.4)	(2.3)	-	-
Other income	5	2.4	3.6	3.3	5.0
Total income		691.0	631.5	248.2	231.8
Administrative expenses	6	(499.1)	(464.4)	(106.0)	(96.5)
Operating profit before impairment losses and provisions		191.9	167.1	142.2	135.3
Impairment credit / (charge) on loans and advances to customers	15	0.3	(8.4)	(1.8)	(7.6)
Impairment losses on associate	16d)	(1.1)	-	-	-
Impairment losses on equity share investments	16e)	(11.3)	-	-	-
Provisions for liabilities	26	(10.9)	(11.8)	(4.8)	(7.5)
Profit before tax		168.9	146.9	135.6	120.2
Tax expense	10	(39.1)	(33.5)	(20.6)	(18.9)
Profit for the financial year		129.8	113.4	115.0	101.3
Profit for the financial year attributable to:					
Members of Skipton Building Society		130.1	114.0	115.0	101.3
Non-controlling interests		(0.3)	(0.6)	-	-
		129.8	113.4	115.0	101.3

Segmental performance of the Group is shown in note 38.

The notes on pages 85 to 166 form part of these Accounts.

Statements of Comprehensive Income

For the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Profit for the financial year		129.8	113.4	115.0	101.3
Other comprehensive income:					
Items that will not be reclassified to profit or loss:					
Remeasurement (losses) / gains on defined benefit obligations	28	(50.0)	5.7	(26.7)	2.8
Movement in reserves attributable to non-controlling interests		0.9	(0.3)	-	-
Income tax on items that will not be reclassified to profit or loss	31	10.2	-	6.6	1.3
		(38.9)	5.4	(20.1)	4.1
Items that may be reclassified subsequently to profit or loss:					
Available-for-sale investments: valuation gains / (losses) taken to equity	31	6.5	6.0	3.8	(1.4)
Available-for-sale investments: realised gains transferred to Income Statement	31	(6.2)	(0.3)	(0.4)	-
Cash flow hedges: gains taken to equity	31	8.9	1.0	8.9	1.0
Cash flow hedges: realised (gains) / losses transferred to Income Statement	31	(0.2)	1.3	(0.2)	1.3
Exchange differences on translation of foreign operations	31	1.7	(1.0)	-	-
Translation loss transferred to Income Statement on deemed disposal of associate	31	0.5	0.1	-	-
Income tax on items that may be reclassified to profit or loss	31	(2.2)	(0.6)	(3.1)	0.1
		9.0	6.5	9.0	1.0
Other comprehensive (expense) / income for the year, net of tax		(29.9)	11.9	(11.1)	5.1
Total comprehensive income for the year		99.9	125.3	103.9	106.4
Total comprehensive income attributable to:					
Members of Skipton Building Society		99.3	126.2	103.9	106.4
Non-controlling interests		0.6	(0.9)	-	-
		99.9	125.3	103.9	106.4

The notes on pages 85 to 166 form part of these Accounts.

Statements of Financial Position

As at 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Assets					
Cash in hand and balances with the Bank of England		1,212.7	1,180.8	1,212.7	1,180.8
Loans and advances to credit institutions	11	409.6	352.6	309.0	241.6
Debt securities	12	1,055.1	1,104.4	1,262.0	1,438.6
Derivative financial instruments	13	116.1	95.1	125.1	99.3
Loans and advances to customers	14	15,781.6	14,363.2	13,523.4	12,127.8
Deferred tax asset	27	30.4	21.6	13.7	9.6
Investments in Group undertakings	16a)	-	-	1,319.6	1,458.2
Investments in joint ventures		12.5	10.8	-	-
Investments in associates	16d)	-	11.5	-	-
Equity share investments	16e)	36.4	40.9	-	-
Property, plant and equipment	17	77.8	67.8	32.2	30.5
Investment property	18	15.0	15.9	14.9	15.8
Intangible assets	19	164.8	153.2	2.6	1.1
Other assets	20	107.7	93.6	11.3	8.8
Total assets		19,019.7	17,511.4	17,826.5	16,612.1
Liabilities					
Shares	21	14,152.5	12,828.2	14,152.5	12,828.2
Amounts owed to credit institutions	22	655.3	735.6	786.5	605.9
Amounts owed to other customers	23	1,493.2	1,389.5	1,054.1	1,576.2
Debt securities in issue	24	534.2	608.8	14.6	21.2
Derivative financial instruments	13	412.3	296.9	409.1	292.2
Current tax liability		19.7	16.8	10.8	9.5
Other liabilities	25	106.2	139.8	5.4	16.3
Accruals and deferred income		52.6	43.2	12.5	9.5
Provisions for liabilities	26	23.3	26.5	7.1	6.1
Deferred tax liability	27	12.2	11.3	3.0	1.6
Retirement benefit obligations	28	110.9	65.2	53.8	30.0
Subordinated liabilities	29	77.2	78.5	77.2	78.5
Subscribed capital	30	92.6	93.5	92.6	93.5
Total liabilities		17,742.2	16,333.8	16,679.2	15,568.7
Members' interests					
General reserve		1,236.6	1,146.3	1,140.0	1,045.1
Available-for-sale reserve		32.0	31.7	4.0	1.5
Cash flow hedging reserve		3.3	(3.2)	3.3	(3.2)
Translation reserve		6.6	4.4	-	-
Attributable to members of Skipton Building Society		1,278.5	1,179.2	1,147.3	1,043.4
Non-controlling interests		(1.0)	(1.6)	-	-
Total members' interests		1,277.5	1,177.6	1,147.3	1,043.4
Total members' interests and liabilities		19,019.7	17,511.4	17,826.5	16,612.1

The notes on pages 85 to 166 form part of these Accounts.

These Accounts were approved by the Board of Directors on 28 February 2017 and were signed on its behalf by:

Mike Ellis	**Chairman**
David Cutter	**Group Chief Executive**
Bobby Ndawula	**Group Finance Director**

Statements of Changes in Members' Interests

For the year ended 31 December 2016

Group	General reserve £m	Available-for-sale financial assets £m	Cash flow hedges £m	Translation of foreign operations £m	Sub Total £m	Non-controlling interests £m	Total £m
Balance at 1 January 2016	**1,146.3**	**31.7**	**(3.2)**	**4.4**	**1,179.2**	**(1.6)**	**1,177.6**
Profit / (loss) for the financial year	130.1	-	-	-	**130.1**	(0.3)	**129.8**
Other comprehensive income							
Remeasurement losses on defined benefit obligations	(39.8)	-	-	-	**(39.8)**	-	**(39.8)**
Movement in reserves attributable to non-controlling interests	-	-	-	-	**-**	0.9	**0.9**
Net gains from changes in fair value	-	3.2	6.7	-	**9.9**	-	**9.9**
Available-for-sale: realised gains transferred to Income Statement	-	(2.9)	-	-	**(2.9)**	-	**(2.9)**
Cash flow hedges: realised gains transferred to Income Statement	-	-	(0.2)	-	**(0.2)**	-	**(0.2)**
Exchange differences on translation of foreign operations	-	-	-	1.7	**1.7**	-	**1.7**
Translation loss transferred to Income Statement on deemed disposal of associate	-	-	-	0.5	**0.5**	-	**0.5**
Total other comprehensive income (note 31)	**(39.8)**	**0.3**	**6.5**	**2.2**	**(30.8)**	**0.9**	**(29.9)**
Total comprehensive income for the year	**90.3**	**0.3**	**6.5**	**2.2**	**99.3**	**0.6**	**99.9**
Balance at 31 December 2016	**1,236.6**	**32.0**	**3.3**	**6.6**	**1,278.5**	**(1.0)**	**1,277.5**
Balance at 1 January 2015	1,026.6	26.4	(5.3)	5.3	1,053.0	(0.7)	1,052.3
Profit / (loss) for the financial year	114.0	-	-	-	114.0	(0.6)	113.4
Other comprehensive income							
Remeasurement gains on defined benefit obligations	5.7	-	-	-	5.7	-	5.7
Movement in reserves attributable to non-controlling interests	-	-	-	-	-	(0.3)	(0.3)
Net gains from changes in fair value	-	5.5	1.1	-	6.6	-	6.6
Available-for-sale: realised gains transferred to Income Statement	-	(0.2)	-	-	(0.2)	-	(0.2)
Cash flow hedges: realised losses transferred to Income Statement	-	-	1.0	-	1.0	-	1.0
Exchange differences on translation of foreign operations	-	-	-	(1.0)	(1.0)	-	(1.0)
Translation loss transferred to Income Statement on deemed disposal of associate	-	-	-	0.1	0.1	-	0.1
Total other comprehensive income (note 31)	5.7	5.3	2.1	(0.9)	12.2	(0.3)	11.9
Total comprehensive income for the year	119.7	5.3	2.1	(0.9)	126.2	(0.9)	125.3
Balance at 31 December 2015	1,146.3	31.7	(3.2)	4.4	1,179.2	(1.6)	1,177.6

Statements of Changes in Members' Interests *(continued)*

For the year ended 31 December 2016

Society	General reserve £m	Available-for-sale financial assets £m	Cash flow hedges £m	Total £m
Balance at 1 January 2016	**1,045.1**	**1.5**	**(3.2)**	**1,043.4**
Profit for the financial year	115.0	-	-	**115.0**
Other comprehensive income				
Remeasurement losses on defined benefit obligations	(20.1)	-	-	**(20.1)**
Net gains from changes in fair value	-	2.8	6.7	**9.5**
Available-for-sale: realised gains transferred to Income Statement	-	(0.3)	-	**(0.3)**
Cash flow hedges: realised gains transferred to Income Statement	-	-	(0.2)	**(0.2)**
Total other comprehensive income (note 31)	**(20.1)**	**2.5**	**6.5**	**(11.1)**
Total comprehensive income for the year	**94.9**	**2.5**	**6.5**	**103.9**
Balance at 31 December 2016	**1,140.0**	**4.0**	**3.3**	**1,147.3**
Balance at 1 January 2015	939.7	2.6	(5.3)	937.0
Profit for the financial year	101.3	-	-	101.3
Other comprehensive income				
Remeasurement gains on defined benefit obligations	4.1	-	-	4.1
Net (losses) / gains from changes in fair value	-	(1.1)	1.1	-
Cash flow hedges: realised losses transferred to Income Statement	-	-	1.0	1.0
Total other comprehensive income (note 31)	4.1	(1.1)	2.1	5.1
Total comprehensive income for the year	105.4	(1.1)	2.1	106.4
Balance at 31 December 2015	1,045.1	1.5	(3.2)	1,043.4

The notes on pages 85 to 166 form part of these Accounts.

Statements of Cash Flows

For the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cash flows from operating activities					
Profit before tax		168.9	146.9	135.6	120.2
Adjustments for:					
Impairment (credit) / charge on loans and advances to customers	15	(0.3)	8.4	1.8	7.6
Loans and advances written off, net of recoveries	15	(4.7)	(5.5)	(2.6)	(1.9)
Depreciation and amortisation	17,18,19	20.6	16.9	4.1	3.4
Impairment of property, plant and equipment and investment property	17,18	-	4.0	-	4.0
Impairment losses on associate	16d)	1.1	-	-	-
Impairment losses on equity share investments	16e)	11.3	-	-	-
Income from shares in subsidiary undertakings		-	-	(57.6)	(30.0)
Dividend income from equity share investments		(0.7)	(0.3)	-	-
Interest on subscribed capital and subordinated liabilities	3	11.4	12.1	11.4	12.1
Profit on sale of property, plant and equipment, investment property and intangible assets	5	(0.1)	(0.2)	-	(0.1)
Profit on treasury assets		(4.6)	(0.1)	(4.6)	(0.8)
Share of losses / (profits) from joint ventures and associates		0.6	(0.2)	-	-
Loss / (profit) on full or part disposal of associate	16d)	0.9	(1.1)	-	-
Profit on part disposal of equity share investments	16e)	(17.0)	(0.3)	-	-
(Profit) / loss on disposal of subsidiary undertakings	16b)	(15.8)	0.4	-	-
Net gains from changes in fair value of cash flow hedges		8.9	1.0	8.9	1.0
Remeasurement (losses) / gains on defined benefit obligations	28	(50.0)	5.7	(26.7)	2.8
Other non-cash movements		7.3	(1.8)	10.0	3.3
		137.8	185.9	80.3	121.6
Changes in operating assets and liabilities:					
Movement in prepayments and accrued income		(4.2)	2.7	(0.4)	2.3
Movement in accruals and deferred income		7.4	2.3	0.2	(0.5)
Movement in provisions for liabilities		(3.4)	(5.9)	0.5	(0.6)
Movement in fair value of derivatives		94.4	27.9	91.1	41.5
Movement in fair value adjustments for hedged risk		(79.9)	(30.5)	(75.5)	(32.1)
Fair value movements in debt securities	12	(9.6)	5.3	(9.6)	5.3
Movement in loans and advances to customers		(1,298.4)	(1,513.5)	(1,284.2)	(1,536.1)
Movement in shares		1,284.6	1,366.9	1,284.6	1,366.9
Income Statement charge for fair value of subsidiary management incentive scheme liability	25	1.0	15.9	-	-
Net movement in amounts owed to credit institutions and other customers		25.5	191.6	(340.7)	(184.6)
Net movement in debt securities in issue		(74.5)	(122.4)	(6.5)	14.0
Net movement in loans and advances to credit institutions		(94.9)	(2.9)	(92.7)	(2.8)
Net movement in other assets		1.4	(8.7)	(4.8)	1.1
Net movement in other liabilities		24.3	13.0	12.5	2.9
Income taxes paid		(37.0)	(36.6)	(18.2)	(21.9)
Net cash flows from operating activities		(25.5)	91.0	(363.4)	(223.0)

Statements of Cash Flows *(continued)*

For the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Net cash flows from operating activities		(25.5)	91.0	(363.4)	(223.0)
Cash flows from investing activities					
Purchase of debt securities	12	(1,130.2)	(500.3)	(1,189.1)	(437.9)
Proceeds from disposal of debt securities		1,193.7	543.3	1,379.9	603.7
Purchase of property, plant and equipment and investment property	17,18	(22.6)	(13.9)	(4.3)	(2.8)
Purchase of intangible assets	19	(5.7)	(2.4)	(1.6)	(0.1)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		1.3	2.3	0.3	1.8
Dividends received from group undertakings		-	-	57.6	30.0
Dividends received from equity share investments		0.7	0.3	-	-
Exercise of share options in subsidiary management incentive scheme	25	(10.0)	-	-	-
Proceeds from disposal of equity share investments		18.2	0.3	-	-
Dividends received from joint ventures		2.1	3.2	-	-
Purchase of subsidiary undertakings, net of cash acquired		(6.6)	(4.8)	-	-
Further investment in subsidiary undertakings	16a)	-	(0.9)	-	-
Investment in joint ventures and equity share investments		(0.4)	(1.2)	-	-
Investment in associate	16d)	(2.5)	-	-	-
Purchase of other business units		(7.1)	(1.2)	-	-
Cash received from sale of subsidiary undertakings, net of cash disposed of		-	3.4	-	-
Net cash flows from investing activities		30.9	28.1	242.8	194.7
Cash flows from financing activities					
Redemption of subordinated liabilities		-	(18.0)	-	(18.0)
Decrease in loans to subsidiary undertakings	16a)	-	-	138.6	161.4
Interest paid on subordinated liabilities		(3.0)	(3.7)	(3.0)	(3.7)
Interest paid on subscribed capital		(8.4)	(8.4)	(8.4)	(8.4)
Net cash flows from financing activities		(11.4)	(30.1)	127.2	131.3
Net (decrease) / increase in cash and cash equivalents		(6.0)	89.0	6.6	103.0
Cash and cash equivalents at 1 January		1,291.6	1,202.6	1,180.7	1,077.7
Cash and cash equivalents at 31 December		1,285.6	1,291.6	1,187.3	1,180.7

Analysis of the cash balances as shown within the Statement of Financial Position:

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cash in hand and balances with the Bank of England		1,212.7	1,180.8	1,212.7	1,180.8
Mandatory reserve deposit with the Bank of England		(25.4)	(22.0)	(25.4)	(22.0)
		1,187.3	1,158.8	1,187.3	1,158.8
Loans and advances to credit institutions	11	98.3	132.8	-	21.9
Cash and cash equivalents as at 31 December		1,285.6	1,291.6	1,187.3	1,180.7

The notes on pages 85 to 166 form part of these Accounts.

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 40 of the Directors' Report) and in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and effective at 31 December 2016 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 revaluation of available-for-sale assets, as well as derivatives and the put option obligation at fair value through profit or loss.

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

During the year the Directors have adopted the following new or amended accounting standards and interpretations, all of which are EU endorsed:

• Amendments to IAS 16 *Property, Plant and Equipment*.

• Amendments to IAS 38 *Intangible Assets*.

• Amendments to IFRS 11 *Joint Arrangements*.

• Amendments to IAS 1 *Presentation of Financial Statements*.

• Amendments to IAS 27 *Consolidated and Separate Financial Statements (2011)*.

• Amendments to IFRS 10 *Consolidated Financial Statements*.

• Amendments to IFRS 12 *Disclosure of Interests in Other Entities*.

• Amendments to IAS 28 *Investments in Associates and Joint Ventures (2011)*.

• Amendments to accounting standards as part of the annual improvements to IFRS 2012 – 2014 cycle.

Note 40 summarises the impact of the above.

b) 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. The financial statements of the subsidiary undertakings are included in the Group results from the date that control commences until the date control ceases. The Group Accounts consolidate the financial statements of the Society and all its subsidiary undertakings, eliminating intra-Group transactions and balances.

The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated Income Statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the accounts of subsidiary undertakings on acquisition to bring the accounting policies in line with those used by the Group.

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' remaining shareholdings (i.e. the put option liability).

In accordance with IFRS 10 *Consolidated Financial Statements (2011)*, for business combinations which have taken place from 1 January 2010 onwards, all transactions with non-controlling interests are recorded in equity if there has been no change in control. In accordance with IFRS 3 *Business Combinations (2008)*, goodwill is accounted for only upon the acquisition of a subsidiary undertaking and subsequent changes in the Group's interest are recognised in equity. Any changes in the valuation of an acquired entity where a put option was issued by the Group are credited or charged through the Income Statement. All transaction or acquisition costs are written off to the Income Statement as incurred. 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 of put options are charged to the Income Statement.

Non-controlling interests in the net assets of non-100% consolidated subsidiary undertakings are identified separately from the Group's equity therein. Non-controlling interests comprise the amount of those interests at the date of the original

1. Accounting policies *(continued)*

business combination and the non-controlling changes in equity since that date. Losses applicable to the non-controlling interests in excess of the non-controlling interests in the subsidiary undertaking's equity are allocated against the interests of the Group unless the non-controlling entity has a binding obligation and is able to make an additional investment to cover those losses.

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 12. 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.

Loss of control

When the Group loses control over a subsidiary, through disposal or other changes in circumstances determining control, it derecognises the assets and liabilities of the subsidiary, as well as any related non-controlling interest and other components of equity. Any resulting gain or loss is recognised in the Income Statement.

Business combinations under common control

Where trading operations, assets and liabilities of a subsidiary are 'hived-up' into the business of another Group undertaking, i.e. the operations of a subsidiary are integrated into another Group undertaking, the Group has chosen to transfer the assets and liabilities at their book value at the date of transfer.

Joint ventures and associates

A joint venture is an undertaking in which the Group has joint control and has rights to the net assets of the arrangement.

An associate is a company over which the Group has significant influence and that is neither a subsidiary undertaking nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is neither control nor joint control over those policies.

The results and assets and liabilities of joint ventures and associates are accounted for in these consolidated financial statements using the equity method of accounting. Investments in joint ventures and associates 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 or associate, 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.

Equity share investments are accounted for in these consolidated financial statements as available-for-sale financial assets. As such they are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in their fair value recognised in equity, except for impairment losses which are recognised in the Income Statement.

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. The Society continues to recognise these assets within its own Statement of Financial Position after the transfer because it retains the risks and rewards of the portfolio. In the Accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPVs.

c) Intangible assets

Goodwill

Goodwill arising on the acquisition of subsidiary undertakings, joint ventures, associates or other businesses represents the excess of the fair value of consideration over the fair value of identifiable net assets and contingent liabilities acquired at the date of acquisition. 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 annually. Any impairment is recognised in the Income Statement and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash generating units expected to benefit from the synergies of combination. The impairment test compares the carrying value of goodwill to its associated value in use. The value in use calculations are carried out by discounting the future cash flows of the cash generating unit (see note 19). 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 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. A 15-year time horizon has been used to reflect the fact that cash generating units are held for the long term.

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 and tested for impairment in the same manner as described above.

On the disposal of a subsidiary undertaking, the profit or loss on disposal is calculated after crediting the net book value of any related goodwill to the Statement of Financial Position.

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 annually, as above. Goodwill written off to reserves under UK GAAP prior to 1 January 2004 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Negative goodwill arising on an acquisition is recognised directly in the Income Statement.

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 when the cost incurred leads to the creation of an identifiable asset and it is probable that the asset created will generate future economic benefits which will flow to the Group. Expenditure incurred to maintain existing levels of performance is recognised as an expense as incurred.

Intangible assets are initially recognised at cost 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.

d) Financial assets

In accordance with IAS 39 *Financial Instruments: Recognition and Measurement*, the financial assets of the Group have been classified into the following categories:

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are not classified as loans and receivables, at fair value through profit or loss or held to maturity. Available-for-sale assets are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in fair value recognised in equity, except for impairment losses which are recognised in the Income Statement. Interest income is recognised in the Income Statement on an effective yield 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 yield basis. Any amounts amortised are charged or credited to the Income Statement in the relevant financial periods.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

The fair values of available-for-sale assets are based on quoted prices or, if these are not available, fair value valuation techniques considered appropriate by the Group. For quoted prices the bid price is used and fair value valuation techniques include, but are not limited to, the use of discounted cash flow models, option pricing models and recent arm's-length transactions.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's loans and advances to customers and the Society's loans to subsidiary undertakings, together with certain investment securities and all other liquidity balances are classified as loans and receivables and are measured at amortised cost using the effective interest method. The effective interest method implies an interest rate which exactly discounts the forecast cash flows of an asset over its expected life back to its carrying value.

In accordance with the effective interest method, directly attributable upfront costs and fees such as cashbacks, mortgage premia paid 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. Mortgage discounts are also 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 in accordance with Application Guidance 8 (AG 8) of IAS 39 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)), this is accounted for in accordance with AG 7 of IAS 39 if it can be demonstrated that this change is driven by changes in market rates. This results in 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 in accordance with AG 8 of IAS 39 (as described 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 16a). 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.

At fair value through profit or loss

Fair value through profit or loss financial assets are those that are designated on initial recognition as assets to be recognised at fair value and movements in fair value are recognised in the Income Statement.

The Group's derivative financial instruments (both assets and liabilities) and put option obligations (see note 1b)) are classified as at fair value through profit or loss and are held at fair value within the Statement of Financial Position.

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. By applying the hedge accounting rules set out in IAS 39, the changes in fair value of derivatives used to hedge particular risks can either be offset in the Income Statement or deferred to equity.

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

- 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) or an unrecognised firm commitment, 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, the hedging instrument and 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 for hedged items, the Group applies estimated prepayments to mortgage assets. The level of prepayment applied is estimated using historical analysis.
- 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 directly in equity. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. Once the forecast transaction has occurred, the cumulative gain or loss recognised in equity is recycled to the Income Statement in the same period in which the underlying transaction affects profit or loss. If the forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss recognised in equity is then recognised immediately in the Income Statement.

The Group discontinues hedge accounting when:

- it is evident from hedge effectiveness testing that a derivative is not, or has ceased to be, highly effective as a hedge;
- the derivative expires or is sold, terminated or exercised; or
- the underlying item matures or is sold or repaid.

The Group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge.

If the derivative no longer meets the criteria for hedge accounting or is de-designated from the hedge relationship, the associated adjustment to the carrying amount of the hedged item or the amount in the cash flow hedging reserve is amortised to the Income Statement over the remaining life of the hedged item.

Certain derivatives are embedded in other financial instruments. These are treated as separate derivatives where:

- the economic characteristics and risks are not closely related to the host instrument;
- the host instrument is not measured at fair value; and
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative. These embedded derivatives are measured at fair value with movements in fair value being recognised in the Income Statement. Depending on the classification of the host instrument, the host is then measured in accordance with the relevant accounting policy.

Fair values are obtained from recent market transactions and valuation techniques, including discounted cash flow models and option pricing models, as appropriate. 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 *Fair Value Measurement*, but has valued each derivative individually.

Interest on derivatives is included within interest receivable where the derivative hedges an asset and within interest expense where the derivative hedges a liability, to align the recognition with its economic purpose. Other gains and losses on all derivatives, hedged items and on the sale of available-for-sale assets are recognised in the 'Fair value (losses) / gains on financial instruments' line in the Income Statement, with the exception of cash flow hedging derivatives, where unrealised fair value gains and losses are recognised in the cash flow hedging reserve.

Any derivatives that do not qualify for hedge accounting are held at fair value with changes in fair value recognised in the Income Statement.

Held to maturity

The Group has not classified any assets as held to maturity.

e) Financial liabilities

Borrowings, including shares, deposits, debt securities in issue and subordinated liabilities held by the Group 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 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. Permanent Interest Bearing Shares 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 in question is economically hedged by derivatives which are held at fair value through profit or loss.

The Society elects to apply the fair value option to the deemed loans repayable to the special purpose vehicles, as described in note 1b). In applying the fair value option to these financial liabilities, the Society has considered the effect of its own credit risk and considers this not to be material.

f) Impairment of financial assets

Impairment of loans and advances secured on residential property or land

The Group carries out an assessment of impairment of loans and advances to customers at each reporting date. Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession or where fraud or negligence has been identified. Objective evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the debt being renegotiated to reduce the burden on the borrower. The key drivers influencing this objective evidence predominantly relate to affordability issues driven by unemployment and increased costs of living. Based upon these assessments an individual impairment provision is made in one of two ways.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

For properties that are either in possession or where sufficient information is available to calculate a specific provision on an account-by-account basis (for example, accounts that are on a defined 'watch list') the provision is calculated as the difference between the existing carrying value and the present value of the estimated future cash flows, discounted at the asset's original effective interest rate. Alternatively, for other individual loans that have reached the point at which an impairment provision is needed but where it is not possible to specifically determine the amount ultimately likely to be received, assumptions are used from groups of loans with similar characteristics, based on historical data including the probability of possession given default and average forced sale discounts, and a provision calculated accordingly against this group of loans.

In addition, a collective impairment provision is made against the remaining portfolio of loans and advances where objective evidence indicates that credit losses have been incurred but not yet identified at the reporting date. The impairment value is calculated by applying various factors to pools within the Group's mortgage portfolio that have similar characteristics. These factors take into account the Group's experience of default rates, loss emergence periods, the effect of regional movements in house prices based on a recognised index, as well as adjustments to allow for ultimate forced sales values and realisation costs.

The impairment model also takes into account the level of forbearance applied to loans, such as payment reductions, term extensions, conversion to interest only and capitalisation of arrears, and reflects the relative performance of each of these pools.

Impairment provisions are recognised in the Income Statement and reflected in a separate account which is netted against the total carrying value of mortgage assets within the Statement of Financial Position. Interest on the impaired asset continues to be recognised through the unwinding of the discount on an effective interest rate basis. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is recognised through the Income Statement.

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

Losses on the equity release portfolio relate to the 'no negative equity guarantee' provided to the customers of this portfolio. This guarantee is accounted for as an embedded derivative due to its economic characteristics, the policy for which is outlined on page 89. Losses on the equity release portfolio are recognised in the 'Impairment on loans and advances to customers' line in the Income Statement.

Forbearance

In certain circumstances, the Group renegotiates loans to customers in financial difficulties (referred to as 'forbearance' activities) to maximise collection opportunities, minimise the risk of default and ensure 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 usually 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.

Impairment of other loans and advances

Individual impairment provisions are made to reduce the value of other impaired loans and advances to the present value of the amount that the Directors consider is likely ultimately to be received, based upon objective evidence. The level of impairment provisions is assessed at each reporting date. Where a loan or advance is not recoverable, it is written off against the related provision for impairment.

Impairment of other financial assets

At each reporting date the Group assesses, on an individual basis, whether there is objective evidence that other financial assets held by the Group, except those held at fair value through profit or loss, are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that financial assets are impaired may include default or delinquency by a counterparty, the disappearance of an active market for a security, indications that a counterparty will enter bankruptcy, a significant and prolonged decline in the fair value of a security or evidence of a sovereign debt crisis.

Impairment losses on other financial assets carried at amortised cost are measured as the difference between the carrying value of the asset and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in the Income Statement and reflected as a deduction against the carrying value of the asset. When a subsequent event causes the amount of impairment loss to decrease, the decrease in the impairment loss is recognised through the Income Statement.

Impairment losses on available-for-sale financial assets are recognised by transferring the cumulative loss that has been recognised directly in equity to the Income Statement. The cumulative loss that is removed from equity and recognised in the Income Statement is measured as the difference between the acquisition cost, net of any principal repayments and amortisation, and the current fair value, less any impairment loss on that asset previously recognised in the Income Statement.

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

Impairment losses on equity instruments classified as available-for-sale are not reversed through the Income Statement and any increase in the fair value of such an instrument after an impairment loss has been recognised is recognised through Other Comprehensive Income.

g) Financial assets and liabilities – derecognition and offsetting

Financial assets are derecognised when the contractual rights to receive cash flows have expired or where substantially all the risks and rewards of ownership have been transferred. 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 1b). Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired. Regular-way purchases and sales of financial assets and liabilities are initially accounted for at the trade date.

Financial assets and financial liabilities are offset and the net amount presented in 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. Therefore, in accordance with IAS 32, there are no financial assets or liabilities which are offset with the net amount presented on the balance sheet. 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.

h) 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 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.

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.

i) Taxation

The income tax expense or credit on the profits or losses 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 enacted during the period, and any adjustments to tax payable in respect of previous years.

Deferred tax is provided using the Statement of Financial Position 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.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

j) Leases

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The leased asset is recorded within the Statement of Financial Position as an item of property, plant and equipment and is 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, net of finance charges, are included within other liabilities. Rentals payable are apportioned between the finance element, which is charged to the Income Statement at a constant annual rate, and the amount which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and the rental charges are charged to the Income Statement on a straight line basis. Assets held by the Group on which operating leases are granted are included as items of property, plant and equipment. Rents receivable under operating leases are recognised in the Income Statement on a straight line basis over the term of the lease.

Where leasehold premises cease to be occupied by the Society or a subsidiary undertaking and current market conditions are expected to preclude sub-letting for a rental sufficient to cover the rental costs, a provision is made to cover the expected deficit.

k) 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

Until 31 January 2016 the Group operated three funded defined benefit pension schemes, at which time two of the schemes were merged (see note 28 for details). The two 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 long-dated AA-rated corporate bonds. 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 and other expenses relating to the defined benefit pension schemes are recognised 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.

Past and current 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.

l) Fees and commissions

Other than those accounted for using the effective interest method, fees and commissions receivable are generally recognised, net of VAT (where applicable), as the services are provided.

Estate agency commissions earned on the sales of properties and land and auction income are recognised on the date contracts are exchanged. 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.

The recognition of fees and commissions receivable from the sale of third party regulated financial services products is dependent on the market in which the adviser operates and therefore the nature of the advice provided. Revenue 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. Ongoing income received monthly over the life of a plan is recognised on an accruals basis over the period of the service provided, whilst commission receivable in relation to ongoing wealth management on behalf of clients is accrued by reference to the value of work performed.

Revenue from software licence fees is recognised on the transfer of significant risks and rewards of ownership of the licensed software under an agreement between the Group and the customer. 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.

Fees and commissions payable are generally recognised on an accruals basis as services are received.

m) Investments in subsidiary undertakings

The Society records investments in subsidiary undertakings at cost and carrying values are reviewed for impairment at least annually.

The impairment test compares the carrying value of each investment to its associated value in use. The value in use of the subsidiary is the higher of its net assets at the reporting date or the discounted future cash flows of the subsidiary undertaking. Future cash flows are ordinarily based upon the corporate plans of the subsidiary for the next five years and assumed growth thereafter for the subsequent 10 years generally in line with long term growth rates. The Society estimates discount rates based upon the weighted average cost of capital which is adjusted to take account of the market risks associated with each subsidiary. A 15-year time horizon has been used to reflect the fact that subsidiaries are held for the long term.

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% of net book value

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 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 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. We have not aggregated any of our operating segments for the purposes of financial reporting.

Information regarding the results of each reportable segment is included in note 38.

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 that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than three months.

The Statements of Cash Flows have been prepared using the indirect method.

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

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.

Any gain or loss on disposal of investment property is recognised in the Income Statement.

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 within 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 agreements and recognised within net interest income.

s) Critical accounting estimates and judgements in applying accounting policies

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

The Group also has to make judgements in applying its accounting policies which affect the amounts recognised in the financial statements.

Estimates and judgements are evaluated continually 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, assumptions and judgements are set out below.

Effective interest rate

The valuation of assets or liabilities measured at amortised cost is calculated using the effective interest method. The effective interest 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 and liabilities held by the Group is the expected lives of these assets and liabilities 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 and Society	
	2016 £m	2015 £m
One month increase / (decrease)	15.1 / (14.5)	14.0 / (10.7)

During the year a charge of £6.2m (2015: £7.9m) 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 Group regularly reviews the performance of its residential loan portfolios to assess the level of impairment. In determining whether an impairment loss should be recorded in the Income Statement, management makes judgements as to whether there is any objective data indicating that there is a measurable impairment loss. Specifically, management regularly assesses key assumptions that contribute to the probability of an account defaulting and the likely loss incurred through forced sale or write-off as a result.

Critical estimates in calculating the eventual loss incurred in the event of sale are the movement in house prices, default rates and cure rates (being the proportion of accounts that go into default, but then return to their original position out of default at a later date). The following table outlines the impact of reasonably possible alternative assumptions of certain estimates used in calculating the impairment provision:

Assumption	Change to current assumption	**Group 2016 Increase in impairment provision £m**	Group 2015 Increase in impairment provision £m	**Society 2016 Increase in impairment provision £m**	Society 2015 Increase in impairment provision £m
House price index	10% decrease in any one year*	**3.5**	6.1	**1.3**	2.1
Default rates	10% increase	**1.2**	1.5	**0.4**	0.5
Cure rates	10% decrease	**1.8**	2.6	**0.6**	0.8

* For example, a 7% fall in house prices compared to an assumption of a 3% increase.

The Group also holds an equity release residential mortgage portfolio and the estimates and judgements used in fair valuing the no negative equity guarantee, a separately identifiable embedded derivative (movements in which impact the Income Statement and are included within the 'Impairment credit / (charge) on loans and advances to customers' line), together with sensitivity disclosures, are outlined in note 37b).

In respect of commercial mortgage exposures, an impairment model exists based on a set of assumptions but, due to the non-standard nature of the properties, each account is also individually reviewed on a monthly basis and suitably qualified commercial underwriters objectively assess additional impairment provisions as required. However, one assumption contained within the commercial impairment model is an assumed forced sale discount, and the impact of an additional 5% discount compared to that assumed (for example, from a forced sale discount assumption of 25% to 30%) would be to increase the total impairment provision by £0.6m (2015: £0.5m).

Impairment of treasury investments

Treasury investments are regularly reviewed for objective evidence of impairment. In determining whether objective evidence exists, the Group considers, amongst other factors, current market conditions (including the disappearance of an active market), fair value volatility (including any significant reduction in market value), any breach of contract or covenants, the financial stability or any financial difficulties of the counterparty and the country it is resident in (i.e. in order to take account of sovereign debt issues).

Put option obligation

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, on acquisition the Group estimates the fair value of the total consideration payable in calculating the goodwill arising.

The fair value of both the put option obligation and the associated goodwill recognised are dependent on the following assumptions: an estimate of when the put option will be exercised by the non-controlling shareholders, the market value growth of the obligation and the discount rate used at the reporting date. These assumptions are reviewed on a regular basis by management. The following table outlines the impact of reasonably possible alternative assumptions of the market values used in calculating the liability, which is the most significant estimate involved within the calculation:

Assumption	Change to current assumption	**Group 2016 Increase in put option liability £m**	Group 2015 Increase in put option liability £m
Market value of subsidiary undertakings	10% increase	**1.2**	1.2

Subsidiary management incentive scheme

In 2012 and 2014, 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. In accordance with IFRS 2 *Share-based Payment*, the Group recognises the increase in the fair value of the liability through the Income Statement, spread over the vesting period, to the 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:

Notes to the Accounts *(continued)*

1. Accounting policies *(continued)*

Assumption	Change to current assumption	Group 2016 Increase / (decrease) in liability* £m	Group 2015 Increase / (decrease) in liability* £m
Connells Limited EBITDA	10% increase (note 1)	3.2	3.9
Date of exercise of options	Latest possible opportunity (note 2)	(0.9)	(3.6)

* 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 to the liability that would result if it was assumed that Connells' forecast EBITDA was 10% higher each year (from 2017 to the period of exercise) than that included in its corporate plans.
2. The fair value of the liability at 31 December 2016 is currently based on the assumption that management will exercise their 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 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 19) 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 2016, to the extent that discount rates were to increase by 10%, e.g. from 10% to 11%, there would be no increase to the goodwill impairment charge (2015: £nil). Similarly, a reduction in the long term growth rate assumption from 2.5% to 0% would also result in no increase to the impairment charge (2015: £nil). This is due to there being sufficient headroom to cover these scenarios.

Fair value of financial instruments

Fair values are determined by the three tier valuation hierarchy as defined within IFRS 13 and Amendments to IFRS 7 *Financial Instruments: Disclosures* and as described in note 37.

The most reliable fair values of financial instruments are quoted market prices in an actively traded market. Where there are no active markets, valuation techniques are used. Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist and other valuation models. Market observable inputs used in valuation techniques include forward risk-free and benchmark interest rates, equity index prices and the retail price index. Assumptions used in valuation techniques include expected price volatilities and mortality rates.

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.

Taxation

Judgement is required in determining the provision for corporation tax. There are a number of transactions for which the final tax determination is uncertain at the reporting date. In these instances a prudent approach is taken.

As outlined in note 1i), deferred tax assets are only recognised to the extent it is probable that future taxable profits will be available against which the asset can be utilised. Based on the Group's detailed five year forecasts, the Directors consider that the carrying value of the Group's and Society's deferred tax assets as at 31 December 2016 of £30.4m and £13.7m respectively (2015: £21.6m and £9.6m respectively) are supportable.

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 which 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 and amounts reported in the Income Statement. These assumptions include inflation and discount rates, life expectancy, commutation allowances and the rate of salary growth; see note 28 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 pension obligations that would result. Each sensitivity considers one change in isolation.

Assumption	Change in assumption	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Discount rate	+/-0.25% pa	-/+12.5	-/+10.0	-/+7.0	-/+5.3
Rate of inflation	+/-0.5% pa	+/-10.3	+/-8.2	+/-5.3	+/-4.0
Rate of salary growth	+/-0.5% pa	-	-	-	-
Commutation allowance	+/-10% pa	+/-2.5	+/-1.7	+/-1.3	+/-0.8
Life expectancy	+1 year	+7.9	+6.0	+4.7	+3.1

The estimated average duration of the defined benefit obligation as at 31 December 2016 is 18 years (2015: 18 years).

Other

Following 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 Board considered whether its decision, in 2010, to remove the ceiling on the Society's Standard Variable Rate ('SVR') could result in future cash outflows, and concluded that the probability of this remains remote.

2. Interest receivable and similar income

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
On financial assets not at fair value through profit or loss:				
On loans fully secured on residential property	473.7	472.0	389.0	384.4
On other loans:				
To subsidiary undertakings	-	-	51.5	52.9
Other	11.9	10.8	6.7	7.6
On debt securities	16.5	15.4	16.2	15.1
On other liquid assets	6.4	5.8	5.9	5.3
	508.5	504.0	469.3	465.3
On financial assets at fair value through profit or loss:				
Net expense on derivative financial instruments held for hedging assets	(81.5)	(64.5)	(81.8)	(64.8)
	427.0	439.5	387.5	400.5

Included within interest receivable and similar income on debt securities is income from fixed income securities in the Group of £13.8m (2015: £12.2m) and in the Society of £13.6m (2015: £12.0m). Also included within interest receivable and similar income on debt securities is income from available-for-sale assets in the Group of £16.3m (2015: £15.2m) and in the Society of £16.0m (2015: £14.9m).

Included within interest receivable and similar income is interest accrued on impaired financial assets in the Group of £2.5m (2015: £3.4m) and in the Society of £0.9m (2015: £1.0m).

Notes to the Accounts *(continued)*

3. Interest payable and similar charges

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
On financial liabilities not at fair value through profit or loss:				
On shares held by individuals	209.0	214.6	209.0	214.6
On shares held by others	1.4	1.4	1.4	1.4
On subscribed capital	8.4	8.4	8.4	8.4
On deposits and other borrowings:				
Subordinated liabilities	3.0	3.7	3.0	3.7
Subsidiary undertakings	-	-	40.4	44.1
Wholesale and other funding	31.0	30.1	3.5	3.6
Finance charge on unwind of put option liability	0.2	0.1	-	-
	253.0	258.3	265.7	275.8
On financial liabilities at fair value through profit or loss:				
Net income on derivative financial instruments held for hedging liabilities	(38.4)	(42.1)	(46.6)	(57.7)
	214.6	216.2	219.1	218.1

4. Fees and commissions receivable

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Mortgage origination related fees	32.3	26.2	-	-
Other mortgage related fees	1.8	2.0	1.8	2.0
General insurance fees	47.4	41.4	2.9	2.8
Commissions earned on property sales	165.4	154.4	-	-
Commissions earned on property lettings	55.5	44.5	-	-
Survey and valuation services	55.2	47.7	-	-
Financial advice fees	31.4	33.4	14.2	-
Other fees and commissions	63.9	59.5	1.4	6.1
	452.9	409.1	20.3	10.9

5. Other income

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Property rents receivable	2.5	2.7	1.8	1.8
Net interest on defined benefit pension obligations (note 28)	(2.4)	(2.5)	(1.0)	(1.3)
Government grants	0.3	0.2	-	-
Net profit on sale of property, plant and equipment, investment properties and intangible assets	0.1	0.2	-	0.1
Other	1.9	3.0	2.5	4.4
	2.4	3.6	3.3	5.0

6. Administrative expenses

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Employee costs:				
Wages and salaries	294.8	261.0	60.7	49.7
Social security costs	28.4	25.2	5.7	4.7
Pension costs:				
Defined contribution arrangements (note 28)	7.9	7.0	4.3	3.2
Settlement gain (note 28)	(0.1)	-	-	-
	331.0	293.2	70.7	57.6
Other administrative expenses	168.1	171.2	47.4	51.2
Central administrative costs recharged to Group undertakings	-	-	(12.1)	(12.3)
	499.1	464.4	106.0	96.5
Other administrative expenses comprise:				
Depreciation and amortisation (notes 17, 18 and 19)	20.6	16.9	4.1	3.4
Impairment of property, plant and equipment and investment property (notes 17 and 18)	-	4.0	-	4.0
Amounts payable under operating leases	18.6	18.0	5.6	5.7
Other property and establishment costs	16.7	15.8	5.5	4.9
Postage and communications	19.1	17.6	5.2	4.5
IT costs	7.8	7.0	6.5	5.8
Marketing and advertising	25.0	22.4	5.6	5.0
Insurance	5.3	3.7	2.2	2.0
Legal, professional and consultancy	19.5	19.8	8.2	11.4
Training, recruitment and other employee related costs	17.8	18.3	3.7	3.8
Costs of Connells' management incentive scheme (note 25)	1.0	15.9	-	-
Other	16.7	11.8	0.8	0.7
	168.1	171.2	47.4	51.2

The remuneration of the external auditor, which is included within legal, professional and consultancy costs above, is set out below (excluding VAT):

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Audit of the Society and Group Annual Accounts	0.2	0.2	0.2	0.2
Audit of the Group's subsidiary undertakings' accounts pursuant to legislation	0.5	0.4	-	-
Audit-related assurance services	0.1	0.1	0.1	0.1
Other assurance services	0.5	0.3	0.4	0.2
	1.3	1.0	0.7	0.5

7. Employee numbers

The average number of full and part-time persons employed during the year (including Executive Directors) was as follows:

	Group 2016	Group 2015	Society 2016	Society 2015
Principal office	1,137	930	1,137	930
Society branches	798	773	798	773
Subsidiary undertakings	7,456	6,817	-	-
	9,391	8,520	1,935	1,703

8. Directors' emoluments

Directors' emoluments are set out within the Directors' Remuneration Report on pages 66 to 72.

Total Directors' emoluments for 2016 amounted to £3.3m (2015: £1.9m).

9. 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

Key management personnel comprises the Executive Directors and Non-Executive Directors, who are responsible for ensuring that the Society and its subsidiary undertakings meet their strategic and operational objectives.

The table below summarises the benefits paid to key management personnel in the year:

Group and Society	**2016** **£m**	2015 £m
Salary, benefits and annual performance pay	**3.1**	1.8
Employer pension contributions	**0.2**	0.1
	3.3	1.9

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:

	2016 **£m**	2015 £m
Mortgage loans outstanding at 31 December	**-**	-
Savings balances at 31 December	**1.1**	1.3

Interest receivable and payable on the above accounts during the year was as follows:

	2016 **£000**	2015 £000
Interest receivable	**1**	2
Interest payable	**11**	21

Loans and savings of key management personnel are at normal commercial rates. There are no provisions for impairment against these loans.

Directors' loans and transactions

At 31 December 2016 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £1,000 (2015: £22,000) made to one (2015: one) Director or persons who are connected with Directors.

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 £14.5m (2015: £11.6m) and £8.2m (2015: £5.3m) 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:

	2016 £m	2015 £m
Rendering and receiving of services	3.3	5.0
Recharges of central costs	12.1	12.3
Interest receivable	51.5	52.9
Interest payable	(40.4)	(44.1)
Other income	2.2	1.8
Collateral transferred to funding vehicles	487.0	375.0
Purchase of debt securities	146.4	-
Repayment of debt securities	(251.2)	(129.9)

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 16.

At 31 December 2016 the Society owed £925.5m (2015: £1,437.9m) to subsidiary undertakings and was owed £1,189.1m (2015: £1,327.7m) by subsidiary undertakings. Interest on intra-Group borrowings is charged at an appropriate market rate.

During the year the Group had the following related party transactions with joint ventures and associates:

	2016 £m	2015 £m
Services provided to the Group	0.7	2.6
Services provided by the Group	5.2	6.9

At 31 December 2016 the Group was owed £nil (2015: £0.4m) by joint ventures and associates, and owed £0.1m (2015: £nil) to joint ventures and associates.

There are 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 2016 or 31 December 2015.

Notes to the Accounts *(continued)*

10. Tax expense

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Current tax	41.0	35.6	21.0	19.4
Deferred tax (note 27)	(1.9)	(2.1)	(0.4)	(0.5)
	39.1	33.5	20.6	18.9

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 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Profit before tax	168.9	146.9	135.6	120.2
Share of losses / (profits) from joint ventures and associates, net of tax	0.6	(0.2)	-	-
	169.5	146.7	135.6	120.2
Tax calculated at standard UK corporation tax rate of 20.00% (2015: 20.25%)	33.9	29.7	27.1	24.3
Effects of:				
Expenses not deductible for tax purposes	4.9	5.5	0.8	1.1
Adjustment to tax expense in respect of prior periods	(0.7)	0.3	(0.2)	(0.2)
Tax assets not recognised on losses	0.3	0.4	-	-
Non-taxable income	(1.9)	(0.3)	(11.6)	(6.5)
Corporation tax rate change	(0.1)	(0.6)	-	0.2
Utilisation of tax losses	-	(0.1)	-	-
Effect of lower tax rates in other jurisdictions (see below)	(1.4)	(1.4)	-	-
Banking surcharge	4.5	-	4.5	-
Other	(0.4)	-	-	-
Tax expense	39.1	33.5	20.6	18.9

The effective tax rate for the Group for the year ended 31 December 2016 is 23.1% (2015: 22.8%) compared with the standard rate of UK Corporation Tax of 20.00% (2015: 20.25%). 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 (including the impairment charge recognised on the Group's investment in Wynyard) 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 2016 is 15.2% (2015: 15.7%). The major impact on the effective rate of tax is the non-taxable dividend income received of £57.6m (2015: £30.0m). This is partially offset by the impact of the 8% surcharge on taxable profits above £25m.

11. Loans and advances to credit institutions

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Repayable on demand:				
Cash and cash equivalents	98.2	100.8	-	21.9
Cash pledged as collateral	300.1	196.7	300.1	196.7
Other loans and advances to credit institutions	1.9	-	-	-
	400.2	297.5	300.1	218.6
In not more than three months:				
Cash and cash equivalents	0.1	32.0	-	-
Cash pledged as collateral	5.9	1.9	5.9	1.9
Other loans and advances to credit institutions	0.3	1.2	-	1.1
	6.3	35.1	5.9	3.0
In more than three months but not more than one year:				
Other loans and advances to credit institutions	0.1	-	-	-
	0.1	-	-	-
In more than one year but not more than five years:				
Cash pledged as collateral	3.0	8.6	3.0	8.6
	3.0	8.6	3.0	8.6
In more than five years:				
Cash pledged as collateral	-	11.4	-	11.4
	-	11.4	-	11.4
Total loans and advances to credit institutions	409.6	352.6	309.0	241.6
Total included within cash and cash equivalents	98.3	132.8	-	21.9

At 31 December 2016 £309.0m (2015: £218.6m) of cash has been pledged by the Group and Society against derivative contracts. The repayment of the cash pledged is dependent upon the fair value movements of the derivative contracts which have a maximum contractual period of up to 40 years.

Notes to the Accounts *(continued)*

12. Debt securities

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Gilts	377.5	325.8	377.5	325.8
Certificates of deposit	232.9	342.7	185.4	312.7
Fixed rate bonds	203.0	175.3	203.0	175.3
Floating rate notes	50.1	90.1	40.1	85.1
Residential mortgage backed securities	191.6	170.5	456.0	539.7
	1,055.1	1,104.4	1,262.0	1,438.6
Debt securities have remaining maturities as follows:				
In not more than one year	363.7	493.8	377.3	710.0
In more than one year	691.4	610.6	884.7	728.6
	1,055.1	1,104.4	1,262.0	1,438.6
Transferable debt securities comprise:				
Listed on a recognised investment exchange	820.5	755.1	1,074.9	1,124.3
Unlisted	234.6	349.3	187.1	314.3
	1,055.1	1,104.4	1,262.0	1,438.6
Market value of listed transferable debt securities	820.5	755.1	1,075.2	1,122.3
Carrying value of on-balance sheet securities pledged as collateral under sale and repurchase agreements	194.0	50.4	206.4	68.7

The Directors consider that the primary purpose of holding debt securities is prudential. The majority of debt securities held are highly liquid assets which are used on a continuing basis in the Group's activities.

Debt securities of the Group, included in the table above, with a carrying value (excluding accrued interest) of £194.0m (2015: £50.4m) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership.

Included in the Society's residential mortgage backed securities are £nil (2015: £251.2m), £71.0m (2015: £71.0m), £47.0m (2015: £47.0m) and £146.4m (2015: £nil) of notes purchased by the Society from the Group's securitisation vehicles Darrowby No. 1 plc, Darrowby No. 2 plc, Darrowby No. 3 plc and Darrowby No. 4 plc respectively. Darrowby No. 1 plc was liquidated during the year.

The Society also holds £12.4m (2015: £18.3m) of securities, included in the table above, which are pledged as collateral with a Group subsidiary, Skipton International Limited (SIL), in a repurchase agreement.

The Group's investments in mortgage backed securities, as shown in the table above, represent investments in unconsolidated structured entities, as described in note 1b).

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 less any unrealised gains recognised within the available-for-sale reserve as shown below:

Group and Society	2016 £m	2015 £m
Carrying value: available-for-sale financial assets	191.6	170.5
Cumulative unrealised gains recognised in available-for-sale reserve	(0.5)	-
Maximum exposure to loss at 31 December	191.1	170.5
Total size of unconsolidated structured entities	191.1	170.5

During the year, the Group and Society received interest income of £2.3m (2015: £2.8m) from its investments in unconsolidated structured entities and incurred impairment charges of £nil (2015: £nil). In addition, £0.5m of unrealised profits (2015: £0.3m unrealised losses) were recognised through the available-for-sale reserve, as shown in the 'Available-for-sale investments: Valuation gains / (losses) taken to equity' line in the Statement of Comprehensive Income.

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 during the 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 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.

Movements in debt securities during the year are summarised as follows:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
At 1 January	1,104.4	1,152.6	1,438.6	1,608.9
Additions	1,130.2	500.3	1,189.1	437.9
Disposals	(1,189.1)	(543.2)	(1,375.3)	(602.9)
Changes in fair value	9.6	(5.3)	9.6	(5.3)
At 31 December	1,055.1	1,104.4	1,262.0	1,438.6

Notes to the Accounts *(continued)*

13. Derivative financial instruments

	Group 2016		Society 2016	
	Positive market value £m	Negative market value £m	Positive market value £m	Negative market value £m
Derivatives designated as fair value hedges:				
Interest rate swaps	80.1	173.6	85.5	174.2
Index swaps	-	216.3	-	216.3
	80.1	**389.9**	**85.5**	**390.5**
Derivatives designated as cash flow hedges:				
Interest rate swaps	14.2	0.7	14.4	0.8
	14.2	**0.7**	**14.4**	**0.8**
Other derivatives held at fair value:				
Interest rate swaps	10.7	10.5	14.1	6.6
Index swaps	11.1	-	11.1	-
Investment products - embedded derivatives	-	11.2	-	11.2
	21.8	**21.7**	**25.2**	**17.8**
	116.1	**412.3**	**125.1**	**409.1**

	Group 2015		Society 2015	
	Positive market value £m	Negative market value £m	Positive market value £m	Negative market value £m
Derivatives designated as fair value hedges:				
Interest rate swaps	62.3	101.4	63.7	101.5
Index swaps	-	172.5	-	172.5
	62.3	273.9	63.7	274.0
Derivatives designated as cash flow hedges:				
Interest rate swaps	9.3	0.8	9.8	1.0
	9.3	0.8	9.8	1.0
Other derivatives held at fair value:				
Interest rate swaps	12.1	10.7	14.4	5.7
Index swaps	11.4	-	11.4	-
Investment products - embedded derivatives	-	11.5	-	11.5
	23.5	22.2	25.8	17.2
	95.1	296.9	99.3	292.2

All derivatives that are not accounted for under hedge accounting rules under IAS 39 are measured at fair value through the Income Statement. All derivatives are held for economic hedging purposes.

14. Loans and advances to customers

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Loans fully secured on residential property*	14,999.6	13,680.8	12,873.3	11,564.5
Other loans:				
Loans fully secured on land	317.4	342.0	317.4	342.0
Other loans and advances	123.8	115.5	0.1	0.2
Fair value adjustment for hedged risk	340.8	224.9	332.6	221.1
	15,781.6	14,363.2	13,523.4	12,127.8
The remaining maturity of loans and advances to customers from the reporting date is as follows:				
On call and at short notice	77.6	75.0	2.2	3.3
In not more than three months	38.1	26.7	21.6	17.4
In more than three months but not more than one year	90.2	72.7	45.2	44.2
In more than one year but not more than five years	515.1	527.8	347.4	353.8
In more than five years	15,117.4	13,722.8	13,149.0	11,751.9
	15,838.4	14,425.0	13,565.4	12,170.6
Less: Impairment (note 15)	(56.8)	(61.8)	(42.0)	(42.8)
	15,781.6	14,363.2	13,523.4	12,127.8

* Includes the equity release portfolio.

At 31 December 2016, loans and advances to customers include £761.8m (2015: £1,302.8m) for both the Group and Society which have been used in secured funding arrangements, resulting in the beneficial interest in these loans being transferred to Darrowby No. 1 plc (£nil; 2015: £405.7m), Darrowby No. 2 plc (£187.3m; 2015: £247.3m), Darrowby No. 3 plc (£226.6m; 2015: £284.7m), Darrowby No. 4 plc (£347.9m; 2015: £nil) and Beckindale No. 2 Limited (£nil; 2015: £365.1m) which are special purpose vehicles consolidated into the Group Accounts. The carrying value of these loans at the date the beneficial interest was transferred was £1,480.0m (2015: £2,568.0m). All the loans pledged are retained within the Society's Statement of Financial Position as the Society retains substantially all the risk and rewards relating to the loans. These loans secure £519.6m (2015: £887.4m) of funding for the Group.

15. 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	Fair value of embedded derivatives on equity release loans £m	Total £m
At 1 January 2016					
Individual impairment	16.2	11.4	0.6	-	28.2
Collective impairment	9.0	0.6	-	24.0	33.6
	25.2	12.0	0.6	24.0	61.8
Amounts written off during the year, net of recoveries					
Individual impairment	(3.3)	(1.2)	(0.1)	-	(4.6)
Collective impairment	-	-	-	(0.1)	(0.1)
	(3.3)	(1.2)	(0.1)	(0.1)	(4.7)
Income Statement					
Impairment losses on loans and advances					
Individual impairment	(0.6)	(1.8)	0.1	-	(2.3)
Collective impairment	(1.7)	0.3	-	3.8	2.4
	(2.3)	(1.5)	0.1	3.8	0.1
Adjustment to impairment losses on loans and advances resulting from recoveries during the year					
Individual impairment	(0.4)	-	-	-	(0.4)
(Credit) / charge for the year	(2.7)	(1.5)	0.1	3.8	(0.3)
At 31 December 2016					
Individual impairment	11.9	8.4	0.6	-	20.9
Collective impairment	7.3	0.9	-	27.7	35.9
	19.2	9.3	0.6	27.7	56.8
At 1 January 2015					
Individual impairment (re-presented*)	19.9	10.4	0.9	-	31.2
Collective impairment (re-presented*)	9.4	0.8	-	17.5	27.7
	29.3	11.2	0.9	17.5	58.9
Amounts written off during the year, net of recoveries					
Individual impairment	(4.6)	(0.5)	(0.3)	-	(5.4)
Collective impairment	(0.1)	-	-	-	(0.1)
	(4.7)	(0.5)	(0.3)	-	(5.5)
Income Statement					
Impairment losses on loans and advances					
Individual impairment (re-presented*)	1.5	1.5	-	-	3.0
Collective impairment (re-presented*)	(0.3)	(0.2)	-	6.5	6.0
	1.2	1.3	-	6.5	9.0
Adjustment to impairment losses on loans and advances resulting from recoveries during the year					
Individual impairment	(0.6)	-	-	-	(0.6)
Charge for the year	0.6	1.3	-	6.5	8.4
At 31 December 2015					
Individual impairment (re-presented*)	16.2	11.4	0.6	-	28.2
Collective impairment (re-presented*)	9.0	0.6	-	24.0	33.6
	25.2	12.0	0.6	24.0	61.8

* The comparative figures above have been re-presented due to a change in the definition of the individual impairment provision, which has been extended to include a number of commercial mortgage accounts previously reported as having a collective impairment provision held against them. This has not resulted in a change to the total impairment provision held against these loans and has had no impact on the impairment charge to the Income Statement.

Society

	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 loans £m	Total £m
At 1 January 2016					
Individual impairment	4.7	11.4	-	-	16.1
Collective impairment	2.1	0.6	-	24.0	26.7
	6.8	12.0	-	24.0	42.8
Amounts written off during the year, net of recoveries					
Individual impairment	(1.3)	(1.2)	-	-	(2.5)
Collective impairment	-	-	-	(0.1)	(0.1)
	(1.3)	(1.2)	-	(0.1)	(2.6)
Income Statement					
Impairment losses on loans and advances					
Individual impairment	(0.1)	(1.8)	-	-	(1.9)
Collective impairment	-	0.3	-	3.8	4.1
	(0.1)	(1.5)	-	3.8	2.2
Adjustment to impairment losses on loans and advances resulting from recoveries during the year					
Individual impairment	(0.4)	-	-	-	(0.4)
(Credit) / charge for the year	(0.5)	(1.5)	-	3.8	1.8
At 31 December 2016					
Individual impairment	2.9	8.4	-	-	11.3
Collective impairment	2.1	0.9	-	27.7	30.7
	5.0	9.3	-	27.7	42.0
At 1 January 2015					
Individual impairment (re-presented*)	5.7	10.4	0.2	-	16.3
Collective impairment (re-presented*)	2.5	0.8	-	17.5	20.8
	8.2	11.2	0.2	17.5	37.1
Amounts written off during the year, net of recoveries					
Individual impairment	(1.1)	(0.5)	(0.2)	-	(1.8)
Collective impairment	(0.1)	-	-	-	(0.1)
	(1.2)	(0.5)	(0.2)	-	(1.9)
Income Statement					
Impairment losses on loans and advances					
Individual impairment (re-presented*)	0.6	1.5	-	-	2.1
Collective impairment (re-presented*)	(0.3)	(0.2)	-	6.5	6.0
	0.3	1.3	-	6.5	8.1
Adjustment to impairment losses on loans and advances resulting from recoveries during the year					
Individual impairment	(0.5)	-	-	-	(0.5)
(Credit) / charge for the year	(0.2)	1.3	-	6.5	7.6
At 31 December 2015					
Individual impairment (re-presented*)	4.7	11.4	-	-	16.1
Collective impairment (re-presented*)	2.1	0.6	-	24.0	26.7
	6.8	12.0	-	24.0	42.8

* The comparative figures above have been re-presented due to a change in the definition of the individual impairment provision, which has been extended to include a number of commercial mortgage accounts previously reported as having a collective impairment provision held against them. This has not resulted in a change to the total impairment provision held against these loans and has had no impact on the impairment charge to the Income Statement.

15. Impairment losses on loans and advances to customers *(continued)*

The no negative equity guarantee provided to equity release customers is accounted for as an embedded derivative due to its economic characteristics (as described in note 37b)). The losses on this portfolio represent the fair value movement of these embedded derivatives and are a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and the specific behaviour of this portfolio.

During the year the Directors have assessed the fair value of these embedded derivatives, based on the performance of the wider economy and management's assessment of the specific characteristics of the portfolio, resulting in a charge of £3.8m to the Income Statement (2015: £6.5m).

16. Investments in Group undertakings

a) Subsidiary undertakings

Investments in subsidiary undertakings are recorded at cost.

The net movement in investments in subsidiary undertakings during the year was as follows:

Society	Shares in subsidiary undertakings		Loans to subsidiary undertakings		Total	
	2016	2015	2016	2015	2016	2015
	£m	£m	£m	£m	£m	£m
Cost						
At 1 January	186.0	188.2	1,327.7	1,489.1	1,513.7	1,677.3
Additions	-	-	2.5	7.1	2.5	7.1
Repayments	-	-	(141.1)	(168.5)	(141.1)	(168.5)
Disposals	-	(2.2)	-	-	-	(2.2)
At 31 December	186.0	186.0	1,189.1	1,327.7	1,375.1	1,513.7
Provisions						
At 1 January	55.5	57.7	-	-	55.5	57.7
Disposals	-	(2.2)	-	-	-	(2.2)
At 31 December	55.5	55.5	-	-	55.5	55.5
Net book value at 31 December	130.5	130.5	1,189.1	1,327.7	1,319.6	1,458.2

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.

The Society reviews the carrying value of its investments in subsidiary undertakings at each reporting date, as described in note 1m), and management has determined that no provision against the carrying value of its subsidiary undertakings was required during the current or prior year.

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	Percentage of ownership interest 2016	2015
Amber Homeloans Limited	Lending body	100.0	100.0
Beckindale No. 2 Limited	Funding vehicle	(See below)	(See below)
Connells Limited and subsidiary undertakings*	Estate agency and related businesses	99.7	99.6
Darrowby No. 1 plc	Funding vehicle	(See below)	(See below)
Darrowby No. 2 plc	Funding vehicle	(See below)	(See below)
Darrowby No. 3 plc	Funding vehicle	(See below)	(See below)
Darrowby No. 4 plc	Funding vehicle	(See below)	(See below)
Jade Software Corporation Limited and subsidiary undertakings	Provider of software development services	56.4	56.4
North Yorkshire Mortgages Limited	Lending body	100.0	100.0
Northwest Investments NZ Limited	Provider of software development services	100.0	100.0
Skipton Business Finance Limited	Provider of debt factoring services	100.0	100.0
Skipton Financial Services Limited	Financial adviser	100.0	100.0
Skipton Group Holdings Limited (SGHL)	Intermediate holding company	100.0	100.0
Skipton International Limited	Offshore deposit taker and lender	100.0	100.0
Skipton Trustees Limited	Provider of will writing services	100.0	100.0

* Indicates where an option to purchase non-controlling interests in the future exists.

All the above entities are incorporated, registered and operate in the United Kingdom except for SIL, which is incorporated and registered in Guernsey and operates in Guernsey, Jersey and the UK; Northwest Investments NZ Limited, which is incorporated, registered and operates in New Zealand; and Jade Software Corporation Limited, which is incorporated and registered in New Zealand and operates worldwide.

Put options

Put options exist in a number of subsidiaries within the Connells group whereby the non-controlling shareholders have options that require the Group to purchase the remaining shareholding at some future date(s). In accordance with IAS 32 and IAS 39, these options are designated as 'financial instruments'. The net present value of the estimated future payments under such put options is therefore presented as a financial liability and the Group consolidates 100% of the results of those subsidiaries where put options exist. Any adjustment to the Group's estimation of the present value of the liability will result in an adjustment to goodwill (for put options issued prior to 1 January 2010 in accordance with IAS 27 (2003) and IFRS 3 (2004)) or a profit or loss in the Income Statement (for put options issued on or after 1 January 2010 in accordance with IFRS 3 (2008 revised) and IFRS 10 (2011)). The estimate of the liability is dependent primarily on the market value and forecast performance of the relevant businesses and the expected timing of the exercise of the option. The change in fair value of the financial liability due to the accretion of the discount of the liability is expensed in the Income Statement.

In 2015 Connells Limited purchased 7.5% of the minority shareholding of Sharman Quinney Limited for £0.9m, increasing its holding to 95%. The valuation undertaken to determine the price for the transaction resulted in a reduction in goodwill of £0.1m.

At 31 December 2016 the total financial liability for the remaining options detailed above was £11.7m (2015: £11.9m). Details of movements in the put option liability during the year are provided in note 25.

Subsidiary management incentive scheme

In 2012 and 2014, members of Connells Limited senior management purchased equity shares in that company for a total of £1.5m, as part of the management incentive scheme described in note 25. At the same time options were issued that require SGHL to purchase this shareholding at some future dates, with further details provided in note 25.

At 31 December 2016 the total liability for these options was £21.4m (2015: £30.4m).

Consolidation of Group undertakings

The special purpose vehicles (SPVs) Darrowby No. 1 plc (which was liquidated during the year), Darrowby No. 2 plc, Darrowby No. 3 plc, Darrowby No. 4 plc and Beckindale No. 2 Limited were formed with only nominal share capital, are funded through loans from the Society and their activities are carried out under the direction of the Society, in line with

16. Investments in Group undertakings *(continued)*

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 and therefore these SPVs pass the test of control under IFRS 10. Consequently they are fully consolidated into the Group Accounts. The Society has no contractual arrangement or intention to provide additional financial or other support to these SPVs.

The remaining subsidiary undertakings are 100% owned except for Jade Software Corporation Limited where the Group holds a 56.4% interest (2015: 56.4%) and no put options exist.

Where the Group does not hold 100% of the share capital of a subsidiary and no put option exists, the profits or losses attributable to the non-controlling interests of the subsidiary are shown in the Income Statement and the non-controlling interests' share of the total members' interests of the subsidiary are shown within the Statement of Financial Position.

The loss of £0.3m (2015: loss of £0.6m) attributable to non-controlling interests as shown in the Income Statement and the members' interests attributable to the non-controlling interests as shown in the Statement of Financial Position of £(1.0)m (2015: £(1.6)m) are attributable solely to the non-controlling interests of Jade Software Corporation Limited.

All the Group's subsidiary undertakings have prepared accounts to 31 December 2016 and their results have been included in these Group Accounts.

Acquisitions

In February 2016, Connells Limited purchased 95% of the share capital and voting rights of the estate agency business Rook Matthews Sayer Limited (RMS) for cash consideration of £6.2m, to strengthen Connells' presence in the North East of England. A put option liability of £0.4m was recognised in relation to the remaining 5% shareholding, bringing the fair value of the total consideration to £6.6m. The transaction resulted in the recognition of intangible assets of £2.0m in relation to customer relationships and brands, and other net assets acquired that were fair valued at £1.1m, generating £3.5m of goodwill. The intangible assets recognised were separately identified in accordance with IAS 38 and valued using the discounted cash flow method.

From the date of acquisition to 31 December 2016, the amount RMS contributed to Group income was £4.2m and profit before tax was £0.4m. If Connells had owned RMS throughout 2016, the amount it would have contributed to Group income during the year would have been £5.1m and the amount contributed to Group profit before tax would have been £0.4m.

Also in 2016, Connells purchased six further subsidiary undertakings for cash consideration of £2.5m (with a further £0.9m deferred consideration), generating £1.0m of goodwill.

In addition, Connells purchased the trade and assets of a number of businesses during 2016 for total consideration of £7.1m (with a further £0.4m deferred consideration), generating goodwill of £3.3m.

The Group made no further increases to its shareholdings in existing subsidiary undertakings during 2016. However, the reassessment of expected future payments under put option agreements resulted in a reduction to goodwill of £0.8m in relation to The Asset Management Group (2015: £nil), a subsidiary of Connells Limited.

In 2015 Connells Limited acquired 75% of the estate agency business Gascoigne Halman Holdings Limited. The total consideration for the shares acquired was £9.0m, of which £3.0m was deferred for up to three years from the date of acquisition and is contingent on certain events, including certain of the selling shareholders remaining employed by the business for that period. Under IFRS 3, this is contingent consideration and does not comprise part of the initial business combination and will be expensed to the Group Income Statement over the three year period.

A put option liability of £4.5m was recognised in relation to the remaining 25% shareholding, bringing the fair value of the total consideration to £10.5m (excluding the £3.0m contingent consideration). The transaction resulted in the recognition of intangible assets of £4.6m in relation to customer relationships and brands, as well as other net liabilities of £0.3m, generating £6.2m of goodwill. The intangible assets recognised were separately identified in accordance with IAS 38 and valued using the discounted cash flow method.

Also in 2015, Connells Limited purchased 75% of White Space Property Group Limited, the parent company of the online estate agent hatched.co.uk Limited (Hatched), for £0.4m. A put option exists for the non-controlling shareholders who own the remaining 25%.

b) Disposals

The profit on disposal of subsidiary undertakings during the year was £15.8m (2015: £0.4m loss), of which £0.1m represents the release of a provision in relation to the disposal of Pearson Jones in 2015 and £15.7m relates to the disposal of HML in 2014. The sale of HML included contingent consideration dependent on HML's performance over a period following the disposal. During the year the ultimate parent company of HML announced that HML had been appointed by UK Asset Resolution (UKAR) to undertake its mortgage servicing activities. This will result in contingent consideration being receivable by the Group between 2018 and 2022, and the amount recognised in the year of £9.9m (2015: £nil) is based on the Directors' best estimate of the present value of an element of the contingent consideration that can be reliably estimated at this stage. An additional element may become due, albeit the amount cannot be reliably estimated at present. In addition, a further £5.8m profit on disposal was recognised during the year following the expiration of the indemnity period relating to this disposal.

In 2015 the Group sold its entire shareholding in Pearson Jones plc and its subsidiary businesses for a loss of £0.8m. Also in 2015, Connells Limited sold its entire 75% shareholding in Connells Relocation Services Limited, resulting in a loss on disposal of £0.3m.

The Group also received contingent consideration in 2015 following the disposals of Mutual One Limited and The Private Health Partnership Limited in 2013 and 2014 respectively, totalling £0.7m.

c) Joint ventures

At 31 December 2016, the Group held non-controlling interests in the following companies that are classed as joint ventures:

Name of investment	Principal business activity
TM Group (UK) Limited	Property search services
Cybele Solutions Holdings Limited	Conveyancing services
Vibrant Energy Matters Limited	Home energy, property and eco services
Home Telecom Limited	Telecommunications services

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.

d) Associates

At 31 December 2015, the Group held a 17.8% shareholding in Wynyard Group Limited, incorporated in New Zealand, which was held as an associate investment.

During 2016, the Group subscribed to a rights issue by Wynyard for £2.5m, whilst an impairment charge of £1.1m (2015: £nil) was recognised as a result of a deterioration in the share price leading to the market value of the Group's shareholding falling below the carrying value at that time.

On 20 June 2016 the Group's holding in Wynyard was reclassified to an equity share investment following the resignation of a senior manager of the Skipton Group from Wynyard's board of directors. This, and consideration of a number of other factors, led the Directors to conclude that the Group no longer held significant influence over Wynyard. This change in accounting treatment resulted in a loss of £0.9m recognised on the deemed disposal of the associate investment, shown in the '(Loss) / profit on full or part disposal of associate' line in the Income Statement.

During 2015, the Group's associate holding in Wynyard was diluted from 21.7% to 17.8% following share issues in the year to which the Group did not subscribe. These deemed part disposals generated a profit of £1.1m for the Group in 2015.

An analysis of the Group's share of Wynyard's assets, liabilities, loss after tax and other comprehensive income up to the point of reclassification is shown in the table below:

	Group 2016 £m	Group 2015 £m
Share of associate's		
Gross assets	-	7.6
Gross liabilities	-	(0.8)
Fair value adjustment in relation to initial recognition of associate investment	-	4.7
At 31 December	-	11.5
Share of associate's		
Income	1.0	3.8
Expenditure	(3.3)	(6.1)
Taxation	(0.1)	-
Share of associate's loss after tax	(2.4)	(2.3)
Share of associate's other comprehensive income	-	-

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16. Investments in Group undertakings *(continued)*

e) Equity share investments

At 31 December 2016, the Group held interests in the following companies:

Name of investment	Principal business activity	Percentage of ownership interest 2016	2015
Zoopla Property Group Plc	Property search provider	2.7	4.0
Hearthstone Investments Limited	Property fund management	13.9	16.1
Tactile Limited	Software application provider	8.7	-
Wynyard Group Limited	Provider of software development services	17.7	-*

* Classified as an associate as at 31 December 2015 when a 17.8% shareholding in the company was held.

The above investments are held as available-for-sale financial assets.

During the year, Connells Limited acquired 22,928 ordinary shares in Tactile Limited (Tactile) for consideration of £0.4m.

The Group's shareholding in Hearthstone Investments Limited (Hearthstone) was diluted to 13.9% during the year (2015: 16.1%) following share issues by Hearthstone to which the Group did not subscribe.

The movement in the Group's equity share investments during the period is analysed below:

	Group 2016 £m	Group 2015 £m
At 1 January	40.9	32.9
Additions	0.4	1.0
Reclassification from associate investment	10.6	-
Disposals	(18.2)	(0.3)
Impairment recognised in Income Statement	(11.3)	-
Gain recognised in Other Comprehensive Income	14.0	7.3
At 31 December	36.4	40.9

An unrealised gain of £14.0m (2015: £7.3m) resulting from the change in fair value of the Group's holding in Zoopla Property Group Plc was recognised in the year. The change in fair value of this investment is based on the change in the quoted share price of the investment.

In September 2016 the Group sold a third of its shareholding in Zoopla, generating a profit of £17.0m (2015: £0.3m). This is shown in the 'Profit on part disposal of equity share investments' line in the Income Statement.

A £10.6m impairment charge has been recognised during the year in relation to the Group's holding in Wynyard Group Limited, following that company going into voluntary administration in October 2016. This is shown in the 'Impairment losses on equity share investments' line in the Income Statement.

The Directors have reviewed the carrying value of the Group's investment in Hearthstone, based on recent trading performance, outlook and expectations of the value of the business, and have concluded that the carrying value of this investment should be written down to £nil, resulting in £0.7m of impairment being recognised during the year, shown in the 'Impairment losses on equity share investments' line in the Income Statement. The Directors have also reviewed the carrying value of the Group's investment in Tactile (trading as Fixflo) and believe its current carrying value of £0.4m is the best indication of its fair value.

17. Property, plant and equipment

Group	2016 Land and buildings £m	2016 Equipment, fixtures and fittings £m	2016 Total £m	2015 Land and buildings £m	2015 Equipment, fixtures and fittings Re-presented* £m	2015 Total Re-presented* £m
Cost						
At 1 January	82.3	74.2	156.5	75.2	69.5	144.7
Additions	8.9	13.6	22.5	6.3	7.6	13.9
Disposals	-	(3.3)	(3.3)	(0.3)	(1.9)	(2.2)
Acquisition of subsidiary undertakings	0.1	0.2	0.3	0.4	0.1	0.5
Acquisition of other business assets	-	0.1	0.1	-	-	-
Disposal of subsidiary undertakings	-	-	-	-	(0.8)	(0.8)
Foreign exchange movements on translation	-	0.8	0.8	-	(0.3)	(0.3)
Reclassification from investment property	-	-	-	0.7	-	0.7
At 31 December	91.3	85.6	176.9	82.3	74.2	156.5
Depreciation						
At 1 January	34.6	54.1	88.7	30.4	50.3	80.7
Charge for the year	4.1	8.1	12.2	4.1	6.1	10.2
Impairment charge	-	-	-	0.3	-	0.3
Disposals	-	(2.4)	(2.4)	(0.2)	(1.5)	(1.7)
Disposal of subsidiary undertakings	-	-	-	-	(0.5)	(0.5)
Foreign exchange movements on translation	-	0.6	0.6	-	(0.3)	(0.3)
At 31 December	38.7	60.4	99.1	34.6	54.1	88.7
Net book value at 1 January	47.7	20.1	67.8	44.8	19.2	64.0
Net book value at 31 December	52.6	25.2	77.8	47.7	20.1	67.8

* The comparative figures have been re-presented due to the re-translation of opening balances of foreign subsidiaries. This has not had any impact on the opening net book values shown above.

The total net book value of land and buildings above, for the current and prior period, relates solely to buildings occupied by Group undertakings.

17. Property, plant and equipment *(continued)*

Society	2016 Land and buildings £m	2016 Equipment, fixtures and fittings £m	2016 Total £m	2015 Land and buildings £m	2015 Equipment, fixtures and fittings £m	2015 Total £m
Cost						
At 1 January	46.6	29.1	75.7	44.4	28.1	72.5
Additions	3.1	1.1	4.2	1.8	1.0	2.8
Disposals	-	-	-	(0.3)	-	(0.3)
Transfer of property, plant and equipment on integration of subsidiary undertaking into the Society	-	0.6	0.6	-	-	-
Reclassification from investment property	-	-	-	0.7	-	0.7
At 31 December	49.7	30.8	80.5	46.6	29.1	75.7
Depreciation						
At 1 January	18.2	27.0	45.2	16.0	26.6	42.6
Charge for the year	2.1	0.8	2.9	2.1	0.4	2.5
Impairment charge	-	-	-	0.3	-	0.3
Disposals	-	-	-	(0.2)	-	(0.2)
Transfer of property, plant and equipment on integration of subsidiary undertaking into the Society	-	0.2	0.2	-	-	-
At 31 December	20.3	28.0	48.3	18.2	27.0	45.2
Net book value at 1 January	28.4	2.1	30.5	28.4	1.5	29.9
Net book value at 31 December	29.4	2.8	32.2	28.4	2.1	30.5

The total net book value of land and buildings above, for the current and prior period, relates solely to buildings occupied by the Society.

In August 2016, assets of Skipton Financial Services Limited (SFS) were transferred to the Society on integration of financial advice activities of SFS into the Society. Property, plant and equipment within SFS with a net book value of £0.4m was transferred at its carrying value.

The net book value of land and buildings comprises:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Freehold	39.8	38.2	24.5	24.2
Long leasehold	1.3	1.0	1.3	1.0
Short leasehold	11.5	8.5	3.6	3.2
	52.6	47.7	29.4	28.4

18. Investment property

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cost				
At 1 January	28.4	31.9	28.1	31.6
Additions	0.1	-	0.1	-
Disposals	(0.3)	(2.8)	(0.3)	(2.8)
Transfer to property, plant and equipment	-	(0.7)	-	(0.7)
At 31 December	28.2	28.4	27.9	28.1
Depreciation				
At 1 January	12.5	9.8	12.3	9.6
Charge for the year	0.7	0.5	0.7	0.5
Impairment charge	-	3.7	-	3.7
Disposals	-	(1.5)	-	(1.5)
At 31 December	13.2	12.5	13.0	12.3
Net book value at 1 January	15.9	22.1	15.8	22.0
Net book value at 31 December	15.0	15.9	14.9	15.8

All investment property relates to property purchased by the Group or Society and is either unoccupied by the Group or Society, or relates to branches where part of the property is sub-leased.

The aggregate estimated market value of investment properties is set out in the table below:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Market value of investment property	16.7	16.9	16.3	16.6

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, based on the inputs to the valuation technique used as described in note 37b).

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 (2015: £3.7m).

19. Intangible assets

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Goodwill	138.9	133.9	-	-
Other intangible assets	25.9	19.3	2.6	1.1
	164.8	153.2	2.6	1.1

Goodwill	Group 2016 £m	Group 2015 £m
Cost, less amortisation to 1 January 2004*		
At 1 January	141.5	149.9
Acquisitions of subsidiary undertakings and business units	7.8	7.8
Additions and revaluations of put options	(0.8)	(0.1)
Transferred to investments in joint ventures	(2.0)	-
Disposal of subsidiary undertakings	-	(16.1)
At 31 December	146.5	141.5
Impairment losses		
At 1 January	7.6	20.3
Disposal of subsidiary undertakings	-	(12.7)
At 31 December	7.6	7.6
Net book value at 1 January	133.9	129.6
Net book value at 31 December	138.9	133.9

* 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 1c).

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 2016	
	Cost of goodwill £m	Accumulated impairment £m	Carrying value £m
Mortgages and Savings	2.9	0.1	2.8
Estate Agency	134.8	2.2	132.6
Investment Portfolio	8.8	5.3	3.5
Total goodwill	146.5	7.6	138.9

Operating segment	Group 2015 Cost of goodwill £m	Accumulated impairment £m	Carrying value £m
Financial Advice	2.9	0.1	2.8
Estate Agency	129.8	2.2	127.6
Investment Portfolio	8.8	5.3	3.5
Total goodwill	141.5	7.6	133.9

Based upon the Directors' assessment of recoverable amounts, the Directors have concluded that no impairment is required to be recognised in respect of goodwill in 2016 (2015: £nil).

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 Group prepares cash flow forecasts on the assumption that the subsidiary undertakings within each operating segment are held for long term investment. 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, and cash flows are extrapolated for subsequent years (up to an additional 10 years) based on a long term growth rate of 2.5% (2015: 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, recurring income and FTSE levels
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

These key drivers are discussed further in the Risk Management Report on pages 53 to 59.

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 2016 %	Group 2015 %
Mortgages and Savings*	13	-
Financial Advice	-	9
Estate Agency	11	13
Investment Portfolio	11	11

* Goodwill previously held in the Financial Advice division is now held in the Mortgages and Savings division following the integration of financial advice activities into the Society during 2016.

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19. Intangible assets *(continued)*

Other intangible assets	Group 2016 £m	Group 2015 Re-presented* £m	Society 2016 £m	Society 2015 £m
Cost				
At 1 January	68.2	62.1	14.5	14.7
Acquisition of subsidiary undertakings	3.5	4.9	-	-
Acquisition of other business assets	4.6	1.2	-	-
Additions	5.7	2.4	1.6	0.1
Transfer of intangible assets on integration of subsidiary undertaking into the Society	-	-	1.8	-
Foreign exchange movements on translation	5.2	(1.8)	-	-
Disposals	(0.3)	(0.4)	-	(0.3)
Disposal of subsidiary undertakings	-	(0.2)	-	-
At 31 December	86.9	68.2	17.9	14.5
Amortisation and impairment				
At 1 January	48.9	44.8	13.4	13.0
Charge for the year	7.7	6.2	0.5	0.4
Transfer of intangible assets on integration of subsidiary undertaking into the Society	-	-	1.4	-
Foreign exchange movements on translation	4.7	(1.8)	-	-
Disposals	(0.3)	(0.1)	-	-
Disposal of subsidiary undertakings	-	(0.2)	-	-
At 31 December	61.0	48.9	15.3	13.4
Net book value at 1 January	19.3	17.3	1.1	1.7
Net book value at 31 December	25.9	19.3	2.6	1.1

* The comparative figures have been re-presented due to the re-translation of opening balances of foreign subsidiaries. This has not had any impact on the opening net book values shown above.

In August 2016, assets of SFS were transferred to the Society on integration of financial advice activities of SFS into the Society. Intangible assets within SFS with a net book value of £0.4m were transferred at their carrying value.

The net book value of other intangible assets comprises:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Brands	6.5	5.3	-	-
Customer contracts and relationships	9.9	8.0	-	-
Computer software and databases	9.5	6.0	2.6	1.1
	25.9	19.3	2.6	1.1

20. Other assets

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Trade receivables	32.8	29.8	1.2	0.5
Prepayments and accrued income	24.3	20.4	9.7	7.5
Undrawn advances to debt factoring clients	37.8	40.6	-	-
Contingent consideration	9.9	-	-	-
Other	2.9	2.8	0.4	0.8
	107.7	93.6	11.3	8.8

In August 2016, on integration of financial advice activities of SFS into the Society, other assets of £2.6m held by SFS were transferred to the Society at their carrying value. These comprised trade receivables (£0.7m) and prepayments and accrued income (£1.9m).

Undrawn advances to debt factoring clients represent the difference between the total of outstanding debts purchased by the Group under recourse agreements and the amounts already advanced to clients in relation to those debts, net of any charges and adjustments. Once recovered, these amounts are paid over to the clients in question and as a result a corresponding creditor is included within other liabilities (see note 25).

The Group has £1.7m (2015: £1.3m) of trade receivables that are individually impaired and £13.8m (2015: £12.9m) of trade receivables that are past due but not individually impaired. The Society has £0.1m of trade receivables that are individually impaired (2015: £nil) and £0.4m of trade receivables that are past due but not individually impaired (2015: £nil).

21. Shares

	Group and Society 2016 £m	Group and Society 2015 £m
Held by individuals	13,967.8	12,694.8
Other shares	125.7	113.8
Fair value adjustment for hedged risk	59.0	19.6
	14,152.5	12,828.2

A maturity analysis of shares is included in note 34.

22. Amounts owed to credit institutions

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Amounts owed to subsidiary undertakings	-	-	131.4	170.3
Other	655.3	735.6	655.1	435.6
	655.3	735.6	786.5	605.9

A maturity analysis of amounts owed to credit institutions is included in note 34.

For the year ended 31 December 2015 amounts owed to credit institutions by the Group included £299.8m of external funding facilitated through the Group's special purpose vehicle Beckindale No. 2 Limited. This was secured on debt securities and loans and advances to customers originated by the Group. There is no external funding facilitated through Beckindale No. 2 Limited at 31 December 2016 following repayment of the secured funding transaction during 2016.

At 31 December 2016, £26.7m (2015: £31.1m) of cash collateral has been received by the Group and £34.3m (2015: £34.8m) of cash collateral has been received by the Society against derivative contracts.

Notes to the Accounts *(continued)*

23. Amounts owed to other customers

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Amounts owed to subsidiary undertakings	-	-	794.1	1,267.6
Other	1,493.0	1,389.3	260.0	308.6
Fair value adjustment for hedged risk	0.2	0.2	-	-
	1,493.2	1,389.5	1,054.1	1,576.2

A maturity analysis of amounts owed to other customers is included in note 34.

Amounts owed to subsidiary undertakings include fair value adjustments of £3.6m (2015: £3.8m) which relates to deemed loans from Darrowby No. 2 plc (£0.2m; 2015: £1.0m), Darrowby No. 3 plc (£2.7m; 2015: £1.2m) and Darrowby No. 4 plc (£0.7m; 2015: £nil) as a result of applying the fair value option on deemed loans from the Group's special purpose vehicles, in line with the accounting policy outlined in note 1e). The 2015 comparative figure also included fair value adjustments of £1.6m which related to deemed loans from Darrowby No. 1 plc, which was liquidated during 2016.

24. Debt securities in issue

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Certificates of deposit	14.6	21.1	14.6	21.1
Floating rate notes	519.6	587.7	-	0.1
	534.2	608.8	14.6	21.2

A maturity analysis of debt securities in issue is included in note 34.

Group debt securities in issue include £519.6m (2015: £587.6m) of funding secured on certain loans and advances to customers through the Group's securitisation vehicles Darrowby No. 2 plc, Darrowby No. 3 plc and Darrowby No. 4 plc. The 2015 figure included £160.0m of funding secured on loans and advances to customers through the Group's securitisation vehicle Darrowby No. 1 plc, which was liquidated during 2016.

25. Other liabilities

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Trade payables	5.4	4.9	0.9	1.2
Tax deducted at source from interest paid	-	2.6	-	2.6
Fair value of put option obligation	11.7	11.9	-	-
Fair value of liability of subsidiary management incentive scheme	21.4	30.4	-	-
Debt factoring liabilities	37.8	40.6	-	-
VAT and employment taxes	15.9	15.1	2.0	1.7
Other	14.0	34.3	2.5	10.8
	106.2	139.8	5.4	16.3

In August 2016, on integration of financial advice activities of SFS within the Society, other liabilities of £0.5m held by SFS were transferred to the Society at their carrying value.

The debt factoring liabilities of £37.8m (2015: £40.6m) represent the difference between the total of outstanding debts purchased by the Group under recourse agreements and the amounts already advanced to clients in relation to those debts, net of any charges and adjustments. Once recovered, these amounts are paid over to the clients in question.

Put option obligation

The movement in the fair value of the put option obligation is summarised below:

	Group 2016 £m	Group 2015 £m
At 1 January	11.9	7.5
Unwind of the discount factor	0.3	0.3
Revaluation of market values and future exercise dates	(0.9)	(0.3)
Exercise of put options by non-controlling shareholders	-	(0.9)
Acquisition of subsidiaries during the year	0.4	5.6
Disposal of subsidiary undertakings	-	(0.3)
At 31 December	11.7	11.9

In February 2016, Connells purchased Rook Matthews Sayer (RMS), as described in note 16. Put options were issued to the 5% non-controlling shareholder of RMS, resulting in the recognition of a put option liability of £0.4m.

Subsidiary management incentive scheme

Six members of Connells Limited senior management purchased equity shares in that company in 2012 and 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. Four of the six options remain outstanding at the 2016 year end (2015: five of six), with the maximum option length being eight years from 31 December 2016. 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 2016 £m	Group 2015 £m
At 1 January	30.4	14.5
Exercise of share options during the year	(10.0)	-
Movement in fair value of the scheme recognised in the Income Statement	1.0	15.9
At 31 December	21.4	30.4

26. Provisions for liabilities

The movements in provisions for liabilities during the year were as follows:

Group 2016	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks / rebates £m	Survey and valuation claims £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	4.7	3.6	5.1	10.3	2.2	0.6	26.5
Charge for the year	-	2.1	5.8	0.1	2.9	-	10.9
Acquisition of subsidiary undertakings and business assets	-	-	-	-	-	0.2	0.2
Utilised during the year	(0.4)	(3.4)	(5.5)	(3.7)	(0.9)	(0.4)	(14.3)
At 31 December	4.3	2.3	5.4	6.7	4.2	0.4	23.3

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26. Provisions for liabilities *(continued)*

Group 2015	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks / rebates £m	Survey and valuation claims £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	4.6	4.3	5.4	13.0	3.4	1.7	32.4
Charge / (credit) for the year	0.6	7.4	3.5	(0.1)	1.0	(0.6)	11.8
Utilised during the year	(0.5)	(8.0)	(3.8)	(2.7)	(0.9)	(0.5)	(16.4)
Reclassified from other liabilities	-	-	-	0.1	-	-	0.1
Disposal of subsidiaries	-	(0.1)	-	-	(1.3)	-	(1.4)
At 31 December	4.7	3.6	5.1	10.3	2.2	0.6	26.5

Society 2016	**Provision for the costs of surplus properties £m**	**FSCS £m**	**Commission clawbacks / rebates £m**	**Customer compensation £m**	**Other provisions £m**	**Total £m**
At 1 January	0.5	3.6	-	1.8	0.2	6.1
Charge for the year	0.1	2.1	0.1	2.5	-	4.8
Transfer of provisions for liabilities on integration of subsidiary undertaking	-	-	0.5	-	-	0.5
Utilised during the year	(0.1)	(3.4)	(0.1)	(0.7)	-	(4.3)
At 31 December	0.5	2.3	0.5	3.6	0.2	7.1

In August 2016, on the integration of financial advice activities of SFS into the Society, provisions for liabilities of £0.5m held by SFS were transferred to the Society at their carrying value.

Society 2015	Provision for the costs of surplus properties £m	FSCS £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	0.6	4.3	1.6	0.2	6.7
Charge for the year	-	6.7	0.8	-	7.5
Utilised during the year	(0.1)	(7.4)	(0.6)	-	(8.1)
At 31 December	0.5	3.6	1.8	0.2	6.1

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.

Financial Services Compensation Scheme

The Society and certain subsidiaries pay levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it as described in note 32b).

In previous years the Society's levy comprised a levy for annual interest costs and a capital levy which was being charged over a three year period. The third and final payment for the Society's share of the capital levy was paid in 2015. The £2.3m provision at 31 December 2016 relates to the estimated interest levy for scheme year 2016/2017, due to be invoiced in August 2017. The Society's provision does not include interest levies for any further scheme years nor capital levies which may arise from future claims made under the scheme.

Commission clawbacks / rebates

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 provided by the Connells group 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 £2.8m (2015: £1.7m). This includes provisions made during 2016 following new rules and guidance issued by the FCA during the year following the recent Supreme Court's decision in the case of *Plevin v Paragon Personal Finance Limited*.

The Group has experienced a slight fall in PPI complaint levels and, despite uphold rates remaining low, 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 three years.

27. Deferred tax

Deferred tax is calculated on temporary differences under the Statement of Financial Position liability method, using the enacted tax rate expected to apply in the relevant tax jurisdiction when these differences reverse, which is 25% (2015: 26%) for the Society and 17% (2015: 18%) for most other Group companies.

The movement in deferred tax during the year was as follows:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
At 1 January	10.3	9.6	8.0	6.7
Income Statement credit (note 10)	1.9	2.1	0.4	0.5
Items taken directly to Other Comprehensive Income	6.7	(1.0)	2.3	0.8
Acquired on acquisition of subsidiaries	(0.7)	(0.3)	-	-
Disposal of subsidiaries	-	(0.1)	-	-
At 31 December	18.2	10.3	10.7	8.0

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

Deferred tax assets	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Fixed asset temporary differences	0.4	0.7	-	-
Pension obligations	23.2	14.1	13.5	7.9
Provisions	1.5	2.1	0.2	0.5
Corporation tax losses	0.2	0.1	-	-
Derivatives and loans	-	1.2	-	1.2
Other	5.1	3.4	-	-
	30.4	21.6	13.7	9.6

27. Deferred tax *(continued)*

Deferred tax liabilities	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Fixed asset temporary differences	1.2	1.8	0.8	1.6
Derivatives and loans	2.6	0.7	2.2	-
Available-for-sale financial assets	5.7	6.6	-	-
Other	2.7	2.2	-	-
	12.2	11.3	3.0	1.6
Net deferred tax asset	18.2	10.3	10.7	8.0

The deferred tax credit in the Income Statement comprises the following:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Fixed asset temporary differences	(1.0)	(0.1)	(0.5)	(0.1)
Provisions	0.6	(0.3)	0.4	(0.4)
Other	(1.5)	(1.7)	(0.3)	-
	(1.9)	(2.1)	(0.4)	(0.5)

Unrecognised deferred tax relating to trading losses carried forward at 31 December 2016 amounts to £5.0m (2015: £4.3m).

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.

28. 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 £7.9m for the Group (2015: £7.0m) and £4.3m for the Society (2015: £3.2m).

Defined benefit schemes

On 31 January 2016, the two schemes sponsored by the Society, the Skipton and the Scarborough schemes, were merged into a new pension scheme, the Skipton (2015) Scheme, and the two former schemes were wound up during 2016.

At the date of the merger, the assets and liabilities of the two merged schemes transferred to the new scheme. This transfer took place at fair value such that no settlement gain or loss is reported.

As part of the merger, members' benefits in the two existing pension schemes were preserved. In addition, as part of the pension scheme merger and wind up, legislation allows members with small pension pots to take their benefits as a cash lump sum which resulted in a small settlement loss (of less than £0.1m). The Skipton (2015) Scheme was open to accrual for one day, on 31 January 2016.

Following the merger of the pension schemes, the Group sponsors two funded defined benefit arrangements:

- The Skipton (2015) Group Pension Scheme (the 'Skipton (2015) Scheme'). As noted above, this scheme was established on 31 January 2016 by the merger of two existing schemes:
  - The Skipton Building Society Pension & Life Assurance Scheme (the 'Old Skipton Scheme'); and
  - The Scarborough Building Society Group Pension and Death Benefits Scheme (the 'Scarborough Scheme').
- The Connells (2014) Group Pension Scheme (the 'Connells (2014) 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 – 794 members
- Connells (2014) Scheme – 1,148 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 both 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. As part of the merger of the two former pension schemes into the Skipton (2015) Scheme, members' benefits in the former pension schemes were preserved, hence there are two separate benefit sections 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 employed by SFS, 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.

The schemes are all now 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 and the Old Skipton Scheme on 1 January 2010. The Skipton (2015) Scheme was open to accrual for one day, on 31 January 2016. 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.

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	31 March 2014	(11.2)	7 years	0.6
Scarborough	31 December 2013	(8.1)	7 years	0.8
Connells (2014)	30 April 2014	(25.7)	7 years	2.7

The first actuarial valuation for the Skipton (2015) Scheme will take place as at 31 December 2016 and is not expected to be concluded until the end of 2017, as such there is no information that can be disclosed in the table above in respect of the Skipton (2015) Scheme and therefore information has been provided for the Old Skipton and Scarborough schemes instead. However as part of the negotiations in respect of the merger, interim arrangements for the Skipton (2015) Scheme have been agreed which will see annual contributions of £0.6m.

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.

For the purposes of IAS 19, the actuarial valuations, which were carried out by a qualified independent actuary, have been updated on an approximate basis to 31 December 2016. There have been no changes in the valuation methodology adopted for this year's disclosures compared to the previous year's disclosures.

The aggregate costs of the two schemes are recognised in accordance with IAS 19. Whilst the Society is the principal employer for the Skipton (2015) Scheme, current and former employees of other Group companies are also members of this scheme and the Society makes recharges to these subsidiaries in relation to deficit contributions under an internal agreement based on the proportion of active members who were employees at the time of closure to future accrual. These

Notes to the Accounts *(continued)*

28. Pensions *(continued)*

companies were previously participating employers in the Old Skipton Scheme and account for the pension scheme on the basis of the deficit contributions paid by that company. The Society accounts for the difference between the aggregate IAS 19 costs of the scheme and the aggregate contributions paid by the other entities.

The main financial assumptions used in the actuarial valuation are as follows:

	Group and Society	
	2016	2015
	%	%
Retail price inflation (RPI)	**3.35**	3.13
Consumer price inflation (CPI)	**2.35**	2.13
Discount rate	**2.65**	3.83
Increases to pension payment:		
in line with RPI, subject to a max of 5% pa	**3.26**	3.07
in line with RPI, subject to a min of 3% and max of 5% pa	**3.67**	3.57
in line with RPI, subject to a max of 2.5% pa	**2.26**	2.19
in line with CPI, subject to a max of 5% pa	**2.36**	2.16
in line with CPI, subject to a min of 3% and max of 5% pa	**3.29**	3.23
in line with CPI, subject to a max of 2.5% pa	**1.88**	1.77
Rate of increase for deferred pensions (in line with CPI, subject to a max of 5% pa)	**2.35**	2.13
Allowance for commutation of pension for cash at retirement	**100% of post A day maximum**	100% of post A day maximum

All the schemes' deferred pensions now 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 2016, 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 2016 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)	
	2016	2015
Male retiring in the current year	**23.1**	23.0
Female retiring in the current year	**24.2**	24.1
Male retiring in 15 years' time	**24.0**	23.9
Female retiring in 15 years' time	**25.3**	25.2

The table below shows the net pension liability recognised within the Statement of Financial Position:

	Group 2016	Group 2015	Society 2016	Society 2015
	£m	£m	**£m**	£m
Fair value of plan assets	**168.9**	163.2	**94.0**	87.8
Present value of defined benefit obligations	**(279.8)**	(228.4)	**(147.8)**	(117.8)
Net pension liability	**(110.9)**	(65.2)	**(53.8)**	(30.0)

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. None of the schemes are in surplus as at 31 December 2016.

The Group has reviewed the guidance provided by IFRIC 14 and has concluded that it is not necessary to make any adjustments to the IAS 19 figures in respect of an asset ceiling or minimum funding requirement as at 31 December 2016. As the schemes remain in deficit, the asset ceiling has no impact and therefore no reconciliation is required.

The table below sets out a reconciliation of the present value of the defined benefit obligation for the year:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
At 1 January	228.4	244.8	117.8	121.6
Current service cost	-	-	-	-
Past service cost	-	-	-	-
Interest expense	8.6	8.4	4.4	4.3
Contributions by employees	-	-	-	-
Remeasurement losses / (gains) arising from changes in:				
Scheme experience	-	-	-	-
Demographic assumptions	-	(1.8)	-	(0.9)
Financial assumptions	54.5	(8.5)	29.3	(4.5)
Actual benefit payments	(8.3)	(14.5)	(3.1)	(2.7)
Liabilities extinguished on settlements	(3.4)	-	(0.6)	-
At 31 December	279.8	228.4	147.8	117.8

As outlined above, on 31 January 2016, the two schemes sponsored by the Society, the Old Skipton and Scarborough schemes, were merged into a new pension scheme, the Skipton (2015) Scheme, and the two former schemes wound up.

At the date of the merger, the assets and liabilities of the two merged schemes transferred to the new scheme. This transfer took place at fair value such that no settlement gain or loss is reported.

As part of the pension scheme merger and wind up, legislation allows members with small pension pots to take their benefits as a cash lump sum and this resulted in no gain or loss on settlement as shown below:

	Group 2016 £m	Group 2015 £m
Assets discharged on wind up	(0.6)	-
Liabilities discharged on wind up	0.6	-
Settlement gain / loss on wind up	-	-

The Connells (2014) Scheme undertook a flexible benefit offer during the year which provided transfer values or early retirement within the scheme to certain members. Transfer values totalling £2.7m (2015: £nil) were paid out of the scheme and the liability extinguished was £2.8m (2015: £nil). This resulted in a settlement gain of £0.1m (2015: £nil).

There have been no other settlements, plan amendments or curtailments in the period.

28. Pensions *(continued)*

The table below sets out the reconciliation of the fair value of scheme assets for the year:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
At 1 January	163.2	171.8	87.8	88.0
Interest income	6.2	5.9	3.4	3.0
Return on plan assets (excluding amounts included in interest income)	4.5	(4.6)	2.6	(2.6)
Contributions by employer	6.6	4.6	3.9	2.1
Contributions by employees	-	-	-	-
Benefits paid	(8.3)	(14.5)	(3.1)	(2.7)
Expenses paid by the schemes	-	-	-	-
Assets distributed on settlements	(3.3)	-	(0.6)	-
At 31 December	168.9	163.2	94.0	87.8

The actual return on the scheme assets, including interest income on plan assets, over the year ended 31 December 2016 was as follows:

- Group £10.7m (2015: £1.3m)
- Society £6.0m (2015: £0.4m)

The table below sets out the fair value of the scheme assets by each major category:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
UK equities	-	-	-	-
Diversified growth fund [1]	145.6	149.8	81.7	81.7
Property	-	-	-	-
Corporate bonds	-	-	-	-
Fixed interest bonds	-	-	-	-
Index linked bonds	-	-	-	-
Liability driven investments [2]	22.9	12.7	12.3	6.0
Cash	0.4	0.7	-	0.1
	168.9	163.2	94.0	87.8

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 in an active market 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 instruments held in these 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.

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.

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.

28. Pensions *(continued)*

The table below sets out the amounts which have been recognised within the Income Statement. The service costs, settlements for the year and administrative expenses are recognised in 'Administrative expenses', whilst the net interest expense is recognised in 'Other income'.

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Service cost:				
Current service cost	-	-	-	-
Past service cost	-	-	-	-
Gains on settlements	(0.1)	-	-	-
Administrative expenses	-	-	-	-
Net interest expense	2.4	2.5	1.0	1.3
Total recognised in Income Statement	2.3	2.5	1.0	1.3

The table below sets out the remeasurements of retirement benefit obligations which have been recognised within the Statement of Comprehensive Income:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Remeasurements of retirement benefit obligations:				
Actuarial (losses) / gains arising from:				
Experience adjustments	-	-	-	-
Demographic assumptions	-	1.8	-	0.9
Financial assumptions	(54.5)	8.5	(29.3)	4.5
Return on plan assets (excluding amounts included in net interest expense)	4.5	(4.6)	2.6	(2.6)
Total amount recognised in Other Comprehensive Income	(50.0)	5.7	(26.7)	2.8

The table below sets out the Group's best estimate of the aggregate contributions expected to be paid to the schemes during the year ending 31 December 2017:

	Group 2017 £m	Society 2017 £m
Estimated employer contributions	3.3	0.6
Estimated employee contributions	-	-
Estimated total contributions	3.3	0.6

29. Subordinated liabilities

	Group and Society 2016 £m	2015 £m
Subordinated fixed rate notes 2017	10.1	10.1
Subordinated fixed rate notes 2018	35.5	35.5
Subordinated fixed rate notes 2022	31.2	31.2
	76.8	76.8
Unamortised discount on issue	(0.2)	(0.2)
Fair value adjustment for hedged risk	0.6	1.9
	77.2	78.5

All the fixed rate notes are denominated in Sterling. Coupons are paid on a fixed basis annually, except for the notes repayable in 2017 where coupons are paid on a fixed basis semi-annually.

All the notes are repayable at maturity or earlier, at the option of the Society. In each case the option for early repayment may only be exercised with the prior consent of the Prudential Regulation Authority (PRA). The note holders' rights are subordinate to those of depositors and other creditors.

Amounts shown in the above table represent the nominal value plus accrued interest, except for 'Unamortised discount on issue' which is the difference between face values and current book values.

30. Subscribed capital

	Group and Society 2016 £m	2015 £m
6.875% Permanent Interest Bearing Shares	50.3	48.8
8.500% Permanent Interest Bearing Shares	15.3	15.6
12.875% Permanent Interest Bearing Shares	26.3	26.3
	91.9	90.7
Fair value adjustment for hedged risk	0.7	2.8
	92.6	93.5

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 Permanent Interest Bearing Shares are undated and as such cannot be repaid by the Society, with the exception of the 6.875% Permanent Interest Bearing Shares, which the Society can elect to repay from April 2017 and on which the Society has given notice it shall repay in line with the market notice issued on 22 February 2017.

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

	Group					
	2016			2015		
	Before-tax amount	Tax (expense) / benefit	Net-of-tax amount	Before-tax amount	Tax (expense) / benefit	Net-of-tax amount
	£m	£m	£m	£m	£m	£m
Available-for-sale financial assets	0.3	-	0.3	5.7	(0.4)	5.3
Cash flow hedges	8.7	(2.2)	6.5	2.3	(0.2)	2.1
Remeasurements of defined benefit obligations	(50.0)	10.2	(39.8)	5.7	-	5.7
Translation of foreign operations	2.2	-	2.2	(0.9)	-	(0.9)
Movement in reserves attributable to non-controlling interests	0.9	-	0.9	(0.3)	-	(0.3)
Other comprehensive income	(37.9)	8.0	(29.9)	12.5	(0.6)	11.9

	Society					
	2016			2015		
	Before-tax amount	Tax (expense) / benefit	Net-of-tax amount	Before-tax amount	Tax benefit / (expense)	Net-of-tax amount
	£m	£m	£m	£m	£m	£m
Available-for-sale financial assets	3.4	(0.9)	2.5	(1.4)	0.3	(1.1)
Cash flow hedges	8.7	(2.2)	6.5	2.3	(0.2)	2.1
Remeasurements of defined benefit obligations	(26.7)	6.6	(20.1)	2.8	1.3	4.1
Other comprehensive income	(14.6)	3.5	(11.1)	3.7	1.4	5.1

32. Other financial commitments and contingent liabilities

a) The Society has given a legal undertaking agreeing to discharge the liabilities of Skipton International Limited (SIL) insofar as it is unable to discharge them out of its own assets whilst it remains a subsidiary of Skipton Building Society. The Society intends to remove this undertaking during 2017, which has been agreed with the Skipton International board of directors and communicated to the Guernsey Financial Services Commission as well as SIL's customers. Additionally, the Society has confirmed it will provide continuing support to those subsidiary undertakings that have net liabilities at 31 December 2016 or which rely on it for ongoing funding.

b) The Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. Following the failure of a number of financial institutions, the FSCS has raised borrowings from the UK Government to cover compensation in relation to protected deposits. The FSCS raises levies against financial institutions to cover the interest cost of the borrowings from the UK Government and charges ongoing management expenses as part of this levy.

   As the ongoing management expenses and interest costs are subject to change, and the Society is potentially exposed to future levies from further capital losses, the Society's ultimate FSCS contribution is uncertain.

c) Total commitments under non-cancellable operating leases are as follows:

Group	2016		2015	
	Land and buildings	Other	Land and buildings	Other
	£m	£m	£m	£m
Amounts falling due:				
Within one year	13.7	5.1	12.9	2.1
Within two to five years inclusive	34.3	2.2	33.1	2.2
Over five years	21.4	-	22.8	-
	69.4	7.3	68.8	4.3

Society	2016		2015	
	Land and buildings	Other	Land and buildings	Other
	£m	£m	£m	£m
Amounts falling due:				
Within one year	3.5	0.9	3.7	1.3
Within two to five years inclusive	8.7	0.3	10.1	1.3
Over five years	4.2	-	6.9	-
	16.4	1.2	20.7	2.6

33. Financial instruments

The Group uses financial instruments to invest liquid asset balances and raise wholesale funding. The Group also 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.

Types of derivatives

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

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

Activity	Risk	Type of hedge
Fixed rate savings products, funding activities, fixed rate mortgage lending and asset investment	Sensitivity to changes in interest rates	Interest rate swaps
Equity-linked investment products	Sensitivity to changes in equity indices	Equity-linked interest rate swaps
Equity release mortgages	Interest rates linked to retail price inflation	Index swaps

Controls over financial instruments

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).

The accounting policies for derivatives are described in note 1d) to the Accounts.

Hedge accounting

A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk

33. Financial instruments *(continued)*

and could affect profit or loss. For each main class of fair value, hedge documentation is produced in accordance with the requirements of IAS 39.

A cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. Cash flow hedge accounting is used primarily for interest rate swaps taken out to pre-hedge fixed mortgage completions and fixed savings products prior to receipt of funds. The weighted average maturity of interest rate swaps being cash flow hedged at 31 December 2016 is approximately 2.6 years (2015: 2.4 years).

Some ineffectiveness has occurred on those fair value and cash flow hedges for which hedge accounting has been achieved, resulting in a charge to the Income Statement of £5.2m (2015: £1.7m credit). As outlined in note 37b), these figures include ineffectiveness arising from swaps that are used to hedge our equity release mortgage book, and such ineffectiveness resulted in a £7.8m charge for the year (2015: £1.3m credit).

34. 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 by short term retail customer balances. Mortgages typically have a contractual maturity date of around 25 years but in practice are frequently repaid early; conversely retail deposits, nominally repayable on demand or with short notice periods, actually 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 prudent 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 management of the Group's liquidity is 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 – where, as noted above, the Group models how far its liquid asset holdings would fall under a number of different stress scenarios.

The table below analyses 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	2016					
	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	1,212.7	-	-	-	-	**1,212.7**
Loans and advances to credit institutions	400.2	6.3	0.1	3.0	-	**409.6**
Debt securities	-	233.0	130.7	464.5	226.9	**1,055.1**
Derivative financial instruments	-	2.3	15.5	91.5	6.8	**116.1**
Loans and advances to customers	77.3	38.0	89.9	513.3	15,063.1	**15,781.6**
Equity share investments	-	-	-	-	36.4	**36.4**
Trade receivables	13.8	19.0	-	-	-	**32.8**
Contingent consideration	-	-	-	8.2	1.7	**9.9**
Total financial assets	**1,704.0**	**298.6**	**236.2**	**1,080.5**	**15,334.9**	**18,654.2**
Liabilities						
Shares	4,041.1	7,412.4	1,297.6	1,400.3	1.1	**14,152.5**
Amounts owed to credit institutions	36.6	274.1	21.5	323.1	-	**655.3**
Amounts owed to other customers	247.2	317.6	757.8	169.3	1.3	**1,493.2**
Debt securities in issue	-	123.3	13.5	397.4	-	**534.2**
Derivative financial instruments	-	3.7	24.5	119.3	264.8	**412.3**
Trade payables	-	5.4	-	-	-	**5.4**
Fair value of put option obligation	-	0.6	5.0	6.1	-	**11.7**
Subordinated liabilities	-	10.1	-	35.4	31.7	**77.2**
Subscribed capital	-	-	-	-	92.6	**92.6**
Total financial liabilities	**4,324.9**	**8,147.2**	**2,119.9**	**2,450.9**	**391.5**	**17,434.4**
Net liquidity gap	**(2,620.9)**	**(7,848.6)**	**(1,883.7)**	**(1,370.4)**	**14,943.4**	**1,219.8**

34. Liquidity risk *(continued)*

Group	2015					
	Repayable on demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Assets						
Cash in hand and balances with the Bank of England	1,180.8	-	-	-	-	1,180.8
Loans and advances to credit institutions	297.5	35.1	-	8.6	11.4	352.6
Debt securities	-	350.3	143.5	452.7	157.9	1,104.4
Derivative financial instruments	-	6.8	9.3	71.3	7.7	95.1
Loans and advances to customers	74.7	26.6	72.4	525.5	13,664.0	14,363.2
Equity share investments	-	-	-	-	40.9	40.9
Trade receivables	12.9	16.9	-	-	-	29.8
Total financial assets	1,565.9	435.7	225.2	1,058.1	13,881.9	17,166.8
Liabilities						
Shares	3,883.0	6,290.3	1,214.3	1,425.1	15.5	12,828.2
Amounts owed to credit institutions	35.7	256.2	107.9	335.8	-	735.6
Amounts owed to other customers	230.3	378.8	601.5	178.9	-	1,389.5
Debt securities in issue	-	170.4	11.5	426.9	-	608.8
Derivative financial instruments	-	4.7	9.7	75.4	207.1	296.9
Trade payables	-	4.9	-	-	-	4.9
Fair value of put option obligation	-	0.6	5.7	5.6	-	11.9
Subordinated liabilities	-	-	-	45.5	33.0	78.5
Subscribed capital	-	-	-	-	93.5	93.5
Total financial liabilities	4,149.0	7,105.9	1,950.6	2,493.2	349.1	16,047.8
Net liquidity gap	(2,583.1)	(6,670.2)	(1,725.4)	(1,435.1)	13,532.8	1,119.0

Debt securities in issue include £519.6m (2015: £587.6m) of funding obtained through the Group's securitisation programme carried out through Darrowby No. 1 plc (which was liquidated during the year), Darrowby No. 2 plc, Darrowby No. 3 plc and Darrowby No. 4 plc. The final maturity dates of these notes are significantly out into the future; however, the Group has an option to exercise call options to repurchase the outstanding notes at dates which will occur 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			**2016**		
Liabilities	**Up to 3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Shares	11,454.4	1,308.0	1,471.8	1.1	**14,235.3**
Amounts owed to credit institutions, other customers and debt securities in issue	999.5	802.3	913.8	1.3	**2,716.9**
Derivative financial instruments	20.4	61.4	147.2	235.5	**464.5**
Trade payables	5.4	-	-	-	**5.4**
Fair value of put option obligation	0.6	5.0	6.7	-	**12.3**
Subordinated liabilities	10.3	2.4	43.6	32.0	**88.3**
Subscribed capital	1.6	6.3	31.7	79.3	**118.9**
	12,492.2	**2,185.4**	**2,614.8**	**349.2**	**17,641.6**

Group			2015		
Liabilities	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	10,174.1	1,227.6	1,540.9	16.8	12,959.4
Amounts owed to credit institutions, other customers and debt securities in issue	1,087.8	731.6	966.1	-	2,785.5
Derivative financial instruments	19.6	47.7	98.7	226.7	392.7
Trade payables	4.9	-	-	-	4.9
Fair value of put option obligation	0.6	5.8	6.2	-	12.6
Subordinated liabilities	0.3	2.7	54.7	34.1	91.8
Subscribed capital	1.6	6.3	31.7	79.3	118.9
	11,288.9	2,021.7	2,698.3	356.9	16,365.8

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 under the tables on page 138 are exercised.

Society			**2016**		
Liabilities	**Up to 3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Shares	11,454.4	1,308.0	1,471.8	1.1	**14,235.3**
Amounts owed to credit institutions, other customers and debt securities in issue	823.9	180.9	880.2	-	**1,885.0**
Derivative financial instruments	20.8	63.3	152.1	235.6	**471.8**
Trade payables	0.9	-	-	-	**0.9**
Subordinated liabilities	10.3	2.4	43.6	32.0	**88.3**
Subscribed capital	1.6	6.3	31.7	79.3	**118.9**
	12,311.9	**1,560.9**	**2,579.4**	**348.0**	**16,800.2**

34. Liquidity risk *(continued)*

Society	2015				
	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities	£m	£m	£m	£m	£m
Shares	10,174.1	1,227.6	1,540.9	16.8	12,959.4
Amounts owed to credit institutions, other customers and debt securities in issue	1,083.6	316.5	834.8	-	2,234.9
Derivative financial instruments	18.2	48.3	102.2	226.8	395.5
Trade payables	1.2	-	-	-	1.2
Subordinated liabilities	0.3	2.7	54.7	34.1	91.8
Subscribed capital	1.6	6.3	31.7	79.3	118.9
	11,279.0	1,601.4	2,564.3	357.0	15,801.7

Amounts owed to other customers in the tables above include deemed loans from the Group's securitisation vehicles Darrowby No. 2 plc, Darrowby No. 3 plc and Darrowby No. 4 plc, which arise from the funding transactions carried out through these entities. The undiscounted gross contractual cash flows arising on these loans have been calculated on the assumption that the call options referred to under the tables on page 138 are exercised. The 2015 comparatives also included deemed loans from the Group's securitisation vehicle Darrowby No. 1 plc, which was liquidated in 2016.

35. 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), foreign currency risk and equity 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, foreign currency risk and equity 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 2016	**Average 2016**	**High 2016**	**Low 2016**	As at 31 December 2015
	£m	**£m**	**£m**	**£m**	£m
Static earnings-at-risk	**3.2**	**5.2**	**8.6**	**2.2**	9.6
Historical value-at-risk	**1.5**	**1.5**	**2.6**	**0.5**	0.4
2% parallel interest rate shift	**9.5**	**5.2**	**9.9**	**0.7**	0.9

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

Both at 31 December 2016 and during the year, the Society and its subsidiaries had no material direct exposure to foreign currency exchange fluctuations. 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 investments in its subsidiary undertakings Jade Software Corporation Limited and Northwest Investments NZ Limited, and its equity share investment in Wynyard Group Limited (however, this investment was fully written down during 2016), 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 2016 are not material.

c) Equity risk

Equity risk is the risk of loss due to movements in equity markets.

The Group holds a 2.7% shareholding in Zoopla Property Group Plc which is listed on the London Stock Exchange. The carrying value of the Group's shareholding in Zoopla, which is equal to the market value and is based on the share price at 31 December 2016, is £36.0m (2015: £40.2m based on a 4.0% shareholding). The Group holds capital to absorb fluctuations in the value of this investment in order to protect its regulatory capital position, whilst the Directors regularly review the Group's strategy for such shareholdings to ensure that members' interests are protected.

The Group also holds a 17.7% stake in Wynyard Group Limited, which is listed on the New Zealand Stock Exchange. During the year Wynyard entered into voluntary administration and the Group's investment in Wynyard was fully impaired to £nil.

d) Other price risk

The Group has a small number of savings products outstanding where the return is dependent on the performance of certain equity markets. Derivative contracts to eliminate this exposure are taken out by the Group that exactly match the terms of the savings products and the market risk on such contracts is therefore fully hedged.

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 no negative equity guarantee provided to customers of the equity release mortgage portfolio, as outlined further on page 158.

36. 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 affect the level of impairment losses.

36. Credit risk *(continued)*

The controlled management of credit risk is critical to the Group's overall strategy and there has been continued investment in the Credit Risk function during the year. 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.

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 £340.8m (2015: £224.9m) is included within loans and advances to customers.
- 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. The total amount of such loans at 31 December 2016 is £1,104.0m (2015: £693.6m).
- The Group holds £980m (2015: £880m) of liquidity representing short dated UK Treasury bills held as a result of FLS drawings. These Treasury bills become an on-balance sheet financial asset once they are converted into cash, and £793.1m of these Treasury bills are held off-balance sheet at the end of 2016 (2015: £631.0m).

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. The performance of these portfolios has continued to improve over the reporting period. The retail lending to customers in the Society includes the equity release mortgage portfolio. The risks relating to the specific nature of this portfolio are discussed in note 37.

Commercial lending to customers and businesses

The Society's commercial mortgage portfolio was closed to new lending in November 2008. We have retained a team of people to manage and monitor the performance of these loans.

Other loans and advances

These principally comprise advances made by our factored debt and invoice discounting business, Skipton Business Finance Limited, which continue to be managed by appropriately skilled teams.

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 whom we have lent to; 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 available-for-sale 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

The table below shows the mix of the Group and Society's loans and advances to customers at the reporting date:

	Group				Society			
	2016		2015		2016		2015	
	£m	%	£m	%	£m	%	£m	%
Total residential mortgages	15,046.5	97.1	13,730.0	96.7	12,906.0	97.5	11,595.3	97.0
Commercial mortgages*	326.7	2.1	354.0	2.5	326.7	2.5	354.0	3.0
Other lending:								
Debt factoring loans	75.4	0.5	71.6	0.5	-	-	-	-
Other loans and advances	49.0	0.3	44.5	0.3	0.1	-	0.2	-
Gross balances	15,497.6	100.0	14,200.1	100.0	13,232.8	100.0	11,949.5	100.0
Impairment provisions	(56.8)		(61.8)		(42.0)		(42.8)	
Fair value adjustment for hedged risk	340.8		224.9		332.6		221.1	
	15,781.6		14,363.2		13,523.4		12,127.8	

* Also known as loans fully secured on land.

i) Residential mortgages

The majority of loans and advances to customers are secured on UK residential properties and are geographically diverse.

The Group's portfolio of loans fully secured on residential property includes lending by the Society, by SIL (which lends in the Channel Islands and in the UK) and the specialist mortgage books of Amber and NYM (closed to new lending since 2008). It also includes the equity release mortgage portfolio. The credit risk appetite explicitly considers geographic regions to manage concentration risk.

The tables below provide further information on the types of lending and geographical split.

Lending analysis	Group				Society			
	2016		2015		2016		2015	
	£m	%	£m	%	£m	%	£m	%
Prime:								
Residential	11,299.4	75.2	10,177.1	74.2	10,332.9	80.1	9,235.0	79.6
Buy-to-let	2,617.8	17.4	2,323.1	16.9	2,226.3	17.3	1,998.8	17.2
Self build	52.4	0.3	58.4	0.4	15.7	0.1	19.3	0.2
Fast track	56.8	0.4	69.2	0.5	56.8	0.4	69.2	0.6
Self certified	500.4	3.3	555.9	4.0	-	-	-	-
Sub-prime:								
Residential	49.4	0.3	55.3	0.4	-	-	-	-
Buy-to-let	40.6	0.3	48.3	0.4	-	-	-	-
Self build	0.5	-	0.5	-	-	-	-	-
Self certified	154.9	1.0	169.2	1.2	-	-	-	-
Equity Release	274.3	1.8	273.0	2.0	274.3	2.1	273.0	2.4
	15,046.5	100.0	13,730.0	100.0	12,906.0	100.0	11,595.3	100.0

Sub-prime mortgages in the table above are defined as loans to borrowers that typically had weakened credit histories at the time the loan was advanced.

36. Credit risk *(continued)*

Geographical analysis	Group				Society			
	2016		2015 Re-presented*		2016		2015 Re-presented*	
	£m	%	£m	%	£m	%	£m	%
North	585.8	3.9	498.2	3.6	546.5	4.2	457.4	3.9
Yorkshire	1,528.1	10.2	1,424.6	10.4	1,439.8	11.2	1,329.8	11.5
East Midlands	1,084.0	7.2	978.0	7.1	1,002.1	7.8	888.3	7.7
East Anglia	548.7	3.6	532.8	3.9	469.3	3.6	446.2	3.8
London	1,884.5	12.5	1,686.2	12.3	1,625.3	12.6	1,447.5	12.5
South East	2,902.0	19.3	2,711.3	19.8	2,625.2	20.3	2,407.7	20.7
South West	1,434.6	9.5	1,249.2	9.1	1,335.2	10.3	1,142.7	9.9
West Midlands	1,037.8	6.9	883.7	6.4	952.5	7.4	791.6	6.8
North West	1,427.6	9.5	1,307.1	9.5	1,279.5	9.9	1,154.6	10.0
Wales	499.5	3.3	417.8	3.0	447.6	3.5	362.3	3.1
Scotland	1,212.8	8.1	1,195.3	8.7	1,159.1	9.0	1,137.8	9.8
Northern Ireland	42.2	0.3	50.1	0.4	23.9	0.2	29.4	0.3
Channel Islands	858.9	5.7	795.7	5.8	-	-	-	-
	15,046.5	100.0	13,730.0	100.0	12,906.0	100.0	11,595.3	100.0

* The 2015 comparative figures have been re-presented due to changes made to the geographical boundaries during 2016 as defined by the Halifax Price Index.

The average indexed loan-to-value information on the Group's residential loan portfolio, together with further information on residential loans by payment due status, is set out below:

Loan-to-value	Neither past due nor individually impaired	Past due but not impaired (up to 3 months)	Individually impaired: Low risk	Individually impaired: High risk	Individually impaired: Possessions	Total
	£m	£m	£m	£m	£m	£m
Group 2016						
<40%	2,250.2	11.1	8.5	-	0.1	2,269.9
40% - 50%	1,742.5	9.6	10.4	-	-	1,762.5
50% - 60%	2,489.0	17.7	14.1	-	0.2	2,521.0
60% - 70%	3,211.1	25.5	27.8	-	-	3,264.4
70% - 80%	2,824.4	20.1	-	23.8	0.3	2,868.6
80% - 90%	1,799.0	15.0	-	16.8	1.6	1,832.4
90% - 100%	433.5	8.6	-	10.1	0.5	452.7
>100%	60.7	4.6	-	7.5	2.2	75.0
	14,810.4	112.2	60.8	58.2	4.9	15,046.5
Group 2015						
<40%	1,978.7	7.9	8.2	-	0.1	1,994.9
40% - 50%	1,458.9	11.0	8.8	-	-	1,478.7
50% - 60%	2,157.4	17.5	16.0	-	-	2,190.9
60% - 70%	2,998.6	23.8	26.1	-	1.1	3,049.6
70% - 80%	2,822.7	28.2	-	32.9	0.2	2,884.0
80% - 90%	1,616.1	22.0	-	25.5	1.3	1,664.9
90% - 100%	354.0	15.4	-	16.0	1.0	386.4
>100%	61.0	5.9	-	11.8	1.9	80.6
	13,447.4	131.7	59.1	86.2	5.6	13,730.0

Loan-to-value	Society 2016					
	Neither past due nor individually impaired	Past due but not impaired (up to 3 months)	Individually impaired			
			Low risk	High risk	Possessions	Total
	£m	£m	£m	£m	£m	£m
<40%	2,100.5	7.5	6.5	-	0.1	**2,114.6**
40% - 50%	1,586.8	5.7	5.7	-	-	**1,598.2**
50% - 60%	2,170.9	6.6	6.7	-	-	**2,184.2**
60% - 70%	2,754.2	7.2	10.2	-	-	**2,771.6**
70% - 80%	2,409.9	5.4	-	8.3	0.3	**2,423.9**
80% - 90%	1,472.3	2.1	-	4.1	-	**1,478.5**
90% - 100%	309.9	0.9	-	2.0	0.1	**312.9**
>100%	18.7	1.1	-	1.0	1.3	**22.1**
	12,823.2	**36.5**	**29.1**	**15.4**	**1.8**	**12,906.0**
	Society 2015					
<40%	1,839.9	4.9	6.7	-	0.1	1,851.6
40% - 50%	1,335.5	6.1	5.0	-	-	1,346.6
50% - 60%	1,911.1	8.0	8.0	-	-	1,927.1
60% - 70%	2,568.6	7.3	7.9	-	0.9	2,584.7
70% - 80%	2,363.1	8.2	-	10.3	0.1	2,381.7
80% - 90%	1,284.0	4.8	-	5.8	-	1,294.6
90% - 100%	180.7	2.1	-	2.2	0.1	185.1
>100%	20.2	0.8	-	1.5	1.4	23.9
	11,503.1	42.2	27.6	19.8	2.6	11,595.3

The indexed loan-to-value is updated on a quarterly basis to reflect changes in the house price index which is applied to the portfolio on a regional basis. The new lending policy is currently a maximum loan-to-value ratio of 90% for residential mortgages and 75% for buy-to-let lending.

At 31 December 2016, the average indexed loan-to-value of Group residential mortgages was 47.9% (2015: 48.5%) and for Society residential mortgages was 46.5% (2015: 46.6%).

Individually impaired accounts in the tables above relate only to accounts in arrears by three months or more. Low risk accounts in the tables above relate to loans with an indexed loan-to-value of less than or equal to 70%. High risk accounts relate to loans with an indexed loan-to-value of more than 70%.

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 balances represent loans against which the Group has taken ownership of properties pending their sale. Possession is generally considered only as a last resort, once all other options for the customer have been exhausted. At 31 December 2016 the balance of residential loans where the property in question has been taken into possession represents less than 0.1% of total outstanding loans for the Group (2015: less than 0.1%) and less than 0.1% of total outstanding loans for the Society (2015: less than 0.1%). 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.

The table below provides further information on residential mortgages at 31 December 2016 by the type of account renegotiations applied to customers over the last two years. For clarity, this table includes all accounts where the terms have been renegotiated during the last two years where the customer has encountered payment difficulties, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms, but does not include accounts where terms have not been renegotiated in the last two years which may still be on renegotiated terms from a previous arrangement prior to this two year period.

36. Credit risk *(continued)*

Group 2016	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	**14,810.4**	3.6	42.2	32.6	11.0	**89.4**	**0.6**
Past due but not impaired:							
Up to 3 months	**112.2**	0.1	14.2	1.5	0.2	**16.0**	**14.3**
	14,922.6	**3.7**	**56.4**	**34.1**	**11.2**	**105.4**	**0.7**
Individually impaired:							
Low risk	**60.8**	0.6	14.5	3.7	0.3	**19.1**	**31.4**
High risk	**58.2**	0.3	10.3	1.4	0.3	**12.3**	**21.1**
Possessions	**4.9**	-	0.5	-	-	**0.5**	**10.2**
	15,046.5	**4.6**	**81.7**	**39.2**	**11.8**	**137.3**	**0.9**
Collective impairment	**(35.0)**	-	(0.3)	-	-	**(0.3)**	**0.9**
Individual impairment	**(11.9)**	-	(2.0)	(0.1)	(0.1)	**(2.2)**	**18.5**
	14,999.6	**4.6**	**79.4**	**39.1**	**11.7**	**134.8**	**0.9**

Group 2015	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	13,447.4	7.1	40.8	37.8	10.2	95.9	0.7
Past due but not impaired:							
Up to 3 months	131.7	1.5	8.7	3.1	0.7	14.0	10.6
	13,579.1	8.6	49.5	40.9	10.9	109.9	0.8
Individually impaired:							
Low risk	59.1	0.4	6.3	4.3	0.9	11.9	20.1
High risk	86.2	0.3	7.7	2.4	1.1	11.5	13.3
Possessions	5.6	-	0.4	0.4	0.1	0.9	16.1
	13,730.0	9.3	63.9	48.0	13.0	134.2	1.0
Collective impairment	(33.0)	-	(0.2)	-	-	(0.2)	0.6
Individual impairment	(16.2)	-	(1.4)	(0.5)	(0.2)	(2.1)	13.0
	13,680.8	9.3	62.3	47.5	12.8	131.9	1.0

Society 2016	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	12,823.2	2.6	32.6	12.5	6.2	53.9	0.4
Past due but not impaired:							
Up to 3 months	36.5	0.1	9.4	0.5	0.1	10.1	27.7
	12,859.7	2.7	42.0	13.0	6.3	64.0	0.5
Individually impaired:							
Low risk	29.1	0.6	9.5	2.9	0.3	13.3	45.7
High risk	15.4	0.3	4.9	0.9	0.3	6.4	41.6
Possessions	1.8	-	0.3	-	-	0.3	16.7
	12,906.0	3.6	56.7	16.8	6.9	84.0	0.7
Collective impairment	(29.8)	-	(0.1)	-	-	(0.1)	0.3
Individual impairment	(2.9)	-	(0.8)	(0.1)	-	(0.9)	31.0
	12,873.3	3.6	55.8	16.7	6.9	83.0	0.6

Society 2015	Total £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	11,503.1	4.9	35.0	16.7	4.1	60.7	0.5
Past due but not impaired:							
Up to 3 months	42.2	0.4	5.7	1.7	0.5	8.3	19.7
	11,545.3	5.3	40.7	18.4	4.6	69.0	0.6
Individually impaired:							
Low risk	27.6	0.4	4.1	2.8	0.8	8.1	29.3
High risk	19.8	0.3	4.7	1.2	0.5	6.7	33.8
Possessions	2.6	-	0.2	0.2	-	0.4	15.4
	11,595.3	6.0	49.7	22.6	5.9	84.2	0.7
Collective impairment	(26.1)	-	(0.1)	-	-	(0.1)	0.4
Individual impairment	(4.7)	-	(0.9)	(0.3)	(0.1)	(1.3)	27.7
	11,564.5	6.0	48.7	22.3	5.8	82.8	0.7

36. Credit risk *(continued)*

The factors considered by the Group in determining the level of individual impairment to be provided are outlined in note 1f) to the Accounts. A collective impairment allowance is made against performing loans where objective evidence indicates it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is calculated by applying various factors to our mortgage portfolio exposures and incorporates the relative credit risk assessment of the account renegotiation categories shown above.

Individual assessments are made of all mortgage loans where objective evidence indicates that losses are likely or the property is in possession or where fraud or negligence has been identified.

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.

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.

Fair value of capped collateral held	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Not individually impaired	14,839.0	13,500.4	12,781.0	11,472.9
Impaired	117.8	143.3	44.2	46.9
Possessions	4.4	5.0	1.5	2.2
	14,961.2	13,648.7	12,826.7	11,522.0
Gross loan balances	15,046.5	13,730.0	12,906.0	11,595.3
Negative equity	85.3	81.3	79.3	73.3

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.

ii) Commercial mortgages

The commercial mortgage portfolio (also known as loans fully secured on land) is currently closed to new business. An analysis of loans secured on commercial property by industry type and geography is provided below:

Industry analysis	Group and Society			
	2016		2015	
	£m	%	£m	%
Leisure and hotels	34.1	10.4	39.1	11.0
Retail	11.4	3.5	12.9	3.6
Nursing / residential homes	15.0	4.6	16.7	4.7
Offices	5.6	1.7	8.9	2.5
Commercial investment and industrial units	251.1	76.9	265.8	75.2
Miscellaneous	9.5	2.9	10.6	3.0
	326.7	100.0	354.0	100.0

Geographical analysis	Group and Society			
	2016		2015 Re-presented*	
	£m	%	£m	%
North	16.3	5.0	17.4	4.9
Yorkshire	27.6	8.4	31.9	9.0
East Midlands	23.7	7.3	25.0	7.1
East Anglia	7.2	2.2	8.4	2.4
London	79.5	24.3	84.0	23.7
South East	62.3	19.1	69.5	19.6
South West	40.2	12.3	43.4	12.3
West Midlands	23.5	7.2	25.2	7.1
North West	32.0	9.8	34.1	9.6
Wales	9.2	2.8	9.7	2.8
Scotland	5.2	1.6	5.4	1.5
	326.7	100.0	354.0	100.0

* The 2015 comparative figures have been re-presented due to changes made to the geographical boundaries during 2016 as defined by the Halifax Price Index.

Loan-to-value information on the Group's commercial loan portfolio, together with further information on commercial mortgages and advances by payment due status, is set out below:

Loan-to-value	Group and Society 2016				
	Neither past due nor individually impaired	Past due but not impaired (up to 3 months)	Individually impaired		
			Low risk	High risk	Total
	£m	£m	£m	£m	£m
<40%	46.6	-	-	-	46.6
40% - 50%	44.1	0.1	0.2	-	44.4
50% - 60%	52.4	-	-	-	52.4
60% - 70%	64.4	1.5	0.3	-	66.2
70% - 80%	33.7	0.9	-	-	34.6
80% - 90%	25.0	0.4	-	-	25.4
90% - 100%	15.0	0.3	-	-	15.3
>100%	36.1	2.4	-	3.3	41.8
	317.3	5.6	0.5	3.3	326.7
	Group and Society 2015				
<40%	45.9	0.7	-	-	46.6
40% - 50%	39.2	0.2	-	-	39.4
50% - 60%	52.4	-	-	-	52.4
60% - 70%	68.1	0.2	0.3	-	68.6
70% - 80%	40.2	2.6	-	-	42.8
80% - 90%	27.5	0.8	-	-	28.3
90% - 100%	17.7	0.2	-	-	17.9
>100%	52.6	4.7	-	0.7	58.0
	343.6	9.4	0.3	0.7	354.0

36. Credit risk *(continued)*

At 31 December 2016 the average loan-to-value of commercial mortgages was 54.1% (2015: 56.1%). The average loan-to-value is based on the latest external valuation of the properties within the portfolio.

Individually impaired accounts in the tables above relate only to accounts in arrears by three months or more. The non-standard nature of the properties within the commercial mortgage portfolio means that there are also a number of loans that are not past due or are past due by less than three months at the reporting date, but where objective evidence indicates that losses are likely (for example, due to significant financial difficulty of the borrower), as described in the Group's accounting policy in note 1f)). A total individual impairment provision of £8.4m (2015: £11.4m), as shown in note 15 to the Accounts, is held against these accounts and the individually impaired loans in the above tables. The total gross balances against which this individual impairment provision has been made are £33.2m (2015: £40.3m).

Low risk accounts in the tables above relate to loans with a loan-to-value of less than or equal to 70%. High risk accounts relate to loans with a loan-to-value of more than 70%.

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 balances represent loans against which the Group has taken ownership of properties pending their sale. Possession is generally considered only as a last resort, once all other options for the customer have been exhausted. All customer accounts are monitored to ensure that these strategies remain appropriate.

The table below provides further information on commercial mortgages at 31 December 2016 by the type of account renegotiations applied to customers over the last two years. For clarity, this table includes all accounts where we have renegotiated terms during the last two years where the customer has encountered payment difficulties, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms, but does not include accounts where terms have not been renegotiated in the last two years which may still be on renegotiated terms from a previous arrangement prior to this two year period.

Group and Society 2016	Total	Capitalisation	Reduced payment	Transfer to interest only	Total renegotiations	
	£m	£m	£m	£m	£m	%
Neither past due nor individually impaired	**317.3**	1.7	0.2	11.0	**12.9**	**4.1**
Past due but not impaired:						
Up to 3 months	**5.6**	-	2.6	1.7	**4.3**	**76.8**
	322.9	**1.7**	**2.8**	**12.7**	**17.2**	**5.3**
Individually impaired:						
Low risk	**0.5**	-	-	0.3	**0.3**	**60.0**
High risk	**3.3**	-	-	2.6	**2.6**	**78.8**
	326.7	**1.7**	**2.8**	**15.6**	**20.1**	**6.2**
Collective impairment	**(0.9)**	-	-	-	**-**	**-**
Individual impairment	**(8.4)**	(0.9)	(0.6)	(2.6)	**(4.1)**	**48.8**
	317.4	**0.8**	**2.2**	**13.0**	**16.0**	**5.0**

Group and Society 2015 Re-presented*	Total	Capitalisation	Reduced payment	Transfer to interest only	Total renegotiations	
	£m	£m	£m	£m	£m	%
Neither past due nor individually impaired	343.6	1.6	-	13.9	15.5	4.5
Past due but not impaired:						
Up to 3 months	9.4	-	-	2.2	2.2	23.4
	353.0	1.6	-	16.1	17.7	5.0
Individually impaired:						
Low risk	0.3	-	-	0.3	0.3	100.0
High risk	0.7	-	0.3	-	0.3	42.9
	354.0	1.6	0.3	16.4	18.3	5.2
Collective impairment	(0.6)	-	-	-	-	-
Individual impairment	(11.4)	(0.8)	(0.1)	(3.3)	(4.2)	36.8
	342.0	0.8	0.2	13.1	14.1	4.1

* The comparative figures above have been re-presented due to a change in the definition of the individual impairment provision, which has been extended to include a number of commercial mortgage accounts previously reported as having a collective impairment provision held against these loans.

Individual impairment provisions are made to reduce the carrying value of commercial mortgages to the present value of the amount the Directors consider is ultimately likely to be received, based upon objective evidence.

A collective impairment allowance is made against performing loans where objective evidence indicates it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is generally based on the most recent external valuation of the mortgaged property or, where one is not available, calculated using third party valuation indices. The valuation is discounted further to assume a forced sale value in addition to default propensity modelling.

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.

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:

Fair value of capped collateral held	**Group and Society**	
	2016	2015
	£m	£m
Not individually impaired	**314.4**	339.7
Individually impaired	**2.4**	0.7
	316.8	340.4
Gross loan balances	**326.7**	354.0
Negative equity	**9.9**	13.6

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.

36. Credit risk *(continued)*

iii) Other loans and advances

	Group			
	2016		2015	
	Gross	Impairment	Gross	Impairment
	£m	£m	£m	£m
Factored debt and invoice discounting	75.4	(0.6)	71.6	(0.6)
Other loans	49.0	-	44.5	-
	124.4	(0.6)	116.1	(0.6)

	Society			
	2016		2015	
	Gross	Impairment	Gross	Impairment
	£m	£m	£m	£m
Other loans	0.1	-	0.2	-

The balances of those assets within our factored debt and invoice discounting business that are individually impaired amount to £3.6m (2015: £3.9m). The factors considered in determining whether these assets are impaired include the existence of objective evidence to doubt ultimate recoverability of the Group's net exposure due to client insolvency.

There were no assets within other loans that were individually impaired at the end of 2016 or 2015 for the Group and Society. The factors considered in determining whether these assets are impaired include the existence of objective evidence that the customer is unable to honour their obligations as they fall due.

The majority of these loans have an original maturity of less than one year. As at 31 December 2016, there are £0.5m (2015: £0.5m) of these loans in the Group, and no such loans at the end of 2016 or 2015 in the Society, which are past due but not individually impaired.

b) Credit risk – 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 which are secured by pools of financial assets.

As at 31 December 2016, none of the Group's treasury portfolio exposure was either past due or impaired (2015: £2.5m); as such, no provision (2015: £2.5m) is held for impaired treasury assets. In assessing the potential impairment of its treasury assets, the Group considers, amongst other factors, objective evidence of deterioration in the counterparty's financial health, the normal volatility in valuation and industry and sectoral performance.

As at 31 December 2016, 98.8% (2015: 99.9%) of the Group's treasury investment assets (including cash in hand and balances with the Bank of England) were rated A3 or better. The Group continues to have no exposure to emerging markets and only limited exposure to non-investment grade debt.

The table below provides further details of the credit ratings of the Group's treasury investment portfolio:

Rating	2016		2015	
	£m	%	£m	%
Aaa	367.7	13.7	344.5	13.0
Aa1	1,621.0	60.5	1,523.7	57.7
Aa2	243.6	9.1	257.4	9.8
Aa3	132.8	5.0	31.1	1.2
A1	171.7	6.4	234.8	8.9
A2	23.0	0.9	125.4	4.8
A3	86.8	3.2	117.8	4.5
Baa1	-	-	0.4	-
Unrated:				
Building societies	1.8	0.1	2.7	0.1
Other (see below)	29.0	1.1	-	-
	2,677.4	100.0	2,637.8	100.0

The above analysis does not include off balance sheet liquidity of £793.1m (2015: £631.0m), which represents short term treasury bills held as a result of FLS drawings. The credit ratings of these treasury bills are Aa1 in both 2016 and 2015.

'Other' in the above analysis comprises an exposure to a central clearing house used to clear derivatives to manage interest rate risk.

The Group also monitors exposure concentrations against a variety of criteria including industry sector / asset class and country of risk.

Industry sector / asset class	2016		2015	
	£m	%	£m	%
Cash in hand and balances with the Bank of England	1,212.7	45.2	1,180.8	44.7
Loans and advances to banks and building societies	409.6	15.3	352.6	13.4
Gilts	377.5	14.1	325.8	12.4
Certificates of deposit	232.9	8.7	342.7	13.0
Fixed rate bonds	203.0	7.6	175.3	6.6
Floating rate notes	50.1	1.9	90.1	3.4
Residential mortgage backed securities	191.6	7.2	170.5	6.5
	2,677.4	100.0	2,637.8	100.0

Geographical exposure	2016		2015	
	£m	%	£m	%
UK	2,317.5	86.5	2,219.9	84.2
Rest of Europe	272.1	10.2	317.6	12.0
North America	74.1	2.8	39.4	1.5
Australasia	13.7	0.5	60.9	2.3
	2,677.4	100.0	2,637.8	100.0

c) 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. The only form of collateral accepted by the Group is cash. Derivatives are transacted under International Swaps and Derivatives Association (ISDA) Master Agreements. No Credit (CVA) or Debit (DVA) Value Adjustments have been made in respect of credit risk in the fair value of the Group's derivative financial instruments as the risk is significantly mitigated as all swaps are cash collateralised. Credit Support Annexes (CSAs) 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.

Netting arrangements do not necessarily result in an offset of Statement of Financial Position 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, subject to an absolute exposure of zero.

Notes to the Accounts *(continued)*

37. Fair values

a) Classification and measurement

The table below summarises the classification of the carrying amounts of the Group's financial assets and liabilities:

	2016			
	Amortised cost	Held at fair value as available-for-sale assets	Fair value through profit or loss	Total
	£m	£m	£m	£m
Cash in hand and balances with the Bank of England	1,212.7	-	-	**1,212.7**
Loans and advances to credit institutions	409.6	-	-	**409.6**
Debt securities	1.7	1,053.4	-	**1,055.1**
Derivative financial instruments	-	-	116.1	**116.1**
Loans and advances to customers	15,809.3	-	(27.7)	**15,781.6**
Equity share investments	-	36.4	-	**36.4**
Trade receivables	32.8	-	-	**32.8**
Contingent consideration	9.9	-	-	**9.9**
Total financial assets	**17,476.0**	**1,089.8**	**88.4**	**18,654.2**
Other non-financial assets				**365.5**
Total assets				**19,019.7**
Shares	14,152.5	-	-	**14,152.5**
Amounts owed to credit institutions and other customers	2,148.5	-	-	**2,148.5**
Debt securities in issue	534.2	-	-	**534.2**
Derivative financial instruments	-	-	412.3	**412.3**
Trade payables	5.4	-	-	**5.4**
Fair value of put option obligation	-	-	11.7	**11.7**
Subordinated liabilities and subscribed capital	169.8	-	-	**169.8**
Total financial liabilities	**17,010.4**	**-**	**424.0**	**17,434.4**
Other non-financial liabilities				**307.8**
Total liabilities				**17,742.2**

	2015			
	Amortised cost	Held at fair value as available-for-sale assets	Fair value through profit or loss	Total
	£m	£m	£m	£m
Cash in hand and balances with the Bank of England	1,180.8	-	-	1,180.8
Loans and advances to credit institutions	352.6	-	-	352.6
Debt securities	1.7	1,102.7	-	1,104.4
Derivative financial instruments	-	-	95.1	95.1
Loans and advances to customers	14,387.2	-	(24.0)	14,363.2
Equity share investments	-	40.9	-	40.9
Trade receivables	29.8	-	-	29.8
Total financial assets	15,952.1	1,143.6	71.1	17,166.8
Other non-financial assets				344.6
Total assets				17,511.4
Shares	12,828.2	-	-	12,828.2
Amounts owed to credit institutions and other customers	2,125.1	-	-	2,125.1
Debt securities in issue	608.8	-	-	608.8
Derivative financial instruments	-	-	296.9	296.9
Trade payables	4.9	-	-	4.9
Fair value of put option obligation	-	-	11.9	11.9
Subordinated liabilities and subscribed capital	172.0	-	-	172.0
Total financial liabilities	15,739.0	-	308.8	16,047.8
Other non-financial liabilities				286.0
Total liabilities				16,333.8

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.

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.

Notes to the Accounts *(continued)*

37. Fair values *(continued)*

The following tables provide an analysis of financial assets and liabilities held within the Group Statement of Financial Position at fair value, grouped into Levels 1 to 3 of the fair value hierarchy.

Group	2016			
	Quoted prices in active markets (Level 1) £m	Valuation techniques using observable inputs (Level 2) £m	Valuation techniques using significant unobservable inputs (Level 3) £m	Total £m
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	820.5	232.9	-	**1,053.4**
Equity share investments	36.0	-	0.4	**36.4**
Financial assets at fair value through profit or loss:				
Embedded derivatives within loans and advances to customers	-	-	(27.7)	**(27.7)**
Derivative financial instruments	-	112.2	3.9	**116.1**
	856.5	**345.1**	**(23.4)**	**1,178.2**
Financial liabilities				
Financial liabilities at fair value through profit or loss:				
Derivative financial instruments	-	161.5	250.8	**412.3**
Fair value of put option obligation	-	-	11.7	**11.7**
	-	**161.5**	**262.5**	**424.0**
	856.5	**183.6**	**(285.9)**	**754.2**

Group	2015			
	£m	£m	£m	£m
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	759.9	342.8	-	1,102.7
Equity share investments	40.2	-	0.7	40.9
Financial assets at fair value through profit or loss:				
Embedded derivatives within loans and advances to customers	-	-	(24.0)	(24.0)
Derivative financial instruments	-	90.0	5.1	95.1
	800.1	432.8	(18.2)	1,214.7
Financial liabilities				
Financial liabilities at fair value through profit or loss:				
Derivative financial instruments	-	96.2	200.7	296.9
Fair value of put option obligation	-	-	11.9	11.9
	-	96.2	212.6	308.8
	800.1	336.6	(230.8)	905.9

The table below analyses the movements in the Level 3 portfolio during the year:

Group	2016				
	Equity share investments	Embedded derivatives	Derivative financial instruments	Fair value of put option obligation	Total
	£m	£m	£m	£m	£m
At 1 January	0.7	(24.0)	(195.6)	(11.9)	**(230.8)**
Loss recognised in Income Statement	(11.3)[1]	(3.8)[2]	(51.3)[3]	(0.2)[4]	**(66.6)**
Losses written off during the year	-	0.1	-	-	**0.1**
Reclassification of associate investment	10.6	-	-	-	**10.6**
Revaluation of market values	-	-	-	0.8	**0.8**
Additions	0.4	-	-	-	**0.4**
Acquisition of subsidiary undertakings	-	-	-	(0.4)	**(0.4)**
At 31 December	**0.4**	**(27.7)**	**(246.9)**	**(11.7)**	**(285.9)**

Notes
1. Included in the 'Impairment losses on equity share investments' line in the Income Statement.
2. Included in the 'Impairment credit / (charge) on loans and advances to customers' line in the Income Statement.
3. Included in the 'Fair value (losses) / gains on financial instruments' line in the Income Statement. As noted below, the majority of these derivatives are held to hedge the Group's equity release mortgage book and a gain, largely offsetting the above amount, was recognised through the same line in the Income Statement in respect of the underlying mortgages that are being hedged. However, some hedge ineffectiveness resulted during the year and this resulted in an overall charge to the Income Statement of £7.8m.
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.

Group	2015				
	Equity share investments	Embedded derivatives	Derivative financial instruments	Fair value of put option obligation	Total
	£m	£m	£m	£m	£m
At 1 January	0.7	(17.5)	(159.6)	(7.5)	(183.9)
Loss recognised in Income Statement	-	(6.5)[1]	(36.0)[2]	(0.1)[3]	(42.6)
Revaluation of market values	-	-	-	0.1	0.1
Disposals	-	-	-	0.3	0.3
Acquisition of subsidiary undertakings	-	-	-	(5.6)	(5.6)
Exercise of put options by non-controlling shareholders	-	-	-	0.9	0.9
At 31 December	0.7	(24.0)	(195.6)	(11.9)	(230.8)

Notes
1. Included in the 'Impairment credit / (charge) on loans and advances to customers' line in the Income Statement.
2. Included in the 'Fair value (losses) / gains on financial instruments' line in the Income Statement. As noted below, the majority of these derivatives are held to hedge the Group's equity release mortgage book and a gain, largely offsetting the above amount, was recognised through the same line in the Income Statement in respect of the underlying mortgages that are being hedged. However, some hedge ineffectiveness resulted during the year and this resulted in an overall credit to the Income Statement of £1.3m.
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.

37. Fair values *(continued)*

Equity share investments

The Group's equity share investments represent a 2.7% (2015: 4.0%) holding in Zoopla Property Group Plc, a 13.9% (2015: 16.1%) holding in Hearthstone Investments Limited, an 8.7% (2015: nil) holding in Tactile Limited and a 17.7% shareholding in Wynyard Group Limited (2015: 17.8% when Wynyard was classed as an associate investment).

The Group's holding in Zoopla is measured based on the fair value of the shareholding by reference to a quoted share price in an active market and therefore represents a Level 1 fair value measurement. Any movement in the fair value of the Group's holding is recognised in the available-for-sale reserve. As at 31 December 2016 the cumulative balance recognised in the available-for-sale reserve in respect of Zoopla, gross of taxation, is £33.7m (31 December 2015: £36.8m).

During the year, the Group's holding in Wynyard Group Limited was reclassified to an equity share investment from an associate holding, as outlined in note 16d). Following this, Wynyard was accounted for in the same way as described for Zoopla above, based on Wynyard's share price, which resulted in an unrealised loss of £6.6m recognised in the available-for-sale reserve during the year. However, on 25 October 2016 Wynyard entered into voluntary administration and an impairment loss of £10.6m was recognised in the Income Statement.

The Group's investment in Hearthstone cost £2.0m when purchased in 2012 and its carrying value was subsequently written down to £0.7m in 2014. The Group's investment in Tactile cost £0.4m when purchased in 2016. The Directors have reviewed the carrying value of these investments at the year end. The Directors believe it is appropriate to continue to hold the Group's investment in Tactile at £0.4m as, in the absence of any observable inputs or other relevant information, the fair value of the Group's shareholding in this company cannot be reliably measured, and the Directors do not consider that any reasonably possible alternative valuation assumptions exist. The Directors have reviewed the carrying value of the Group's investment in Hearthstone, based on recent trading performance, outlook and expectations of the value of the business, and have concluded that the carrying value of this investment should be written down to £nil, resulting in £0.7m of impairment being recognised during the year, shown in the 'Impairment losses on equity share investments' line in the Income Statement.

Embedded derivatives

The Group holds an equity release mortgage book under the terms of which the Group is required to provide a 'no negative equity guarantee' to its customers. This guarantee means that the Group's maximum return is limited to the value of the customer's property on redemption.

In accordance with the accounting policy as described in note 1d), this guarantee is accounted for as an embedded derivative as the characteristics and risks of the guarantee are not closely related to the economic characteristics and risks of the underlying mortgages. The guarantee is impacted by the interaction of a number of factors, not all of which also impact on the performance of the underlying equity release book. These factors include future expected house prices, future expected inflation, mortality rates and estimated redemption profiles. As a result, the embedded derivatives are bifurcated from the underlying mortgage book and measured at fair value, with any changes in fair value recognised within the 'Impairment credit / (charge) on loans and advances to customers' line in the Income Statement. As certain of these inputs are not market observable, the fair value of the embedded derivatives is regarded as a Level 3 valuation technique.

The following table outlines the impact of reasonably possible alternative assumptions of certain inputs outlined above. Each sensitivity considers one change in isolation and the combined impact on the valuation of the embedded derivatives of all sensitivities occurring would not necessarily be the sum of the impact of the individual sensitivities.

		Group and Society	
		2016	2015
		(Decrease) / increase in fair value	(Decrease) / increase in fair value
		£m	£m
Future change in house prices	+/-10% in any one year*	(8.1) / 11.8	(6.4) / 9.6
Redemption rates	+/-1% pa	(3.3) / 3.8	(2.9) / 3.4
Retail Price Index (RPI)	+/-0.1% pa	2.4 / (2.3)	2.1 / (1.9)

* For example, a 13% increase or 7% fall in house prices compared to an assumption of a 3% increase.

There would be a corresponding (credit) / charge to the Income Statement within the 'Impairment credit / (charge) on loans and advances to customers' line arising from the (decrease) / increase in the fair value of the embedded derivatives as shown in the table above.

Derivative financial instruments

Some of the derivative financial instruments included in the tables on page 157 comprise derivatives used to hedge the Group's interest rate risk arising from its equity release mortgage book (this is separate to the no negative equity guarantee described above, i.e. the embedded derivative, for which the Group holds no natural hedging instrument). These derivatives that hedge equity release mortgages are valued using discounted cash flow models using market observable benchmark rates consistent with accepted economic 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 that are based on historical data and reviewed periodically to ensure forecasts remain broadly in line with actual data.

These redemption profiles are not market observable, therefore these derivatives are categorised as Level 3 financial instruments within the fair value hierarchy.

Two of the derivative financial instruments described above contain contractual 'boundaries', within which any change in fair value of the derivatives will be offset by a corresponding but opposite change in the value of the associated hedged item within loans and advances to customers. These boundaries exist in order to alleviate risk to the counterparty. If these boundaries are crossed, hedge ineffectiveness and therefore Income Statement volatility can arise and during the year this resulted in an Income Statement charge of £7.8m (2015: credit of £1.3m), which is included in the 'Fair value (losses) / gains on financial instruments' line in the Income Statement.

During the year, the reference curve used for the purposes of discounting within the valuation of these derivatives was revised and the derivatives are now valued using a yield curve linked to an overnight index ('SONIA') rather than by reference to LIBOR. This has resulted in a charge of £5.7m to the Income Statement, which is included in the £7.8m charge above, as LIBOR continues to be the most appropriate rate to discount the hedged risk of the mortgage loans hence no offset is created on the hedged item.

In addition, as described above, certain inputs into the valuation of these derivatives are not market observable and the effect on the fair value of these derivatives of reasonably possible alternative valuation assumptions of certain of these inputs is outlined below. Each sensitivity considers one change in isolation and the combined impact on the valuation of the derivatives of all sensitivities occurring would not necessarily be equal to the sum of the impact of the individual sensitivities.

		Group and Society	
		2016	2015
		Increase / (decrease) in liability	Increase / (decrease) in liability
		£m	£m
Retail Price Index (RPI)	+/-0.1% pa	7.8 / (7.7)	7.7 / (7.5)
Redemption rates	+/-1% pa	(21.7) / 26.0	(24.3) / 31.2

Any change in fair value of the derivative liabilities as shown above would be largely offset by a corresponding but opposite change in the value of the associated hedged item within loans and advances to customers. A 0.1% increase in RPI would result in an Income Statement charge of £0.2m (2015: £nil), whilst a 0.1% decrease in RPI would result in an Income Statement credit of £0.2m (2015: £nil). A 1% increase in redemption rates would result in an Income Statement charge of £nil (2015: £0.7m), whilst a 1% decrease in redemption rates would result in an Income Statement charge of £0.4m (2015: £0.1m credit).

As can be seen, the valuation of these swaps is very sensitive to the underlying assumptions such as redemption rates; however, as described above, changes in the fair value of these derivatives are generally offset to a significant degree by changes in the fair value of the associated hedged item within loans and advances to customers.

Fair value of put option obligation

Key inputs into the calculation of the fair value of the put option obligation include an estimate of the market value of the non-controlling shareholding and an estimate of when the put option will be exercised by the non-controlling shareholders. As these inputs are based on the judgement of management, the valuation of the put option obligation is considered to be a Level 3 valuation technique. The impact of reasonably possible alternative valuation assumptions for the fair value of the put option obligation is shown in note 1s) to the Accounts.

37. Fair values *(continued)*

c) Fair values of financial assets and liabilities 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 2016		Society 2016	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash in hand and balances with the Bank of England	1,212.7	1,212.7	1,212.7	1,212.7
Loans and advances to credit institutions	409.6	409.6	309.0	309.0
Debt securities	1.7	1.7	266.1	266.4
Loans and advances to customers	15,809.3	15,613.2	13,551.1	13,380.3
Trade receivables	32.8	32.8	1.2	1.2
Contingent consideration	9.9	9.9	-	-
	17,476.0	**17,279.9**	**15,340.1**	**15,169.6**
Financial liabilities				
Shares	14,152.5	14,238.0	14,152.5	14,238.0
Amounts owed to credit institutions	655.3	666.4	786.5	797.6
Amounts owed to other customers	1,493.2	1,498.8	292.3	292.6
Debt securities in issue	534.2	541.1	14.6	14.6
Trade payables	5.4	5.4	0.9	0.9
Subordinated liabilities and subscribed capital	169.8	190.4	169.8	190.4
	17,010.4	**17,140.1**	**15,416.6**	**15,534.1**

	Group 2015		Society 2015	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash in hand and balances with the Bank of England	1,180.8	1,180.8	1,180.8	1,180.8
Loans and advances to credit institutions	352.6	352.6	241.6	241.6
Debt securities	1.7	1.7	370.9	368.9
Loans and advances to customers	14,387.2	14,300.0	12,151.8	12,114.0
Trade receivables	29.8	29.8	0.5	0.5
	15,952.1	15,864.9	13,945.6	13,905.8
Financial liabilities				
Shares	12,828.2	12,938.3	12,828.2	12,938.3
Amounts owed to credit institutions	735.6	734.5	605.9	604.8
Amounts owed to other customers	1,389.5	1,395.2	638.5	639.0
Debt securities in issue	608.8	612.2	21.2	21.2
Trade payables	4.9	4.9	1.2	1.2
Subordinated liabilities and subscribed capital	172.0	183.0	172.0	183.0
	15,739.0	15,868.1	14,267.0	14,387.5

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.

Subordinated liabilities and 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 18 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.

38. Group segmental reporting

The Group's structure and reportable segments are outlined in the Strategic Report on page 12.

On 1 August 2016, financial advice activities previously carried out through SFS were integrated into the Society. Previously the performance of SFS was reported within the Financial Advice division and following integration, the Financial Advice division ceased to be a reportable segment. The performance of SFS prior to the integration into the Society, including prior year results, has been re-presented to be shown within the Mortgages and Savings division, and as such, the Mortgages and Savings division's comparative figures have been re-presented accordingly.

The 2015 results reported for the Financial Advice division comprise solely the results of Pearson Jones plc up until the date of its disposal by the Group in May 2015, together with the resulting loss on disposal of £0.8m.

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.

No geographical analysis is presented because substantially all of the Group's activities are conducted within the UK. Of the total external income, £36.7m (2015: £32.0m) was generated outside the UK.

A breakdown of the allocation of goodwill to each segmental area is included within note 19.

	2016				
	Mortgages and Savings	Estate Agency	Investment Portfolio	Sundry incl. inter-divisional adjustments	Total
	£m	£m	£m	£m	£m
Net interest income	206.3	0.3	1.8	4.0	**212.4**
Net non-interest income	30.1	397.6	27.0	(9.0)	**445.7**
Fair value losses on financial instruments	(3.7)	-	-	-	**(3.7)**
Profit on treasury assets	4.6	-	-	-	**4.6**
Profit / (loss) on disposal of Group undertakings	-	17.0	(0.9)	15.8	**31.9**
Dividend income from equity share investments	-	0.7	-	-	**0.7**
Share of profits / (losses) from joint ventures and associates	-	1.8	(2.4)	-	**(0.6)**
Total income	**237.3**	**417.4**	**25.5**	**10.8**	**691.0**
Administrative expenses	(135.9)	(337.7)	(25.8)	0.3	**(499.1)**
Impairment losses and provisions for liabilities	(4.8)	(6.3)	(11.9)	-	**(23.0)**
Profit / (loss) before tax	**96.6**	**73.4**	**(12.2)**	**11.1**	**168.9**
Taxation	(23.3)	(15.2)	(0.9)	0.3	**(39.1)**
Profit / (loss) after tax	**73.3**	**58.2**	**(13.1)**	**11.4**	**129.8**
Total assets	**18,736.3**	**289.1**	**129.6**	**(135.3)**	**19,019.7**
Total liabilities	**17,540.7**	**154.0**	**124.1**	**(76.6)**	**17,742.2**
Capital expenditure	**7.8**	**18.5**	**2.0**	**-**	**28.3**

Total income can be analysed as follows:

	2016				
	Mortgages and Savings	Estate Agency	Investment Portfolio	Sundry incl. inter-divisional adjustments	Total
	£m	£m	£m	£m	£m
External income	236.1	405.8	26.3	22.8	**691.0**
Income from other segments	1.2	11.6	(0.8)	(12.0)	**-**
Total income	**237.3**	**417.4**	**25.5**	**10.8**	**691.0**

	2015					
	Mortgages and Savings	Estate Agency	Financial Advice	Investment Portfolio	Sundry incl. inter-divisional adjustments	Total
	Re-presented*		Re-presented*			
	£m	£m	£m	£m	£m	£m
Net interest income	219.8	0.6	-	1.9	1.0	223.3
Net non-interest income	33.1	351.4	3.5	20.9	(6.3)	402.6
Fair value gains on financial instruments	4.0	-	-	-	-	4.0
Profit on treasury assets	0.1	-	-	-	-	0.1
(Loss) / profit on disposal of Group undertakings	-	-	(0.8)	1.8	-	1.0
Dividend income from equity share investments	-	0.3	-	-	-	0.3
Share of profits / (losses) from joint ventures and associates	-	2.5	-	(2.3)	-	0.2
Total income	257.0	354.8	2.7	22.3	(5.3)	631.5
Administrative expenses	(137.1)	(289.0)	(2.7)	(20.9)	(14.7)	(464.4)
Impairment losses and provisions for liabilities	(16.8)	(3.3)	(0.1)	-	-	(20.2)
Profit / (loss) before tax	103.1	62.5	(0.1)	1.4	(20.0)	146.9
Taxation	(20.4)	(13.8)	(0.1)	(0.8)	1.6	(33.5)
Profit / (loss) after tax	82.7	48.7	(0.2)	0.6	(18.4)	113.4
Total assets	17,279.2	280.1	-	129.5	(177.4)	17,511.4
Total liabilities	16,200.8	135.6	-	119.2	(121.8)	16,333.8
Capital expenditure	3.3	11.9	-	1.1	-	16.3

* On 1 August 2016, SFS was integrated into the Society and so the Financial Advice division ceased to be a reportable segment. The prior year results of SFS have been re-presented to be shown within the Mortgages and Savings division.

Total income can be analysed as follows:

	2015					
	Mortgages and Savings	Estate Agency	Financial Advice	Investment Portfolio	Sundry incl. inter-divisional adjustments	Total
	Re-presented*		Re-presented*			
	£m	£m	£m	£m	£m	£m
External income	256.1	346.9	2.7	23.0	2.8	631.5
Income from other segments	0.9	7.9	-	(0.7)	(8.1)	-
Total income	257.0	354.8	2.7	22.3	(5.3)	631.5

* The prior year results of SFS have been re-presented to be shown within the Mortgages and Savings division as outlined above.

Notes to the Accounts *(continued)*

39. Capital management

Page 27 of the Strategic Report describes the components of the Group's capital and the associated regulatory framework, and is followed by quantitative disclosure of the components of capital or 'Own funds'. Page 29 of the Strategic Report sets out the Group's capital management processes. Throughout the current and previous year, the Group complied with and maintained surplus capital above all externally imposed capital requirements.

40. Adoption of new and revised International Financial Reporting Standards

Disclosed below are amendments to existing standards which have been adopted during the year, all of which are effective for accounting periods starting on or after 1 January 2016. There have been no new standards effective and adopted during the year.

- Amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. These amendments clarify acceptable methods of depreciation and amortisation and have had no impact on these financial statements.
- Amendments to IFRS 11 *Joint Arrangements*. These amendments require business combination accounting to be applied to acquisitions of interests in a joint operation that constitutes a business and have had no impact on these financial statements.
- Amendments to IAS 1 *Presentation of Financial Statements*. These amendments include a number of key clarifications and have had no impact on these financial statements.
- Amendments to IAS 27 *Consolidated and Separate Financial Statements (2011)*. These amendments allow businesses to apply the equity method of accounting in separate financial statements for accounting for investments in subsidiary undertakings, associates and joint ventures and have had no impact on these financial statements.
- Amendments to IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosure of Interests in Other Entities* and Amendments to IAS 28 *Investments in Associates and Joint Ventures (2011)*. This suite of amendments clarifies when investment entities are exempt from consolidating the financial results of subsidiary undertakings and have had no impact on these financial statements.
- Amendments to accounting standards as part of the annual improvements to IFRS 2012 – 2014 cycle. These amendments have had no impact on these financial statements.

Amendments issued but not yet effective

The Group notes a number of amendments effective for future reporting periods, subject to EU endorsement. These include amendments to IAS 7 *Statement of Cash Flows*, IAS 12 *Income Taxes* and amendments to accounting standards as part of the annual improvements to IFRS 2014 – 2016 cycle. These are effective for annual reporting periods beginning on or after 1 January 2017. In addition, amendments to IAS 40 *Investment Property* have been issued and are effective for annual reporting periods beginning on or after 1 January 2018. The impact is not expected to be significant.

Standards issued but not yet effective

The Group notes a number of new accounting standards which will be effective for future reporting periods (subject, for IFRS 16 *Leases*, to EU endorsement). The Group has not early adopted the following new standards in preparing these consolidated financial statements.

IFRS 9 Financial Instruments

IFRS 9 replaces the existing requirements in IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 includes revised requirements on the classification and measurement of financial instruments, a new expected credit loss model for calculating impairment on financial assets and new general hedge accounting requirements. It also carries forward the requirements on recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Group currently plans to apply IFRS 9 initially on 1 January 2018.

The Group is in the process of assessing the potential impact of IFRS 9 application on its consolidated financial statements which, given the nature of the Group's operations, is expected to be significant. In particular, the calculation of impairment of financial instruments on an expected credit loss basis is expected to result in an increase in the overall level of impairment allowances. The actual impact of adopting IFRS 9 on the Group's consolidated financial statements in 2018 is not yet known and cannot be reliably estimated; this will be dependent on the financial instruments held by the Group and the economic conditions at that time, as well as accounting elections and judgements that the Group will make in the future. The new standard will require the Group to revise its accounting processes and internal controls related to reporting financial instruments, for which preparations are well underway.

The Group is also assessing the potential impact of IFRS 9 application for regulatory capital purposes. This requires a detailed technical assessment of the initial one-off impact on transition to IFRS 9, as well as consideration of the ongoing impact of this change. The supervisory bodies are currently consulting on possible capital treatments following IFRS 9 adoption, including transitional arrangements, and we await confirmation of the final rules. The actual impact of adopting

IFRS 9 for capital planning purposes is not yet known and cannot be reliably estimated. The quantitative effect will depend on, inter alia, the actual impact of adopting IFRS 9 on the Group's consolidated financial statements and also the final capital rules.

Based on its preliminary assessments and information available to date, the Group summarises below its expected approach and its current expectations regarding the potential impact of IFRS 9 on the Group's consolidated financial statements. The Group will continue its IFRS 9 preparations during 2017, including parallel running of new systems, and expects to disclose further information in the 2017 Annual Report and Accounts.

i) Financial assets - classification

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The standard eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available-for–sale, whilst FVTPL is retained.

The Group has performed a preliminary assessment of expected financial asset classifications under IFRS 9, including a high-level review of portfolio characteristics. Based on its preliminary assessment, the Group's current expectation is that the Group's financial assets will broadly be reclassified as follows:

Existing classification under IAS 39	Expected classification under IFRS 9
Loans and receivables (excluding equity release portfolio)	Amortised cost
Loans and receivables – Equity release portfolio	FVTPL*
Available-for-sale	FVOCI
FVTPL	FVTPL

* The Group's equity release portfolio is currently accounted for under IAS 39. The loan balances are held at amortised cost and the no negative equity guarantee, an embedded derivative, is bifurcated and held at fair value. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are not bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification. Based on the cash flow characteristics of the equity release portfolio, we expect to classify the equity release portfolio as FVTPL.

ii) Financial assets – impairment

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. This new impairment model will apply to the Group's financial assets measured at amortised cost or FVOCI, except for investments in equity instruments.

Development of the Group's IFRS 9 impairment methodologies is well underway and work will continue throughout 2017 to finalise and refine our planned approach. IFRS 9's new ECL model involves a number of factors that will require significant judgement. These factors include, for example, assessing probability of default, determining when the risk of default has significantly increased and forming a view as to the future direction of relevant economic variables. To implement its IFRS 9 methodologies, the Group is currently designing and building an appropriate suite of models. The modelling techniques to be used will vary according to the characteristics of each impacted portfolio of financial assets, ranging from complex statistical models for the Group's residential loan portfolios, to a more simplified approach for trade receivables. We will perform parallel testing of our IFRS 9 models during 2017.

Based on its preliminary assessment, the Group currently expects that impairment losses will significantly increase on application of IFRS 9, and also become more volatile. However, as noted above, the Group has not yet finalised the impairment methodologies that it will apply under IFRS 9.

iii) Financial liabilities – classification

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

However, under IAS 39 all fair value changes of liabilities designated as at FVTPL are recognised in profit or loss, whereas under IFRS 9 these fair value changes are generally presented as follows:

- The amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in other comprehensive income; and
- The remaining amount of change in the fair value is presented in profit or loss.

Based on its preliminary assessment, the Group's current expectation is that the impact of IFRS 9's requirements regarding the classification of financial liabilities will not be significant.

Notes to the Accounts *(continued)*

40. Adoption of new and revised International Financial Reporting Standards *(continued)*

iv) Hedge accounting

When initially applying IFRS 9, the Group may choose as its accounting policy to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements in IFRS 9. The Group's current plan is that it will continue to apply the hedge accounting requirements of IAS 39.

v) Disclosures

IFRS 9 will require extensive new disclosures, in particular for hedge accounting, credit risk and expected credit losses. The Group has performed analysis to identify data gaps against current processes and the Group plans to implement during 2017 the systems and controls changes that it believes will be necessary to capture the required data.

vi) Transition

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively, with certain exceptions. The Group plans to take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 generally will be recognised in retained earnings and reserves as at 1 January 2018.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition requirements, including IAS 18 *Revenue*. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Group currently plans to adopt IFRS 15 in its consolidated financial statements for the year ending 31 December 2018.

The Group is assessing the potential impact of IFRS 15 application on its consolidated financial statements; this may be significant as the timing of revenue recognition for certain Group income streams is likely to be impacted. The quantitative impact of adopting IFRS 15 is not yet known and cannot be reliably estimated. The quantitative impact will depend on, inter alia, the Group's interpretation of how the principles and requirements of IFRS 15 apply to each of the Group's income streams. The Group will continue to assess the impact and expects to disclose further information prior to adopting IFRS 15.

IFRS 16 Leases

IFRS 16 replaces the existing requirements in IAS 17 *Leases*. IFRS 16 introduces a single, on-balance sheet accounting model for lessees. A lessee recognises a right-of-use asset, representing its right to use the underlying asset, and a lease liability, representing its obligation to make lease payments. There are optional exemptions for short term leases and leases of low value items. Lessor accounting remains similar to the existing standard in that lessors will continue to classify leases as finance leases or operating leases. IFRS 16 is effective for accounting periods beginning on or after 1 January 2019, with early adoption permitted (subject to also applying IFRS 15).

The Group is assessing the potential impact of IFRS 16 application on its consolidated financial statements. The most significant impact identified to date is that the Group will recognise new assets and liabilities for its operating leases, which mainly relate to numerous branch premises. In addition, the nature of expenses related to those leases will change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and an interest expense on lease liabilities. The quantitative impact of adopting IFRS 16 on the Group's reported assets and liabilities is not yet known and cannot be reliably estimated. The quantitative effect will depend on, inter alia, the transition method chosen, the extent to which the Group uses practical expedients and recognition exemptions, and any additional leases that the Group enters into. The Group expects to disclose further information prior to adopting IFRS 16.

41. Subsequent events

On 9 February 2017, Wynyard Group Limited, in which the Group holds a 17.7% shareholding, was placed into liquidation. This follows Wynyard entering voluntary administration in October 2016, at which point the Group recognised an impairment charge against the whole of its investment.

As outlined in note 30, on 22 February 2017 the Society issued notice that it will repay the 6.875% Permanent Interest Bearing Shares (PIBS) on the call date of 13 April 2017 at the principal amount of £50m, together with any interest accrued. The PIBS will be cancelled immediately following repayment.

There have been no other material subsequent events between 31 December 2016 and the date of approval of this Annual Report and Accounts by the Board.

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 16a) of these financial statements.

Name of subsidiary undertaking	Principal business activity	Country of incorporation	% ownership interest 31.12.16
Jade Software Corporation Limited	Provider of software development services	New Zealand	56.4
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 UK Limited (Netherlands Branch)	Netherlands
Jade Software Corporation USA	USA
Jade Software Corporation Limited Dubai Branch	United Arab Emirates
Jade Logistics Holdings Limited	New Zealand
Jade Logistics Platform Limited	New Zealand
Jade Logistics Group Limited	New Zealand
Jade Logistics Group Limited Geneva Branch	Switzerland
Jade Logistics Limited	New Zealand
Jade Logistics (NZ) Limited	New Zealand
Jade Logistics Corporation (USA)	USA
Jade Logistics B.V.	Netherlands
Jade Logistics (Middle East) Limited	New Zealand
Jade Logistics (Asia) Limited	New Zealand

In addition, the Group holds a non-controlling interest of 17.7% in Wynyard Group Limited, which entered voluntary administration during 2016 (and subsequently entered liquidation in February 2017) and which is incorporated in New Zealand and has subsidiaries in Australia, Canada, USA and the UK.

Country by Country Reporting *(continued)*

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 for the year ended 31 December 2016 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.

£m	UK	Australia	United Arab Emirates	Guernsey	Netherlands	New Zealand	USA	Total
Total income - gross	666.1	3.4	-	19.8	1.5	13.6	0.8	**705.2**
Intra-Group adjustments	(16.4)	-	-	3.0	-	(0.8)	-	**(14.2)**
Total income - net	649.7	3.4	-	22.8	1.5	12.8	0.8	**691.0**
Profit before tax - gross	158.9	0.4	(0.3)	15.2	0.1	(0.8)	0.2	**173.7**
Intra-Group adjustments	(4.0)	-	-	-	-	(0.8)	-	**(4.8)**
Profit before tax - net	154.9	0.4	(0.3)	15.2	0.1	(1.6)	0.2	**168.9**

£m	UK	Australia	United Arab Emirates	Guernsey	Netherlands	New Zealand	Switzerland	USA	Total
Current tax expense	39.4	0.2	-	1.4	-	-	-	-	**41.0**
Corporation taxes paid	35.4	0.1	-	1.5	-	-	-	-	**37.0**
Public subsidies received*	-	-	-	-	-	0.3	-	-	**0.3**
Average number of employees	8,247	15	6	42	5	174	2	5	**8,496**

* Public subsidies received relate to cash payments received from governments in the form of grants.

Annual Business Statement

1. Statutory percentages

	As at 31 December 2016 %	Statutory limit %
Lending limit	6.79	25.00
Funding limit	10.41	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 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

	2016 %	2015 %
As a percentage of shares, deposits and borrowings:		
(i) Gross capital	8.60	8.67
(ii) Free capital	7.28	7.39
(iii) Liquid assets	15.90	16.95
As a percentage of mean total assets:		
(i) Group profit after taxation	0.71	0.68
(ii) Group management expenses	2.73	2.77
(iii) Society management expenses	0.62	0.60
As a percentage of closing total assets:		
(i) Group profit after tax	0.68	0.65

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 available-for-sale reserve, cash flow hedging reserve, translation reserve, subordinated liabilities, subscribed capital and non-controlling interests, as shown within the Group Statement of Financial Position.

Free capital represents gross capital and provisions for collective impairment losses on loans and advances to customers, less property, plant and equipment, 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 2016 and 2015 total assets.

Management expenses represent administrative expenses.

Annual Business Statement *(continued)*

3. Information relating to Directors at 31 December 2016

The Board of Directors at 31 December 2016, 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
M Cassoni	27 December 1951	31 July 2012
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
M H Ellis	4 August 1951	24 May 2011
M J Lund	1 July 1957	25 April 2016
R S D M Ndawula*	24 February 1974	23 February 2015
G E Picken	21 April 1949	17 January 2012
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, Sovereign House, Sovereign Street, Leeds, LS1 1HQ.

The Directors' business occupations and other Directorships at 31 December 2016 were as follows:

A P Bottomley	Building Society Distribution and Financial Services Director	Skipton Financial Services Limited Skipton Group Holdings Limited
A J Burton	Non-Executive Director	Battersea Dogs and Cats Home Countryside Properties Plc HSS Hire Group Plc Monitise Plc Skipton Group Holdings Limited
M Cassoni	Non-Executive Director	AO World Plc Enterprise Inns Plc Jacob's Island (Providence Square Blocks A, B & C) Limited Skipton Group Holdings Limited The People's Operator Plc
D P Cockrem	Non-Executive Director	Good Energy Brynwhilach Solar Park Limited Good Energy Carloggas Solar Park (009) Limited Good Energy Cedar Windfarm Limited Good Energy Creathorne Farm Solar Park (003) Limited Good Energy Cross Road Plantation Solar Park (028) Limited Good Energy Delabole Windfarm Limited Good Energy Development (No.1) Limited Good Energy Development (No.3) Limited Good Energy Development (No.4) Limited Good Energy Development (No.5) Limited Good Energy Development (No.6) Limited Good Energy Development (No.7) Limited Good Energy Development (No.8) Limited Good Energy Development (No.9) Limited Good Energy Development (No.10) Limited Good Energy Development (No.12) Limited Good Energy Development (No.14) Limited Good Energy Development (No.15) Limited Good Energy Development (No.16) Limited Good Energy Development (No.17) Limited Good Energy Development (No.20) Limited Good Energy Development (No.21) Limited Good Energy Development (No.22) Limited Good Energy Development (No.23) Limited Good Energy Development (No.24) Limited Good Energy Development (No.25) Limited Good Energy Development (No.26) Limited Good Energy Development (No.27) Limited Good Energy Development (No.28) Limited Good Energy Development (No.29) Limited Good Energy Development (No.30) Limited Good Energy Gas Limited Good Energy Generation Assets No. 1 Limited Good Energy Generation Limited Good Energy Group Plc Good Energy Hampole Windfarm Limited Good Energy Holding Company No.1 Limited Good Energy Lanyon Solar Park (011) Limited Good Energy Limited Good Energy Lower End Farm Solar Park (026) Limited Good Energy Mapperton Solar Park (007) Limited Good Energy Oaklands Plantation Solar Park (031) Limited Good Energy Rook Wood Solar Park (057) Limited Good Energy Tidal Limited Good Energy Woolbridge Solar Park (010) Limited Homegrown Energy Limited Llangyfelach Community Solar Farm C.I.C. Macintyre Care Skipton Group Holdings Limited Worminster Down Somerset Community Solar Farm C.I.C.

Annual Business Statement *(continued)*

I M Cornelius	Building Society Commercial Director	BCHT Development Company Limited Incommunities Group Limited Skipton Group Holdings Limited Skipton International Limited Skipton Trustees Limited
D J Cutter	Building Society Group Chief Executive	Bailey Computer Services Limited Connells Limited Craven Educational Trust Leeds Share Shop Limited Malsis School 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	Cattles Holdings Limited Compass Credit Limited Dial4aloan Limited Hampshire Trust Bank Plc Moneytopia Bank Limited Skipton Group Holdings Limited Welcome Financial Services Limited
M H Ellis	Non-Executive Director & Chairman	Leeds Theatre Trust Limited MH Ellis Consulting Limited Skipton Group Holdings Limited West Yorkshire Playhouse (Enterprises) Limited
M J Lund	Non-Executive Director	British Ski and Snowboard Limited 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	Amber Homeloans Limited Connells Limited Leeds Share Shop Limited North Yorkshire Mortgages 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
G E Picken	Non-Executive Director	Connells Limited Skipton Group Holdings Limited
H C Stevenson	Non-Executive Director	Henley Business School NHW Consultancy Limited One Smart Star UK Limited Skipton Group Holdings Limited St Ives Plc Trinity Mirror Plc

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.

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.
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.
Delinquency	A debt or financial obligation is considered to be in a state of delinquency when payments are overdue.
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, equity and currency risk.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period.
Fair value	Fair value is the amount for which an asset could be exchanged, or a liability settled, 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. Every firm authorised by the FCA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.

Glossary *(continued)*

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 and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment, investment properties and intangible assets.
Funding for Lending Scheme	A scheme launched by the Bank of England and HM Treasury in August 2012 which provides funding to participating banks and building societies with the aim of stimulating lending within the economy.
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 identifiable net assets and contingent liabilities acquired at the date of acquisition.
Gross capital	The aggregate of the general reserve, translation reserve, available-for-sale reserve, cash flow hedging reserve, subscribed capital, subordinated liabilities and non-controlling interests.
Help to Buy	A government-backed scheme in the UK that aims to help first time buyers, whereby the Government effectively provides an equity loan to assist the purchase of new-build properties.
Impaired loans	Loans where the Group expects to collect the contractual cash flows later than they are contractually due.
Individually / collectively assessed	Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.
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 BIPRU 12 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 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.
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.
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.

Glossary *(continued)*

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 bonds as security for cash. As part of the agreement the borrower agrees to repurchase the security at some later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo, 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.
Subordinated debt / liabilities	A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors and investing members (other than holders of PIBS).
Sub-prime	Loans to borrowers typically having weakened credit histories that include payment delinquencies and in some cases potentially more severe problems such as court judgements and discharged bankruptcies.

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 regulated subordinated liabilities and 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 £40m of our 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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