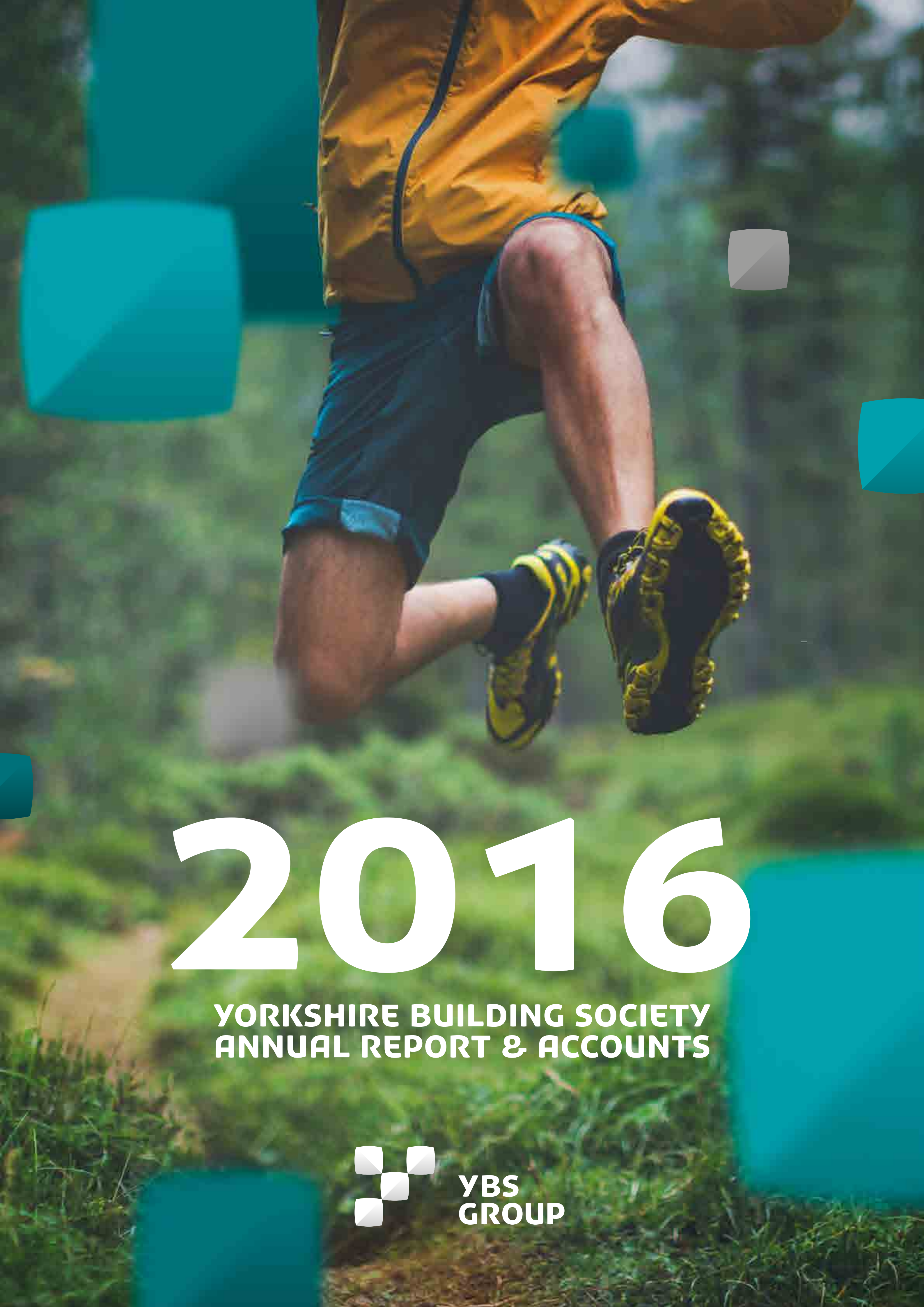


2016

YORKSHIRE BUILDING SOCIETY ANNUAL REPORT & ACCOUNTS

YBS GROUP

DELIVERING LONG-TERM VALUE TO OUR MEMBERSHIP

A focus on a solid performance throughout 2016.

Introduction	2
Performance at a Glance	2
Chairman's Welcome	4
Chief Executive's Introduction	9

Strategic Report	12
Market Review	12
Strategy	14
Business Model	16
Trading Performance	17
Customer Experience	20
People Experience	22
Delivery of Change Activity	26
Locally Famous	28
Financial Performance	29
Principal Risks and Uncertainties	38
Outlook	44
Viability and Going Concern	45

Corporate Responsibility	46
Society Matters	46

Governance	52
Non-Executive Directors	52
Executive Directors	55
Other Chief Officers	56
Directors' Report	58
Corporate Governance Report	61
Audit Committee Report	71
Risk Management Report	75
Directors' Remuneration Report	79
Independent Auditor's Report	94

Financial Information	103
Income Statements	103
Statements of Comprehensive Income	104
Statements of Financial Position	105
Statements of Changes in Members' Interest	106
Statements of Cash Flows	107
Notes to the Accounts	108
Annual Business Statement	181

Other Information	184
Glossary	184

Performance at a Glance

2016 HAS BEEN A CHALLENGING YEAR BUT THE GROUP'S FINANCIAL PERFORMANCE HAS REMAINED SOLID.

- ↑ Gross lending increased by **4.9%** to **£7.2bn**
- ↑ Overall mortgage balances grew by **2.3%** to **£34.1bn**
- ↓ Net lending decreased by **36.3%** to **£0.7bn**
- ↓ **2.9%**[1] share of the gross mortgage market, compared to **3.1%** in 2015

- ↑ Overall savings balances grew by **4.2%** to **£29.1bn**
- ↑ Savings inflow was **£0.9bn** compared to an outflow of **£0.2bn** in 2015
- ↓ **114,000** new savings accounts opened, reduced from **166,000** in 2015
- ↑ Our average savings rates across the Group were **0.38%**[2] above the market average

- ↑ Common Equity Tier 1 (CET1) ratio was **14.9%** up from **14.5%** in 2015

- ↑ Liquidity was **12.8%** up from **12.5%** in 2015 and remains above regulatory requirements

- ↓ Core operating profit decreased to **£128m** from **£185m**
- ↓ Statutory profit decreased to **£152m** from **£173m**

Cost to income ratio increased to **67%** from **63%** in 2015

15 awards across the YBS Group

1,124 Group savings and mortgage Best Buy mentions in 2016, reduced from **3,300** in 2015[3]

Our Net Promoter Score® has increased to **+31**[4] from **+29** in 2015.

In the **top 10%** of the UK brands in the KPMG Nunwood Customer Experience Excellence Study[5].

We are confident that we will be able to build on our solid foundations and manage both challenges and opportunities as they arise.

Sources: [1]Bank of England, as at December 2016.

[2]Based on latest data available. Average savings rates based on savings stock from CACI's Current Account and Savings Database (CSDB) currently covering 85% of retail savings market (based on stock value). Data as at 31 October 2016.

[3]Presswatch Financial from Kantar Media, January 2016 – December 2016.

[4]Nunwood Customer Voice Programme, January 2016 – December 2016. Based on interviews with 29,290 customers.

[5]Nunwood Consulting – Nunwood Customer Experience Excellence Centre Top 100 UK Brands 2016, 287 companies were subject to the study but only the top 100 is published.

Chairman's Welcome

JOHN HEAPS REPORTS ON ANOTHER SOLID FINANCIAL PERFORMANCE.

I am pleased to report that the Yorkshire Building Society has delivered another solid financial performance, and our customers really are noticing the continued focus that we place on them being at the heart of everything we do.

As an organisation owned by our members, who are also our customers, we consistently prioritise delivering good long-term value to our membership and maintaining a strong, sustainable business fit for the future. Our goal is to deliver sufficient profit to maintain financial security, returning potential profits above this level back to our customers in pricing, service and investment for the future.

In 2016 your Board reviewed the Group's strategy to ensure it fully reflects the external environment in which we operate. The review reaffirmed the Vision – to be ***the most trusted provider of financial services in the UK*** – and clarified that our aim for delivering the Vision is to focus on our core business areas of mortgages and savings.

A changing marketplace

The financial services market is changing rapidly as we see increased regulation and competition, changing customer behaviours and a growing demand for digital services. Our mutual business model enables us to recognise and respond to the changing environment whilst remaining focused on keeping our members' interests at the heart of all that we do.

We regularly communicate with members and encourage feedback to help us better understand what matters to them. We also continually review all areas of the business to ensure we are responding to our members' requirements, improving the services we provide and delivering long-term value.

As part of our reviews in 2016, we have recently announced plans to withdraw the Norwich & Peterborough (N&P) brand from the high street and to close 20 Yorkshire and 28 N&P branches. We also plan to withdraw the N&P current account for existing members. These plans, which reflect the changing ways our customers interact with us, ensure that all parts of our business are commercially sustainable and will allow us to focus on our core business areas of providing a safe place for members' savings and funding to help them buy their own home.

These were difficult decisions to make, and we understand the significant impact they will have on some members and colleagues. It is important that we remain relevant to our overall membership and also maintain the long-term sustainability of the Group.

Financial performance

Whilst our profit before tax (PBT) of £152m in 2016 reduced compared to 2015 (£173m) we performed ahead of our expectations for the year. This performance reflects factors mentioned in last year's report and includes a combination of market competition, existing customer product migration, continued commitment to paying savings rates ahead of the market and ongoing investment in our business change activities.

It is your Board's view that this profit level is ahead of that required for the Group to remain sustainable in the long-term and our future financial planning has been based on similar levels. Going forward, we remain strongly focused on enhancing our efficiency so we can continue to offer good rates to our customers and deliver real long-term value.

Full details of our financial performance are outlined in the Strategic Review on pages 29 to 37.

Economic Conditions

The UK saw an impact on confidence immediately following the outcome of the European Union (EU) referendum, but so far the economic indicators have not shown the marked slowdown that many had predicted.

As a UK focused business, the exit of the UK from the EU should not materially affect our core activities of savings and mortgages except through its implications for the broader economic and regulatory environment within which we operate. The process of withdrawing from the EU introduces significant uncertainty into the economic outlook and makes forecasting the next five to ten years even more difficult than usual.

Given this uncertainty the Bank of England chose to cut the Bank Rate to a new historic low of just 0.25% in August 2016 and introduced the Term Funding Scheme to give financial institutions access to low cost funding. These interventions support the current low mortgage rates but have put even greater pressure on savings rates. I'm pleased to report that during 2016 we continued to provide an average savings rate[1] that is higher than the market average. The very low rate environment is unlikely to improve significantly in the near term with very few forecasters believing that the Bank of England will increase the Bank Rate in 2017. During this period we will continue to support our savers to the extent that we are able.

In the housing market, prices have continued to increase at a faster rate than wages, making it more difficult for potential first time buyers to get on the housing ladder, especially as affordability rules do not factor in the current low market rates. In the coming year these affordability constraints are expected to come into sharper focus as inflation increases, putting an even greater squeeze on household finances. For these reasons we expect to see house price growth slow throughout 2017. The supply of housing also needs to increase and we will continue to call on Government and policymakers to address this issue as we do all that we can to help our customers afford the homes they need and want.

Source: [1] Average rates based on Savings stock from CACI's Current Account and Savings Database (CSDB), currently covering 85% of retail savings market (based on stock value). Data as at 31 October 2016.

Chairman's Welcome continued...

Regulation and Legislation

The regulatory landscape is one which has changed much since the financial crisis. The past year has been a time for financial institutions and regulators to take stock of the progress made to date and reflect on areas where some refinement may still be required to regulate lower risk business models proportionately. This includes the building society mutual model which can generate measurable and significant benefits for members, and serve the wider interests of UK consumers.

There are significant developments underway which will affect the Group. Despite being a UK focused business, future changes at a European level, such as changes to capital requirements, will have an impact on us.

"Going forward, we will remain focused strongly on enhancing our efficiency so we can continue to offer good rates to our customers and deliver real long-term value."

The reforms and regulations in the current account market, which will come into effect later this year, mean that continuing to provide this service, and extend it to new customers, would require significant investment. We do not think investing in this area represents long-term value for the wider membership which is why we have taken the difficult decision to withdraw from the current account market and focus on our core business areas of mortgages and savings.

At the time of writing, the Financial Conduct Authority has consulted on its future vision and we are pleased that it has demonstrated a clear and well thought out approach. We are supportive of its study of the mortgage market and believe it will lead to simple, effective and, most importantly, proportionate interventions.

Looking to the future of regulation, it is inevitable that the result of the EU referendum will significantly change the economic landscape, but the full extent of the implications is not yet clear. It is important that during this period of change there is both regulatory certainty and a meaningful transitional period.

Valuing our people

Our performance would not have been possible without the continued dedication, enthusiasm and hard work of the Group's colleagues.

The planned changes to our brands, branches and current account clearly have an impact. Through this period of change, we are doing all that we can to support our colleagues at a time that will inevitably be difficult for them.

On behalf of the Board, I would like to express my thanks to all our colleagues for the way in which they have worked together with professionalism and focus on the Group's long-term strategy, never wavering from our commitment to deliver an exceptional customer experience.

Board Approach to Governance

Our approach to corporate governance is based on the principles and provisions of the UK Corporate Governance Code[2].

Maintaining high standards of corporate governance is a priority for your Board. Good governance provides a framework for the allocation of authority and responsibility and ensures the culture, activities and behaviour within the Group are aligned to the organisation's Values as well as relevant laws and regulations. In 2016 we completed an evaluation of your Board to ensure it remains effective and achieves these requirements.

More information on our Corporate Governance approach and activity is outlined in the report which begins on page 61.

Your Board's role in the development of culture and diversity has been a particular focus during the last year and will remain a priority throughout 2017. The Group has a positive culture and to understand this further and reinforce the behaviours we expect of our people we are working with external experts to help us develop a target culture that is in line with our Strategy, Vision and Values.

More detail about our work on culture and diversity is provided in the Strategic Report on page 24.

Changes to your Board

Chris Pilling, who served as Chief Executive for five years, stepped down from the Board on 31 December 2016. I would like to thank him for his outstanding contribution to the Group's success and we all wish him well for the future.

Chris was succeeded as Chief Executive by Mike Regnier, who joined the Board in 2014. Prior to his appointment as Chief Executive, Mike was Chief Customer Officer and Executive Director. During his time with the Group, Mike has demonstrated a strong commitment to mutual values, considerable commercial command and an engaging style of leadership. These qualities, together with his clear strategic outlook, will ensure we continue to deliver long-term value and excellent service to our members and build on the Group's continued success.

As mentioned in last year's report, Stephen White was appointed to the new role of Chief Operating Officer and Executive Director in February 2016. Stephen has responsibility for leading the Group's operational, IT and change management functions. Andy Caton, Chief Treasury and Corporate Affairs Officer and Executive Director stepped down from the Board in December 2016. Andy had served 25 years with the Group and had been a member of the Board since 2004. I would like to thank him for his considerable contribution and wish him every success for the future.

Non-executive directors, Dame Kate Barker and David Paige, are due to retire from your Board at the conclusion of the 2017 AGM. Kate joined the Board in 2010, and had previously been a non-executive director but stepped down between 2001 and 2010 when she became a member of the Bank of England's Monetary Policy Committee. Kate's extensive knowledge of the economy and financial service industry has been of great value to the Group. David Paige has been a Board member since 2006 and has made an extremely valuable contribution to the Group, particularly in his role as Chair of the Group Risk Committee. I would like to record our thanks and appreciation to both Kate and David for their support and commitment during their service.

I continually monitor the size and composition of your Board to ensure we maintain the balance of relevant skills, adequate succession planning and appropriate recruitment and I expect to be able to announce a new Board appointment shortly.

Corporate Responsibility

As an organisation with a rich heritage of improving and supporting our local communities, acting responsibly has always been part of our Values. In 2016 we increased our focus on corporate responsibility across the business and developed a new strategy, which we call Society Matters. The aim of the strategy is to build on our legacy and create a lasting, positive impact on society, because we believe society matters.

You can read more about our new 'Society Matters' strategy on pages 46 to 47 or see our full Society Matters Report at ybs.co.uk/societymatters

The Future

As I have highlighted in this report, the marketplace in which we are operating is rapidly changing, with economic and political uncertainty expected to continue throughout 2017. Macroeconomic developments are likely to be key drivers of any substantial change in the outlook and we will continue to monitor these challenges.

Competition for retail mortgages will remain fierce, continuing the trend of increased margin pressure. The low rate environment will continue to impact savers and provide challenges in how we can best support them. Customer needs and demands are also changing with an increased reliance on digital channels.

Our customer-led strategy, centred on our core business areas of mortgages and savings will remain our focus for the future. We will continue to make necessary changes to improve the service and value we deliver to our members whilst maintaining and improving the financial strength of the Group.

John Heaps
Chairman

27 February 2017

[2] UK Corporate Governance Code published by the Financial Reporting Council (the FRC) in June 2016.


WITH OUR MUTUAL OWNERSHIP STRUCTURE WE REALLY DO PUT CUSTOMERS AT OUR HEART

Chief Executive's Introduction

Taking over as Chief Executive in January 2017 I am proud to be leading an organisation with such a fantastic legacy strengthened by continued progress in 2016. I am optimistic about the future of the Yorkshire Building Society Group as we continue towards our vision ***"to be the most trusted provider of financial services in the UK"***.

I am pleased to introduce the Group's Strategic Report which provides a comprehensive review of the Group's performance in 2016 including the progress made against the strategic priorities over the past few years.

As a strong, focused, national organisation we face far less distraction than the larger banks when it comes to the impacts of ongoing economic uncertainty, certain regulatory changes and the UK's exit from the EU. This ability to focus means we can continue to devote more of our attention to fulfilling the needs of our members. A good example, highlighted below, is the support we have offered to hard-hit savings customers during 2016. The latest available data shows that the Society paid an average of 0.38% higher than the average market rate[3] compared to 0.19% a year ago. This differential is likely to be higher than we can sensibly sustain in the long run but we are committed to paying 0.15% to 0.25% higher than the average of the market.

Performance

Whilst 2016 was a challenging year, our overall performance was ahead of expectations. The Group has further strengthened its underlying capital base and balance sheet sustainability.

In 2016 we:

- Opened 114,000 new savings accounts (2015 – 166,000), which contributed to net retail inflow of £0.9bn, (2015 – outflow £0.2bn).
- Paid an average savings rate of 1.36% against a market average[3] of 0.98% (2015 – 1.40% (YBS) vs 1.21% (market)).
- Lent a total of £7.2bn in mortgages (2015 – £6.9bn), including £1.3bn to first time buyers (2015 – £1.3bn). This delivered an increase in net lending of £0.7bn (2015 – £1.1bn).

In terms of overall profitability we have seen expected reductions in both profit before tax and core operating profit in 2016. The Group delivered profit before tax of £152m (2015 – £173m). Core operating profit was £128m (2015 – £185m) and we believe this provides a better measure of the underlying profitability of the Group.

This result reflects a combination of the following:

- Increased investment in supporting our savings customers.
- Pressure on mortgage margins driven by ongoing market competitiveness.
- Existing business maturities and redemptions from higher profitability mortgages written during the financial crisis, combined with expected reductions in the number of customers on our standard variable rate mortgages.
- Our ongoing investment in transforming our business. This investment is focused on a combination of further improvements to our customer experience, improving our efficiency and maintaining regulatory compliance.

This performance delivers a level of profit above that needed to sustain the business, whilst ensuring we provide strong long-term value to our members through our products (as demonstrated by the 1,124 best buy mentions we received across our brands).

Our cost:income ratio is in line with our expectations and reflects a reduction in income combined with sustained investment in transforming the business. As we deliver the initiatives noted in the Strategic Report we expect to realise efficiencies which, when combined with our focus on cost management, will result in an improving cost position. Our medium-term goal is to deliver a cost:income ratio below 55%.

[3] Average rates based on Savings stock from CACI's Current Account and Savings Database (CSDB), currently covering 85% of retail savings market (based on stock value). Data as at 31 October 2016.

Chief Executive's Introduction continued...

Customer experience

A key measure of customer satisfaction with our products and service is the Net Promoter Score[4] (NPS) which was +31, increasing by 2 on 2015. NPS is a measure of how willing customers are to recommend the Group's products to others. The NPS measure we use considers the experience of our customers across all brands and product lines, whether they have interacted with us or not in the period.

We are also delighted that we have maintained our rank of 27th for customer experience in the UK through the KPMG Nunwood Customer Experience Study[5]. This is an improvement of 38 places since 2012 and means we maintain our position in the top 10% of all organisations in the study. This demonstrates that our customers really are noticing the continued focus that we place on them, being at the heart of everything we do.

During the year we have also made further improvements to the customer experience within Accord Mortgages (our intermediary lending subsidiary). Key changes made during the year include the continued improvement of mortgage offer times (reducing from 16 days to just over 11), simplifications to our lending policy and website experience as well as improvements to product functionality, particularly the ability for customers to manage their offset savings accounts online. We are seeing much greater levels of customer and broker satisfaction with our products and service as a result of these changes.

Looking forward to 2017

Whilst the economic outlook is uncertain, we believe our conservative approach means the Group is well positioned to manage any risks as they arise.

The Group has a further year of significant change ahead as we continue to adapt our business to reflect changing customer demand, and as we work towards achieving our vision of being the most trusted provider of financial services in the UK. In addition, the pace of regulatory change we need to respond to shows no sign of slowing.

We continually review all areas of the business to ensure we remain focused on what our members require, whilst utilising their money as effectively as possible. This means we must sometimes make adjustments to the way the business operates. The changing demands of our customer base, with increasing demand for digital services and a corresponding reduction in footfall across our branches, are trends that we need to respond to. That's why we have taken the difficult decision to close 48 branches that are not commercially viable. However we remain fully committed to providing the face-to-face service that many of our members value by maintaining a strong, sustainable national network of branches and agencies, with a more extensive network than many of our competitors.

The current account market is also changing, and the regulatory overhead continues to increase as competition authorities encourage more customers to switch providers. This means that continuing to provide the current account service, or extending it to new customers in a commercially viable way, would require a significant increase in our investment in this part of the business. As we do not believe this level of investment would represent good long-term value for the wider membership we have decided to close the N&P current account. Although we understand the proposal may be disappointing to current account customers, it follows thorough research and assessment.

We are also looking to simplify and improve the efficiency of our business to increase engagement both with our customers and our colleagues. Last year we rebranded Chelsea Building Society and withdrew the Barnsley Building Society brand as it is more efficient for us to operate with fewer brands. Hence we have decided that in 2017 we will also be withdrawing the N&P brand from the high street for our retail customers. The N&P brand has been part of the Yorkshire Building Society since 2011, and inevitably, some of our colleagues and members are disappointed by our plans. However the values of the N&P and Yorkshire brands are synonymous and we believe operating with Yorkshire Building Society as our sole high street brand right across the Group will allow us to run the business more effectively and efficiently, enabling us to deliver better products and services for our members.

We believe we will best achieve our vision by focusing on being "simply brilliant" at mortgages and savings.

[4] Nunwood Customer Voice Programme, January 2016 – December 2016. Based on 29,290 completed interviews with customers.

[5] Nunwood Consulting - Nunwood Customer Experience Excellence Centre Top 100 UK Brands 2016; 287 companies were subject to the study but only the top 100 are published.

That is the standard against which we will measure our progress over the next two years. Our plans for the future will allow us to focus more on a streamlined and efficient core business. This means we can reinvest cost savings from greater efficiency in improving the level of service and the value we provide to our members, as well as making our business more sustainable for the future. These are not decisions that we have taken lightly as they impact a number of colleagues as well as customers. We will be looking to manage this process in a way that is consistent with our values and in a way that will minimise the impact on those affected.

Irrespective of our planned changes, our colleagues play a key part in providing a good customer experience for our members and we are focused on creating an environment where our people are engaged, happy and committed in their workplace. In my new role, I am privileged to be leading the Group forward and I will ensure we remain focused on having a financially sustainable business model and that we use our mutual heritage to provide as much value to our members as possible.

Mike Regnier
Chief Executive

27 February 2017

Across the Group we are proud to have won the following industry awards in 2016:

Award	Accolade
Business Desk – Yorkshire Business Masters 2016	Pride CSR
Moneynet Personal Finance Awards 2016	Best Offset Mortgage Provider
Moneynet Personal Finance Awards 2016	Best Fixed Rate Mortgage Provider
Moneynet Personal Finance Awards 2016	Best Debit Card for Use Abroad
Consumer Moneyfacts Awards 2016	First Time Mortgage Buyers' Choice
Business Moneyfacts Awards 2016	Best Service from a Commercial Mortgage Provider
Third Sector Business Charity Awards 2016	Employee Engagement Initiative of the Year
Third Sector Business Charity Awards 2016	Business of the Year
Moneywise Awards 2016	Best Fixed Rate Mortgage Provider
Moneywise Awards 2016	Best First Time Buyer Mortgages
Corporate IT Forum Awards 2016	IT Team of the Year
Moneyfacts Awards 2016	Best Building Society Mortgage Provider
Moneyfacts Awards 2016	Best Fixed Rate Mortgage Provider
Mortgage Finance Gazette Awards 2016	Community Service Award
Mortgage Finance Gazette Awards 2016	Best buy-to-let lender

STRATEGIC REPORT

In this strategic review we set out our assessment of the environment in which we operate, our progress against a range of strategic aims and measures, and the key risks that the Group faces.

1. Market Review

Economic and political overview

The level of political and economic uncertainty in both the UK and internationally increased through 2016.

Key drivers of this include:

- The UK's exit from the EU and how this will be managed is a key factor for 2017 and beyond. To date the impact has been relatively limited with the greatest effects being seen on exchange rates and broader economic confidence. From a Group perspective, given that we operate almost entirely within the UK, we anticipate the direct impacts of an exit from the EU will be relatively limited although there will be an impact from the health of the broader economy.
- The outcome of the US election creates further uncertainty. The direct impact on the UK is not expected to be significant but the broader uncertainty in the US and international economies may be felt.
- International uncertainty has continued to be driven by conflicts in the Middle East, continued levels of terrorist activity, and volatility in both commodity prices and global equity markets. In addition there are continuing difficulties in the European economy including the impacts of the UK's exit referred to above.
- The Government's 2016 Autumn Statement suggested that the public sector deficit would not be reduced as fast as previously indicated and so considerable restriction of public spending is likely. This poses a risk to the broader economy as it will likely impact consumer appetites to save, especially when coupled with the continued low interest rate environment.

Following an initial knock to confidence, the UK economy has posted robust growth in the wake of the EU referendum. The level of impact we will see from our exit of the EU is the key unknown. Any financial shocks resulting from the process of negotiating any trade and wider arrangements with the EU could have a significant impact on the wider economy, affect confidence in the UK housing market and may also impact regulation of the market. The approach taken by the Bank of England so far has indicated that there will be significant support for the economy and so any monetary policy tightening is likely to have moved back further. Current financial market pricing suggests that, following on from the reduction in the bank rate in August 2016, it is likely to be some time before we see a bank rate rise. We believe that the impact of regulatory change and the broader economic impact is likely to impact more on the larger international financial institutions as a result of their greater geographical spread and broader regulatory oversight. We remain vigilant to the changes as they emerge, and to ensuring the Group is positioned to come through them a strong and sustainable business.

UK housing market

The main influences on the UK housing market in 2016 related to stamp duty changes and the impact of the EU referendum. The introduction of a higher rate of stamp duty on second homes combined with changes to stamp duty on buy-to-let (BTL) properties has had an adverse impact on that part of the market. The general concern over EU exit had an immediate impact on confidence. These have been offset by first time buyer growth (partly driven by government supported housing schemes) and an increase in re-mortgage activity as customers seek to take advantage of lower interest rates.

Landlords face more changes in 2017 in the form of stricter affordability checks for BTL mortgages and the start of the withdrawal of tax relief on mortgage interest. The Council of Mortgage Lenders (CML), in their Market View dated December 2016, expects activity to slow as a result and it believes that 2015 will be viewed as the peak for BTL purchases.

The official House Price Index (HPI), re-launched in June 2016 by the Office for National Statistics, looks at the prices paid for all homes and is published several months after the data is collected. 2016 figures show that across the UK prices were up by 7.2%[6] year-on-year. We believe that the shortage of homes for sale is supporting prices at the moment, especially when combined with the current low interest rates available in the market. However, inflationary pressures are likely to impact affordability, particularly in the first time buyer market.

UK savings market

We have seen savings rates under continued pressure throughout 2016. This results from competitive market pressures combined with the forward view of bank rate falling through the year and, ultimately, the reduction in the Bank of England base rate in August 2016.

Reductions to mortgage rates and margins across the sector are putting pressure on lenders' income and the market is reacting by reducing rates to savers as a way of managing overall income. We have seen rates reduce on new business as well as reductions being made to existing customers across the market.

The availability of the new Term Funding Scheme from the Government has put further downward pressure on savings rates as it provides an alternative source of low cost wholesale funding, increasing market liquidity at rates much lower than those paid to retail savings customers.

Competitive landscape

The competitive environment in 2016 continued to be challenging with traditional banks, challenger banks and building societies all competing heavily for mortgages. Interest rates for retail mortgage customers reduced further through the year across all product types and this has also driven increased levels of re-mortgage activity across the market.

We have seen some appetite from new market entrants to grow their savings books but established institutions have experienced relatively low levels of customer attrition. The low rate environment is impacting how rates have been managed across the market, with greater levels of existing customer repricing activity.

Regulatory overview

A significant amount of new regulation is expected to impact the financial services industry over the next few years. The key changes in regulation include:

- **Deposit Guarantee Scheme Directive (DGSD)** – This provides protection to customers in the event of an institution's failure. The additional requirements will enable depositors to access their funds much more quickly in the course of a resolution, as well as an amendment to the support limit in 2017 back to £85,000 (£75,000 in 2016). The majority of these changes are now implemented but refinements will continue.
- **General Data Protection Regulation (GDPR)** – This relates to changes around data protection within the EU including "the right to be forgotten".
- **IFRS 9** – This relates to new rules on how we should account for financial instruments. This will come into effect on 1 January 2018 and will have a large impact on the industry; in particular loan loss provisioning will require a very different approach.
- **Payments Services Directive 2 (PSD 2)** – This is a significant evolution of regulation for the payments industry that aims to increase competition, bring into scope new types of payment services and enhance customer protection and security.
- **Cheque imaging legislation** – Which will require selected banks and building societies to be able to clear cheques electronically via scanned images rather than the current approach of physical cheque clearing.
- **International tax compliance rules** – Which require us to understand where customers are domiciled for tax purposes and share data with the relevant national tax authorities.
- **Ring fencing of retail banking activities** – Which relates to the separation of retail banking activities and investment banking activities, mainly in larger institutions.
- **The latest Basel committee proposals (Basel IV)** – Which relate to capital management and which may lead to a requirement to hold higher levels of capital.
- **The Bank of England's statement of policy** on setting the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) – Which will have an impact in the medium-term on capital and wholesale funding requirements across the industry. Whilst this has been pushed back to full implementation in 2022, the requirement to hold either more capital or have access to debt that can be converted to capital will make the industry more resilient, but will increase costs of funding and capital.

[6] Official National Statistics, Land Registry – UK House Price Index summary: December 2016

1. Market Review continued...

Some of these requirements are intended to increase competition in the financial services market and others are intended to reduce customer risk and risks surrounding organisational failure. These changes will incur cost to meet requirements and may also impact the way the market does business. This adds both a requirement for change and additional uncertainty to how markets will work in the future.

On 14 March 2016, the Financial Advice Market Review (FAMR) published its final report setting out 28 recommendations to increase the accessibility and affordability of the advice and guidance that consumers want and need at all stages of their lives in relation to financial products and services.

The recommendations focus on three key areas:

- **Affordability** – steps to make the provision of advice and guidance to the mass market more cost-effective. The recommendations are intended to allow firms to develop services and engage with customers in a more effective way.
- **Accessibility** – measures to help consumers engage more effectively with advice. These include making consumers' own information more easily available to them and those who advise them, as well as the development of "rules of thumb" and the use of "nudges" to encourage customers to seek support at key life stages.
- **Liabilities and consumer redress** – recommendations to increase clarity and transparency about the way in which the Financial Ombudsman Service deals with consumer complaints.

The Financial Conduct Authority (FCA) now has a working group in place to move these recommendations forward. As the requirements become clearer it is likely to have further impacts on the financial services market in the UK. We welcome these changes as they will help consumers to access advice more easily but the timing of delivery and level of change needed is still not clear.

On 7 February 2017 the Government issued a new White Paper on the UK housing market. This paper sets out the Government's plans to boost the supply of new homes in England. We welcome the direction of these changes as access to affordable housing will support the first-time buyer market.

2. Strategy

> *"Our Vision is to be the most trusted provider of financial services in the UK."*

We monitor our progress against this monthly through a survey which asks people if they agree that "Yorkshire Building Society is an organisation you can trust". For most of 2016 the survey ranked us third out of 15 financial services organisations measured[7].

The Group's current strategy was set and originally approved by the Board in September 2012. It is constantly monitored and adapted to current conditions and was fully reviewed in 2016. It remains valid today.

[7] YBS Brand Tracker, conducted by YouGov (data is on a three month end rolling basis).

Our Vision is supported by five Strategic Priorities:

- Deliver a market leading **customer experience** built on empathy, simplicity and trust.
- Attract and retain the best talent, with a leading **people experience** built on our cultural foundation of 'mutual trust'.
- Deliver **sustainable financial performance** that ensures real financial security for our customers, within our risk appetite.
- Deliver products, processes and systems for all our channels and brands that are **easy and simple** to use.
- Be **locally famous** and meaningfully engaged in our communities.

Our Values, developed and adopted by our people, were introduced in 2013. These are:

- **Customers at our heart** – a simple but powerful principle that guides everything we do.

Achieved by:

- **Being trustworthy** – keeping our promises so people can count on us when it matters most.
- **Keeping it personal** – putting people first with humanity, decency, warmth and care.
- **Being passionate** – loving what we do today and sharing our ideas to make things better for tomorrow.

During our 2016 strategy review we clarified our strategy by being clear on our aim to be ***"simply brilliant at mortgages and savings"***. In order to achieve this we reviewed our business operating model and there were several factors that needed to be considered:

- The changing needs and expectations of our customer base, with increasing demand for digital services and a corresponding reduction in footfall in branches.
- The changing current account market, in particular the likely need for significant investment to meet regulatory requirements and grow the business to a sustainable level.
- The need to simplify and improve the efficiency of our business to improve our sustainability and ability to continue to deliver value to members.

This resulted in the plans we announced recently to close our current account, close 48 branches and withdraw the N&P brand from our retail activities.

These were difficult decisions to make but they allow us to achieve the following:

- Adapt our business model to reflect the changing behaviour and expectations of our customers.
- Simplify and improve the efficiency of our business.
- Maintain a commercially sound and sustainable business; in particular supporting an improvement to our cost:income ratio beyond 2017.
- Allow us to reinvest cost savings from greater efficiency to improve customer experience and service levels.

These decisions were made with a focus on our whole membership, current and future, but also while clearly understanding the impact on those of our colleagues and customers who are directly affected.

We are mindful that, as a mutual organisation, we are able to operate differently to other organisations. In particular, our profitability targets are set around being financially sustainable and returning profits we make, over and above this level, to our customers in pricing, service and investment for the future. Our strategy is built around being clear, on exactly how we will invest those profits to meet our overall vision and purpose. In conjunction with this we have worked hard to understand which parts of our business should drive commercial value, which potentially reduce the value we can give to members, and which parts should be invested in for the benefit of our members. The changes to our operating model reflect this work.

3. Business Model

The fundamental Business Model of the Group is based on differentiating ourselves in the area of 'customer intimacy' – building on the trust agenda. Our two core business segments are retail and non-retail.

The **Retail Business** represents the core focus of the Group in terms of customers, resources, and people. We concentrate on residential mortgages principally funded through retail savings. Together the business units in this area offer:

- Retail savings products.
- Direct and introduced residential mortgages.
- BTL mortgages for landlords (offered through intermediary partners).
- Employee savings and share schemes for companies (via our SharePlans business).
- A range of insurance products and services provided through trusted third party providers.

The **Non-retail Business** consists of our commercial lending business. Commercial lending is a profitable and active business which provides loans to small commercial customers and housing associations, supporting the Group's long-term sustainability through a profitable and stable income stream.

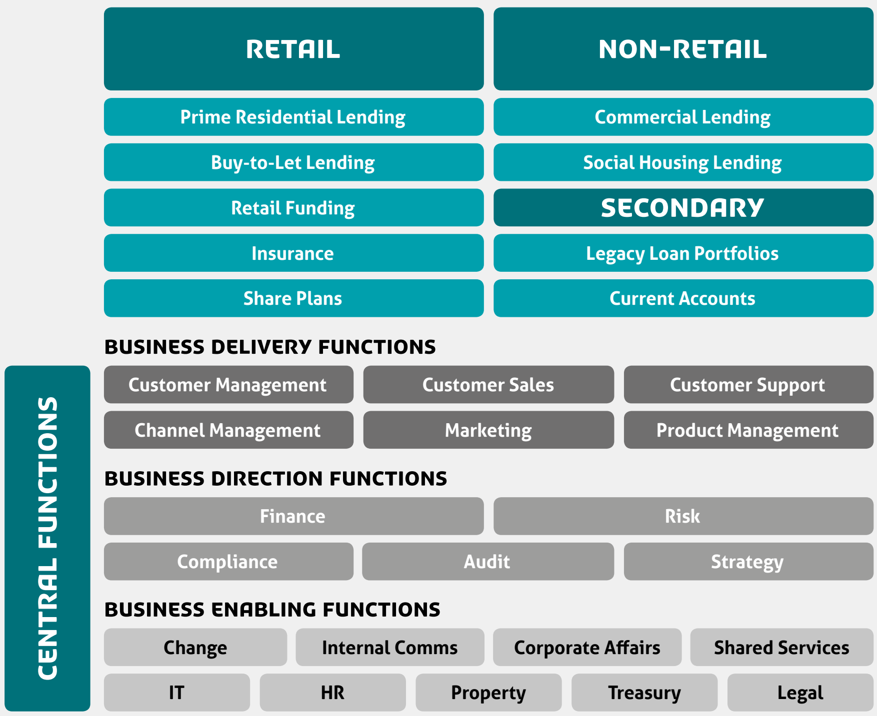
The Group has a set of **Secondary** businesses which consists of portfolios that are no longer open for new business, and which were either inherited through mergers and acquisitions or are areas in which the Group no longer operates. We are managing down these areas, which include a small structured credit portfolio, our credit repair mortgage portfolio and a number of other small loan portfolios. We now categorise our current account business as a secondary business that is being managed down.

Our products and services are distributed through a national network of branches, intermediaries and agencies, as well as through telephony and digital channels.

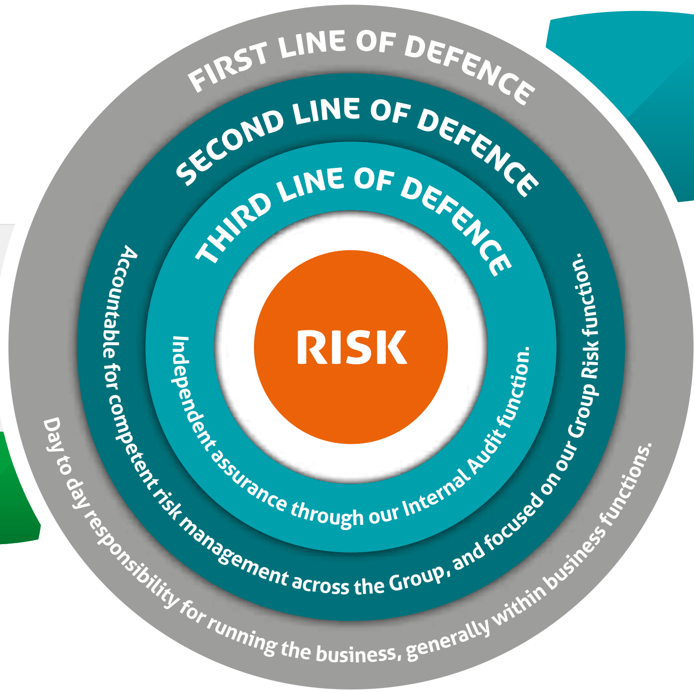
Our businesses are supported by the **Central functions**, which we categorise into Business Direction or Business Enabling functions as appropriate.

Our business model

Our model and business functions can be visualised as:



During 2016 we have continued to embed and improve the Group's three lines of defence model for risk management, which cuts across all areas of our business model. We continue to embed this approach across the organisation as shown in this diagram:



4. Trading Performance

The competitive environment in 2016 has continued to be challenging with traditional banks, challenger banks and building societies all competing heavily for mortgages and driving down rates as a result. In parallel, this competition combined with low base rates has put downward pressure on savings rates across the market. As in previous years we have balanced the growth of the mortgage book with our ability to maintain savings rates. Whilst we aim to protect savers from the impact of low rates we can only do this within the context of maintaining our financial security and ensuring that we do not attract more deposits than we can safely and sensibly lend. We have seen through the course of 2016 that savings rate reductions by other institutions has resulted in the growth of our savings book, to a higher level than planned, as we had decided to insulate our customers from the effect of falling interest rates across the market. As a result of this growth we have had to reduce our rates and have needed to pass rate reductions on to a proportion of our existing customers as we were finding significant balance growth in existing member accounts beyond a level that was sustainable. We nevertheless continued to look to pay above average market rates across our book. Through the course of the year our savings rate differential increased, reaching 0.38% in October and we are in the process of managing this back closer to our long-term target of 0.15% to 0.25% ahead of the market.

Providing residential mortgages is at the core of being a building society and we primarily focus our lending on properties within the prime residential mortgage market.

"As in previous years we have balanced the growth of the mortgage book with our ability to maintain savings rates."

4. Trading Performance continued...

During 2016 we delivered:

Gross lending of

£7.2BN

an increase of 5% on 2015 (£6.9bn) while ensuring our lending has sustainable margins and is within our risk appetite.

Net lending of

£0.7BN

£1.1bn achieved in 2015. The reduction in 2016 is linked to increased customer attrition as explained below.

Market share of gross lending[8]

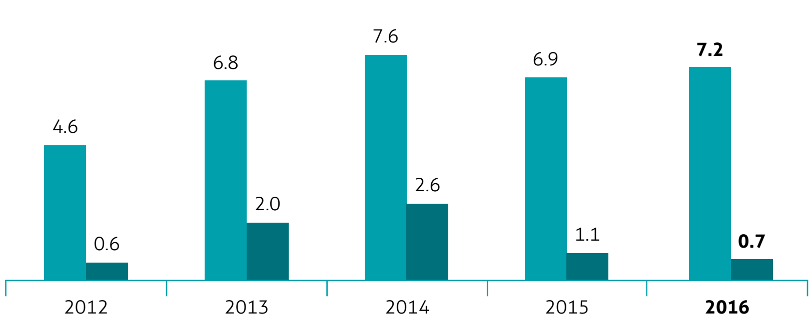
2.9%

compared to 2015's level of 3.1%.

- Within the lending figures noted above we maintained our BTL portfolio at £0.8bn (£0.8bn in 2015). This is not a primary source of business for us but the margins help to support our ability to pay above average market rates to savings customers and we have seen significant market growth in this sector in recent years. Government interventions have impacted this market in 2016 and will do further again in 2017. As such our approach has been to maintain lending at a constant level and risk mix whilst the market reacts to these changes.
- 2016 has continued to see further change in demand with more customers transacting through the intermediary market, and further shifts away from branches towards the web and telephony channels. We aim to allocate our resources to meet customer demand where possible and will continue to reflect their needs in our customer experience investment programme.

Net lending is a key measure to monitor the Group's overall lending performance. It represents gross lending less repayments of principal and redemptions. This measures our effectiveness in both new mortgage lending and in retaining borrowers. We experienced an increase in redemptions and repayments to £6.4bn (up from £5.8bn in 2015). This reflects our balance sheet growth in prior years now reaching maturity combined with the high level of market re-mortgage activity.

Gross and Net Lending £bn



[8] Bank of England, as at December 2016.

Overall mortgage balances grew by 2.3% to

£34.1BN

(£33.3bn in 2015)

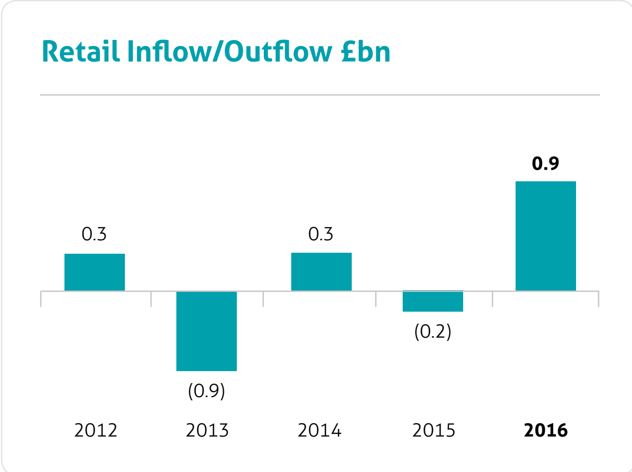
This mortgage growth has been achieved within the risk appetite set by the Board. The average loan-to-value (LTV) on new lending was 69.9% (2015 – 68.9%). The average indexed LTV for the overall residential portfolio was 48.0% (2015 – 49.5%). Our book remains resilient with 83.2% of customers having an LTV of 75% or less (2015 – 80.4%).

The Board monitors the Group's retail savings performance by tracking the net difference between retail savings deposits and withdrawals in any period – referred to as net retail inflow. Our overall savings portfolios had an inflow of £0.9bn in 2016 (compared to an outflow of £0.2bn in 2015) with balances increasing to £29.1bn. This is reflective of our position against the savings rate reductions made across the market in 2015 and 2016. This additional growth is higher than we had planned and so we had to take steps to bring our rates closer to the market and slow this inflow. We achieved this through a combination of reductions to new customer pricing and reductions to existing customer rates where our rate being paid was substantially ahead of the market average and in some cases ahead of 'best buy' rates available elsewhere. We continue to offer average rates that are higher than the market average – the latest data available at the year end shows that our retail savings averaged 1.36% against a market average of 0.98%, a difference of 0.38% (2015 – 0.19%).

We obtain the majority of our funding from retail deposits but also utilise the wholesale funding markets.

We aim to optimise our mix of funding to balance:

- The impact on existing customers.
- The sustainability of the Group.



- Over reliance on one source.
- The level of liquidity we need to hold to ensure we meet our regulatory requirements and internal risk appetite.

Our overall funding mix also needs to be balanced against net lending in terms of overall level and term and future expectations. We have continued to utilise the Government's Funding for Lending Scheme in 2016 and plan to utilise the new Term Funding Scheme as it will support our ability to offer good value mortgage and savings products. As noted earlier this scheme has, however, put greater pressure on savings rates across the market.

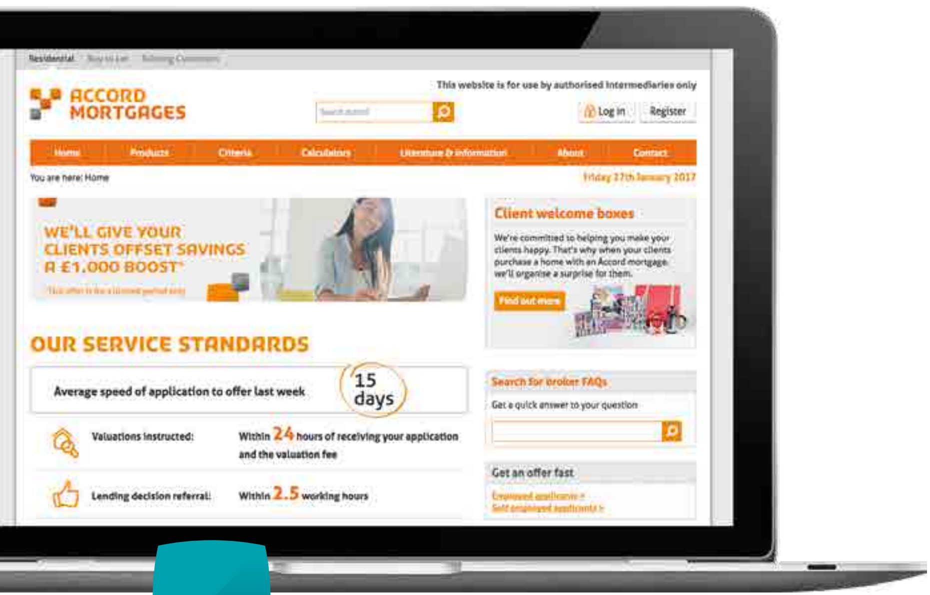
5. Customer Experience

During 2016 we have continued to improve our customer experience across our channels and brands.

This included:

- Embedding the improvements made to our mortgage application processes in 2015 which have resulted in faster turnaround of offers, a more consistent customer experience and improved feedback from our customers and intermediary partners.
- Improvements to our digital offering for Accord, providing benefits to both our customers and intermediary partners who are better able to obtain information and support directly from our website.
- Ongoing integration of our internal systems is allowing greater efficiency internally and also allowing customers from our Chelsea brand to transact in all YBS branches.
- Extending our engagement with our customers through social media.
- Ongoing process improvements – following the successes of work completed in 2015 we now have a rolling programme of process improvements underway. The intention is to improve customer experience and reduce inefficient processes. Approximately a quarter of the organisation has been upskilled in continuous improvement and customer centricity.
- Savings statements – a new annual Savings Statement was developed in 2016 for all 1.1m savers with balances of at least £500. This customer level summary replaced account level statements and provides customers with an aggregated view of their product holdings, balances and interest earned. It also provides customers with information about alternative products available from the Group that could more closely meet their needs.
- The offset mortgage savings functionality available on our Yorkshire and Chelsea websites was replicated for our Accord customers.

As a result of our focus on customer experience we have seen an improvement in the NPS measure during 2016 to a score of +31 (2015: +29). As noted in 2015 this measure reflects a Relationship NPS score which considers the experience of all our customers across all brands and product lines, whether they have interacted with us or not.



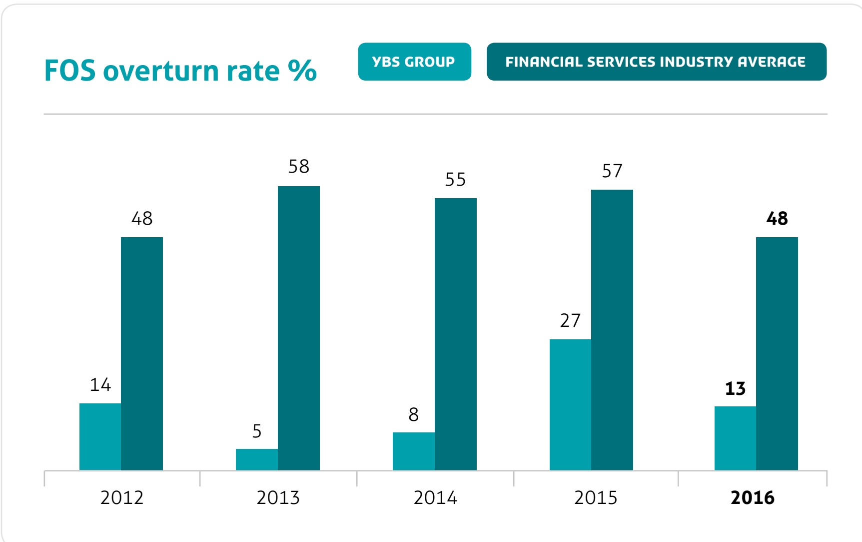
OUR SAVINGS PLEDGES 2017

For savings members we have renewed our annual Savings Pledges originally made in 2015. The six pledges build on our core value of ***"customers at our heart"*** and detail what customers can expect from the Group as a savings provider. The Saving Pledges, which have been welcomed by our customers, are reviewed and updated regularly. As part of these pledges:

- Customers can simply share their email addresses with us and be one of the first to hear about new savings accounts.
- If a customer sees an available savings account and goes on to book an appointment in a branch or agency to discuss it, then we guarantee the account will be available to them for the next 14 days, even if it's withdrawn from sale.
- Customers can make the most of their savings with a health check, to make sure they have the right savings account for their savings goal.

Understanding, adapting and improving the service we offer is an important part of ensuring customers remain at our heart. One of the ways we can do this is by monitoring the complaints we receive and evaluating how well we handle them. In the first half of 2016 the independent Financial Ombudsman Service (FOS) overturned our decisions in just 13% of cases, compared to 27% in the same period in 2015. This change was driven by improvements in the way we handled mortgage complaints and Mortgage Payment Protection Insurance (MPPI) complaints leading to quicker, more effective resolution for all our customers. Our FOS Overturn rate remains significantly better than the Financial Services industry average of 48%[9].

We also received 18% fewer reportable complaints in the first half of 2016 compared to the same period in 2015 meaning we received one banking or savings complaint and 12 mortgage related complaints for every 1,000 customers. In 2016, on average, complaints (excluding MPPI) were resolved in nine days, reduced from 18 days in 2015.



* All figures are for the six months to 30 June to allow comparison to the available industry data.

[9] Financial Ombudsman Service, complaints data showing individual financial business, as at June 2016.

6. People Experience

Engagement
77%
Compared to 70% in 2015

Resignation
11.6%
Compared to 13.6% in 2015

Through our people practices, we aim to create a workplace where people can give their best and thrive. We believe that valuing our colleagues is critical to delivering a market leading customer experience. Consequently, we put significant effort into understanding our colleagues' needs, and what will lead to their enjoyment and commitment at work. For some years, we have been putting the basics into place to reflect a modern organisation, and in 2016 we made further progress on creating a leading people experience.

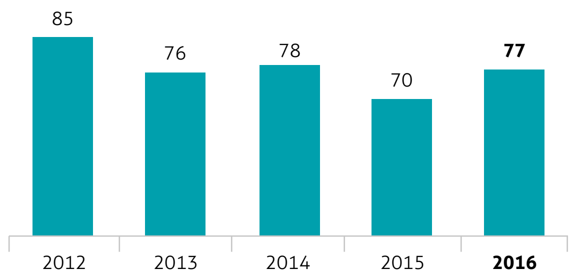
In 2016, we introduced a new bonus scheme which brought all colleagues together on to one bonus framework, with customer experience at the heart of the scheme. We continually talk to our colleagues throughout the year on how we are performing to ensure people understand their contribution to our success. We also introduced a career framework which enables all jobs in the organisation to be transparent on size and position. We will follow this with more support to enable colleagues to influence their future careers.

We have enhanced our recognition scheme to visibly and frequently recognise our colleagues. We've built on the success of our inaugural 'Raising the Roof' event in 2015, and expanded the scheme to include monthly awards. In total more than 1,500 colleagues were nominated in 2016 and our judging panel, made up of colleagues and senior leaders, choose the best nomination each month to attend the next annual event. We also have another scheme targeted at more instant recognition to give 'Everyday Thanks' to colleagues. This has been hugely successful and in its first full year over 17,500 'thank-you's' were sent – more than 40 every day.

We have also improved the ways we listen to our colleagues through an improved intranet, Let's Talk sessions (where colleagues informally meet with senior leaders), and through our colleague survey. The efforts are showing positive progress with our engagement levels improving to 77% in 2016 (from 70% in 2015).

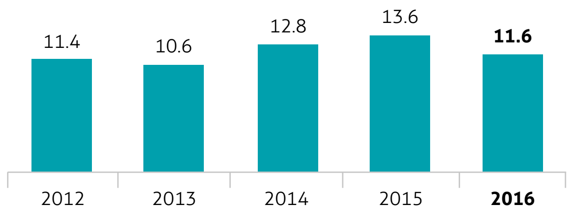
We've kept the same measure of engagement this year; however this will change in future reports as we're now taking part in the Best Workplaces programme run globally by the Great Place to Work® Institute. This gives us the opportunity to be listed as one of the UK's Best Large Workplaces. The 2017 Best Workplaces listings are published in May and it's an important aspiration for us to feature in it.

Engagement %

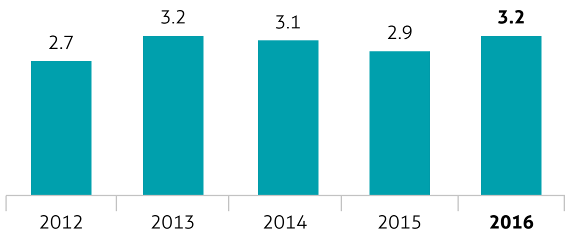


In addition to our higher rates of colleague engagement, we have also seen an improvement in our resignations, decreasing from 13.6% to 11.6%. Absenteeism has increased slightly but is at a level we are comfortable with.

Resignation %



Absenteeism %



We place a great deal of importance on development and support for colleagues to ensure they are able to give their best at work. All our people were supported by a wide range of development opportunities in 2016, either online or through attendance on courses, both internal and external. This included over 1,700 hours of new management and leadership development, designed and delivered both in-house and in partnership with external organisations, as part of our enhanced talent programmes.

During 2017 and beyond we are building better, more effective ways of delivering development so people can effectively utilise it in their role. Currently the majority of training days are part of role-specific inductions, and we are continually improving these courses so that they best meet the needs of our colleagues and the Group. This often means less 'formal' training and more 'informal' development in the workplace, learning from peers or business experts, and colleagues being supported by their line managers. As part of this we are re-shaping our development content to be more relevant and accessible, using an online framework that will become the foundation of all our colleagues' training during 2017.

In 2016 we successfully developed and piloted our new apprenticeship programme, bringing 12 new colleagues into a range of roles in our Bradford administrative office and local branch network, all under the new Government Trailblazer standards. In 2017 we will be expanding the programme into more head office and branch locations across the business.

6. People Experience continued...

Culture

Our culture matters a great deal to us. In 2016 we appointed a new external partner to work with us on developing our already strong culture in line with our strategy and vision, which will continue throughout 2017. Work so far has focused on creating a shared view of the culture we would like across the Group. We are looking to further develop the culture to be confident of delivering future business success along with safeguarding good customer outcomes. In 2017 we will engage everyone across the Group in ensuring this is the way we operate.

Diversity and Inclusion

In 2016 we created a new Diversity and Inclusion role within the People division. Early work has focused on developing an accurate picture of Diversity and Inclusion across the Group. This foundation work has shaped our plan for 2017 and beyond – a plan that isn't driven by specific diversity targets, but instead by an emphasis on inclusion for all.

The Group has a genuine commitment to diversity through fostering an inclusive environment where everyone can contribute to the Group's success and building a balanced workforce.

In order to deliver our commitments, from 2017 the Group will:

- Engage with our colleagues and our partners to provide a wider understanding of diversity, broaden colleague views and ultimately eliminate bias and discrimination.
- Invest in an environment where all colleagues can develop to their full potential, where each individual is treated fairly and valued for their unique contribution.
- Create a working environment that values individuality and difference and fosters an inclusive workplace culture.

Our commitment to building a balanced workforce that genuinely represents the best interests of our colleagues and customers will be an important area for us in 2017; and fostering an inclusive environment where everyone connected to the brand can contribute to the Group's success is our Diversity and Inclusion intent. In 2016 we chose not to sign the Women in Finance Charter as we want to initially build awareness and capability. We will review how we express this commitment externally as we build our capability internally.

Our commitment to building a balanced workforce that genuinely represents the best interests of our colleagues and customers will be an important area for us in 2017.

7. Delivery of Change Activity

A core element of our investment programme is to make things easier and simpler both for our customers and our people. We are well into this programme with substantial delivery to date and the programme continues to adapt to meet both external needs (including regulatory requirements) and internal capabilities. Expectations from our customers continue to change and we need to make sure we are meeting these requirements. We also have to make sure that we are fully compliant with all new regulation that applies to us and this is driving additional demand for change activity.

To date we have mostly focused on strengthening our risk foundations and other core infrastructure, enhancing our three lines of defence risk model, refreshing our branches and offices and embarking on bringing all of our brands together on a single platform. More recently we have started to invest in new and better systems and processes to improve our customer service and efficiency.

Some of the key deliverables in 2016 included:

- Successful migration of our Accord and Chelsea Building Society data to our Single Multi Brand Platform following on from the migration of Barnsley Building Society customer data in 2015. This consolidation allows all Barnsley and Chelsea Building Society customers to manage their accounts in all the Yorkshire Building Society branches and agencies across the UK. It also expands the availability of products and services to these customers whilst allowing us to operate our systems and processes more efficiently.
- Completion of the branding changes announced last year which included the withdrawal of the Barnsley Building Society brand and the conversion of the Chelsea Building Society brand to a web and telesales brand. This resulted in the closure of a number of branches that were no longer needed and their disposal was completed during the year. Linked to this we expanded our agency network, opening six new agencies in the year.
- Investing in making our mortgage lending processes easier for customers and brokers. Customers and brokers now have direct access to an underwriter who will case manage an application throughout the mortgage offer process. This has improved both the time taken to make a mortgage offer and the efficiency of our service. Mortgage offer times reduced by nearly five days during 2016, to an average of just over 11 days. Feedback from brokers and customers has been very positive on the changes that we have made.
- Improving our Accord Mortgages processes, particularly the ability for customers to manage their offset savings accounts in a similar way to our Yorkshire and Chelsea Building Society customers. We have simplified our lending policies (while remaining within risk appetite), as well as improving the Accord website functionality with refreshed branding and a more structured way of providing information to brokers and customers.
- Delivery of the first stage of an outsourced procurement approach to improve our supplier management and procurement efficiency.

As we have progressed on our investments we are ever aware of the increasing regulatory demands across the Group and have to balance the delivery of our customer focused objectives with these regulatory requirements. These projects impact the level of customer focused change we can implement as they tie up subject matter expertise and require changes to our underlying systems and operations.

Our plans for 2017 are targeted mainly at helping us to be simply brilliant at mortgages and savings. Key areas of focus for 2017 are targeted at adapting our business model to focus on mortgage and savings activity, improving our effectiveness and efficiency with a view to enhancing customer experience and ensuring compliance with new regulatory requirements.

The main projects we will be working on in 2017 are:

- Delivery of the changes announced recently which includes the withdrawal of our N&P brand for our retail customers, closure of the N&P current account, integration of N&P systems with other Group systems, and closure and subsequent disposal of 48 branches across our network.
- Building on the process improvements already completed, updating our mortgage processing system to provide a market leading customer experience and provide further efficiencies.
- Ongoing reviews and improvements to a number of our key processes – applying the "lean" methodology to some of our more complex processes and improve the customer experience and our efficiency.
- Delivery of a number of regulatory projects linked to those requirements noted earlier in this report to make sure we are fully compliant with new requirements as appropriate.
- Improvements to our ability to detect and manage financial crime.
- Centralisation and transformation of our customer communication processes to provide a more effective and efficient way of managing customer communications.
- Implementation of a new arrears management system to build our capability and capacity for the future as well as improve the service to our customers. A number of challenges delayed implementation of the system until 2017. However the wider arrears transformation programme continued at pace over 2016 resulting in improved customer experience, people engagement, risk management and control.
- Ongoing work to improve our data and analytics capability. This is initially focused on operationalising our data warehouse and ensuring appropriate governance over data sources and definitions for any data that will be utilised across the business. We are also delivering consistent cross-society approaches for reporting and data analysis.
- Ongoing progress on our Internal Ratings Based (IRB) capital requirements project, which will allow us greater capability in understanding our underlying business and to better utilise our available capital.

We expect 2017 and 2018 to reflect the potential peak of our investment programme, when combined with the efficiencies resulting from the above project. This should result in improvements to our cost:income ratio from 2018 onwards.

8. Locally Famous

Whilst the Locally Famous strategic priority has in previous years focused on our community and environmental activities, during 2016 we expanded the scope to reflect our wider corporate responsibility ambitions. Following a period of thorough stakeholder research, we created our corporate responsibility strategy which we have named Society Matters.

In addition we have published our first Society Matters report which is available from ybs.co.uk/societymatters.

An overview of our Society Matters strategy and a summary of our achievements to date is provided on pages 46 to 51.

9. Financial Performance

In 2016 the Group recorded another year of solid financial performance, with healthy profit underpinned by continued strong capital and liquidity positions.

Progress towards the Group's Vision and Strategic Priorities is closely monitored through a set of Key Performance Indicators (KPIs) reported to the Board monthly via a balanced scorecard which also reports on our current trading performance.

The table below provides a summary of performance against our top KPIs. These and other measures are covered in more detail in this report.

Scorecard category	KPI	2016 Actual	2016 Target	2015 Actual	Page
Trading Performance	Group net lending	£0.7bn	£0.8bn	£1.1bn	18
	Group net retail inflow/(outflow)	£0.9bn	£(0.1)bn	£(0.2)bn	19
	Retail savings balances	£29.1bn	£28.1bn	£27.9bn	19
People Experience	Colleague engagement	77%	*	70%	22
Customer Experience	Net Promoter Score®	+31	+36	+29	20
Easy and Simple	Customer feedback – simplicity	78%	N/A	75%	N/A
Financial Sustainability	Statutory profit before tax	£152m	£130m	£173m	30
	Cost:income ratio	67%	69%	63%	33
	Common Equity Tier 1 Capital ratio	14.9%	15.1%	14.5%	37
	Liquidity ratio	12.8%	**	12.5%	37

Note:

*** We set a target in 2016 to improve on the 2015 result. We have changed survey supplier and hence measurement methodology for 2016. We have maintained the existing methodology for consistency purposes in 2016 but will be aligning the methodology to the Great Place To Work® approach in 2017.**

**** Our liquidity is maintained at all times above our internal stressed and regulatory requirements rather than above a set percentage. This variable target was met at all times during 2016.**

9. Financial Performance continued...

IN 2016 THE GROUP RECORDED ANOTHER YEAR OF SOLID FINANCIAL PERFORMANCE.

As the KPIs show, 2016 has seen a number of improvements compared to the plan we set but there are still a number of challenges driven by the competitive trading environment and our ongoing investment programme.

The Board monitors the Group's performance on both a statutory profit and core operating profit basis. Statutory profit is defined by accounting regulations and provides a clear comparison between organisations. Core operating profit measures underlying performance by excluding non-core items, both positive and negative, such as timing differences that reverse over time (e.g. fair value adjustments) or items of a one-off nature (e.g. asset sales). Statutory profit before tax for 2016 was £152m, (2015 – £173m). Our core operating profit was £128m (2015 – £185m). In a competitive market this is a strong performance and is above the level required for the Group to be a sustainable business as well as being ahead of our original expectations for the year.

£152M
Statutory profit before tax

£173m in 2015

£128M
Core operating profit

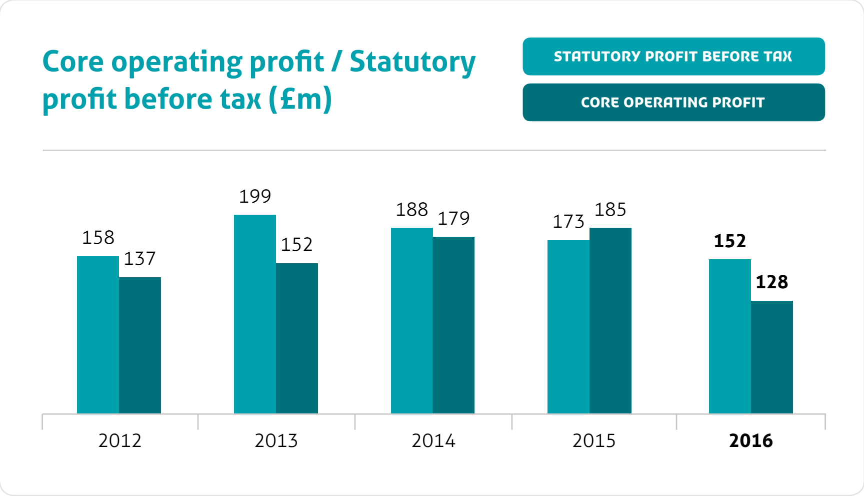
£185m in 2015

£m	2012	2013	2014	2015	2016
Net interest income	346	532	549	535	476
Fair value volatility	(12)	16	(11)	(7)	1
Net realised gains/(losses)	78	(42)	1	2	2
Other income	48	37	26	18	36
Total income	**460**	**543**	**565**	**548**	**515**
Management expenses	(250)	(300)	(331)	(346)	(346)
	210	**243**	**234**	**202**	**169**
Loan loss provisions	(39)	(23)	(20)	(13)	–
Other provisions	(13)	(21)	(26)	(16)	(17)
Statutory profit before tax	**158**	**199**	**188**	**173**	**152**

£m	2012	2013	2014	2015	2016
Statutory profit before tax	**158**	**199**	**188**	**173**	**152**
Reverse out –					
FSCS levy	5	12	12	11	5
Non-core investments	(1)	(14)	(11)	1	(1)
Timing differences – fair value volatility	13	(2)	22	6	(1)
Mergers – adjustments to balances acquired	6	(94)	(32)	(4)	(3)
Mergers and acquisitions – costs	16	2	–	–	–
Mortgage book disposal	-	13	–	–	–
Balance sheet structured debt buy back	(62)	30	–	–	–
Other non-core items	2	6	–	(2)	(24)
Core operating profit	**137**	**152**	**179**	**185**	**128**

The items reversed out in calculating core operating profit include:

- The FSCS levy (£5m) which is our share of the overall cost of funding failed institutions through this scheme.
- The release of fair value adjustment made on merger for the provision of expected lifetime losses (£3m).
- The impact of the following:
  - the sale of properties that we would not expect to see on an outgoing basis (£12m)
  - the Group's benefit from its shareholding in Visa Europe following the latter's acquistion by Visa Inc. (£12m).

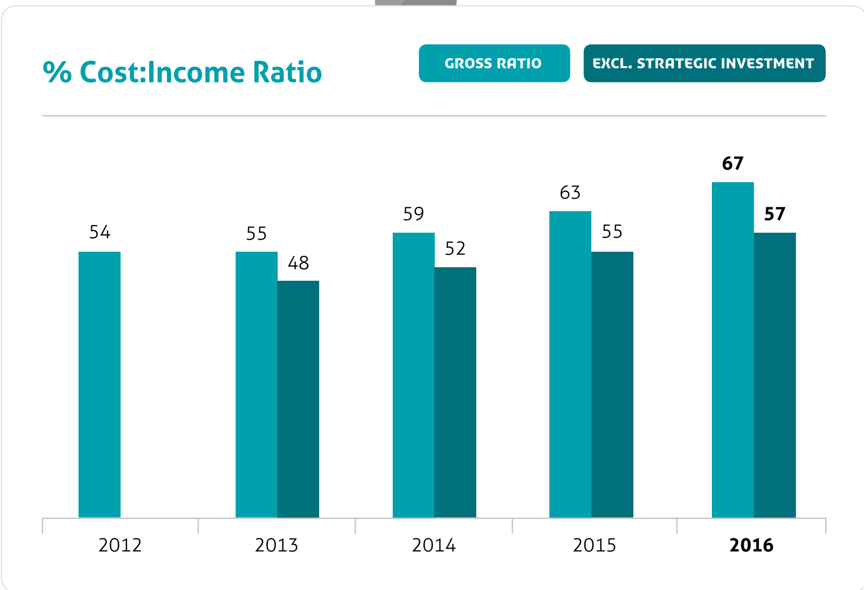


9. Financial Performance continued...

The key movements and trends within the Income Statement were as follows:

- Net interest income was £476m (2015 – £535m). At 1.22% (2015 – 1.41%) Net Interest Margin was down but this was expected and remained in line with our plan. This is a key measure used by the Board and reflects how we have managed the income from our assets and interest paid on our funding. The main factors impacting this through the year include:
  - An expected reduction in the margin on mortgages was experienced through a combination of factors:
    - The relatively low margins currently being experienced on new business due to the competitive environment.
    - A number of product maturities from historic products earning higher margins than current products earn.
    - Increased transfer/redemption activity from SVR customers and customers reaching the end of their product term as rates on new products in the market became increasingly attractive.
  - The continued availability of relatively low-cost retail funding. As mentioned earlier we have seen further reductions to rates in the savings market and when combined with the reduction in the Bank of England base rate made in August this has led to a steady reduction in the cost of funding in 2016. The continued impact of the Government's Funding for Lending Scheme (FLS) and new Term Funding Scheme also put downward pressure on funding rates.
  - Through 2016 we have had to manage our savings rates in line with reductions in the market to avoid excessive deposit inflow, since, whilst we aim to protect savers from the impact of low rates, we must ensure we do not attract more money than we can safely and sensibly lend. Surplus liquidity is held at the Bank of England at the Bank Rate which is much lower than the rates we pay our savers and so we need to manage our liquidity carefully.
- Fair value volatility represents adjustments to the value of some of our assets and liabilities to reflect changes in underlying market rates. These are almost entirely timing differences which will reverse in future years as the assets and liabilities themselves mature. As such this figure could move materially year on year, and we aim to minimise its impact. In 2016 we saw a fair amount of volatility through the year driven by volatile interest and exchange rates in the markets. The final year end figure was less than £1m compared to a loss of £7m in 2015. This follows on from a positive £25m as shown in our half year numbers that related to movements on hedge accounting related to foreign currency denominated wholesale funding and volatility in the wake of the EU referendum. We have continued to review our hedge accounting practices in the second half of the year and made further alignments to best practice that are incorporated in the year end position.
- Other income increased by £18m to £36m. This includes the profits on sales of properties in the year that amounted to £12m, with the sales of our Kings Road, Croydon and Westminster branch properties making up the majority of the proceeds. This also includes the proceeds from the sale of Visa Europe to Visa Inc. where the Group had a small percentage of the proceeds from the transaction as a result of being a member of Visa Europe through our trading activities. All of these items are one-off in nature and so are excluded from our core operating profit.
- Management expenses remained stable at £346m. The factors impacting this included:
  - General inflationary pressures and growth in the size of the business put upward pressure on our cost base.
  - The ongoing impact of increased and changing regulation further increased cost pressure.
  - Continued investment in our change programme. In 2016 we spent a total of £75m on our change activities, of which £66m was charged to the income statement. This level is slightly less than 2015 where we spent £82m, with £71m being charged to the income statement. We do expect this level of spend to increase in 2017 and 2018 which, subject to unexpected factors, will be the peak of our investment plans.
  - Impacts from our cost initiatives being delivered, in particular the closer management of expenses combined with changes made to our operating model as a result of branding changes earlier in 2016. These changes went some way to offsetting the cost pressures noted above.

A key measure used by the Group to manage its overall cost position is the cost:income ratio which looks at the relationship between income generation and our costs. The lower the ratio, the less an institution is spending to generate every pound of income. We have seen an increase in our cost:income ratio in line with our expectations and reflecting the fall in income combined with sustained investment in change initiatives. Excluding our strategic investment costs the cost:income ratio was 57% (2015 – 55%) with the increase driven mainly by expected reductions in income. As we progress the delivery of our planned initiatives through 2017 we then expect to realise efficiencies which, when combined with our focus on cost management, will start to drive a reduction in this ratio from 2018. Our medium-term goal is to deliver a cost:income ratio below 55% including investment costs.



The charge made for impairment on our mortgage portfolios fell from £13m in 2015 to nil. This reflects our continued efforts to manage the quality of our loan portfolios, and the improved economic and housing market conditions during the year.

Charges for other provisions of £17m compared to £16m in 2015. This represents three main items:

- Provisions for customer redress and other similar items which at £12m is higher level than in 2015 (£5m). This charge mainly relates to:
  - The ongoing provision for claims against payment protection insurance (PPI). We have extended the period of the provision as the deadline for claims is still to be confirmed and we have also factored a forecast increase in volumes to reflect greater publicity in the run up to a deadline once it is announced. Our total cost for PPI to date remains low compared to most other institutions.
  - Other customer remediation relating to a small number of specific instances where we had made mistakes we needed to rectify. We remain committed to identifying and fairly rectifying areas where we have made mistakes.
- The cost of the Financial Services Compensation Scheme whereby we, and other retail savings institutions, fund the wind down of a number of failed institutions. This charge of £5m in 2016 (2015 – £11m) reduced mainly as a result of lower interest rates as well as further resolution being completed against institutions that failed through the financial crisis.
- Onerous lease provisions relating to branches that have been closed, but where we still have a lease in place.

9. Financial Performance continued...

Group Balance Sheet

£bn	2012	2013	2014	2015	2016
Liquid assets	5.2	4.4	4.8	4.4	4.7
Mortgage and other loans	27.6	29.5	32.2	33.3	34.1
Other assets	0.7	0.6	0.6	0.5	0.8
Total assets	**33.5**	**34.5**	**37.6**	**38.2**	**39.6**
Retail savings	26.8	26.3	27.2	27.4	28.7
Wholesale funding	4.2	5.9	7.5	7.9	7.9
Other liabilities	0.8	0.4	0.6	0.5	0.5
	31.8	**32.6**	**35.3**	**35.8**	**37.1**
Remunerated capital	0.1	0.1	0.3	0.3	0.3
Reserves	1.6	1.8	2.0	2.1	2.2
Total liabilities	**33.5**	**34.5**	**37.6**	**38.2**	**39.6**

The overall balance sheet grew by 3.6% in 2016. This growth has been driven by a combination of net lending, increased liquidity as a result of higher retail deposits and increased value of other assets. The increase in other asset value links to exchange rate movements impacting derivative valuations on wholesale funding and is offset by an equivalent movement in liquid assets.

Our funding base is predominantly comprised of retail savings but we do have a diversified approach to our funding. At the end of 2016, 92% (2015 – 90%) of mortgages were funded by retail savings and retained profits.

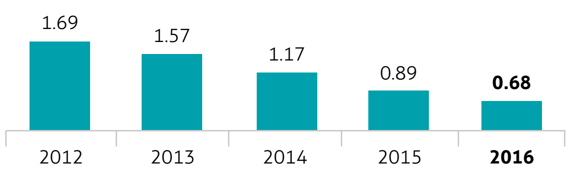

Maths Challenge

Arrears

The quality of our mortgage portfolio is monitored by management and the Board on a monthly basis using a number of indicators. The most important indicator is the percentage of outstanding retail mortgage balances in arrears by three months or more (including possessions). The value of such loans reduced from 0.89% in 2015 to 0.68% as at 31 December 2016.

The industry average for mortgage arrears is measured as the number of accounts more than three months in arrears (including possessions) – and at 0.76%, (2015 – 0.96%) our performance remains below the CML industry average of 1.03%[10] (2015 – 1.20%).

Three months arrears %

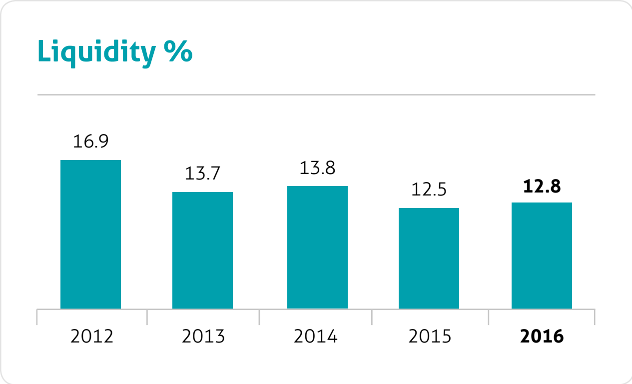


[10] Source: Council of Mortgage Lenders, as at December 2016.

Liquidity and wholesale funding

One of the key measures that we are required to report to the Prudential Regulation Authority (PRA) is the liquidity ratio. This expresses the total cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets as a percentage of our shares and borrowings. It is inefficient to hold significantly more liquidity than is required as excess liquidity earns less than it costs to fund. For this reason the Group has managed its liquidity levels down in recent years (to optimise the cost of holding it) whilst continuing to maintain prudent levels of liquidity. Throughout the year we remained comfortably above the liquidity thresholds set by the PRA (and by our own stress testing models).

We have continued to participate in the wholesale funding markets in 2016, with successful £400m ten year unsecured debt and £300m mortgaged backed securitisation issuances.



Capital

Whilst delivering further balance sheet growth we have improved the Group's already strong capital position. One key measure that the Board monitors on a monthly basis is the Common Equity Tier 1 (CET1) ratio which represents the strongest form of capital. For us it mainly reflects our accumulated profits built up over time. The ratio compares this to the Group's assets, weighted by the level of risk they carry.

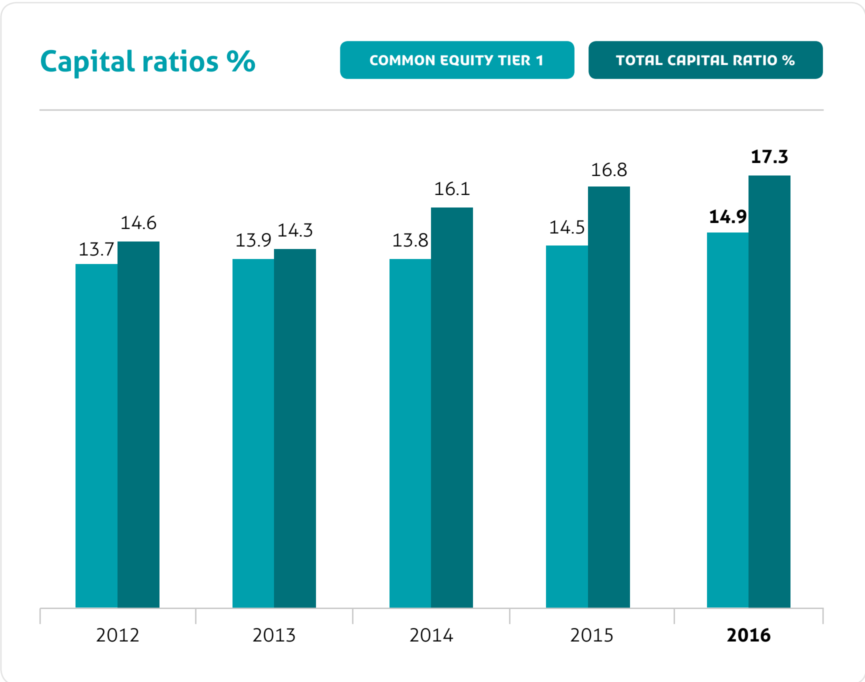
As at 31 December 2016:

- Our Common Equity Tier 1 capital ratio was 14.9%, increasing from 14.5% at the end of 2015.
- Our Total Capital Ratio increased from 16.8% in 2015 to 17.3% in 2016.

The leverage ratio provides another measure of our capital position. This measure removes the risk weighting used in the CET1 ratio and adds in a measure of off-balance sheet exposures to the asset side of the equation, requiring capital to be held against items such as mortgage offers that have yet to complete.

At the end of 2016 our leverage ratio increased to 5.1% (2015 – 5.0%).

This does not become a mandatory measure for the Group until 2018 but we are already well above the minimum regulatory requirement of 3% and we expect our leverage ratio will compare favourably with most of our key competitors. The leverage ratio would be 5.6% if the Group applied for the temporary modification of the ratio based on the recommendation of the Financial Policy Committee of the Bank of England, issued in August 2016.



10. Principal Risks and Uncertainties

The Group has constructed its systems of risk monitoring and control around the full set of risks identified across the organisation. The Board manage risk through risk appetite metrics, which are aligned to the principal risks set out below:

Prudential – Credit Risk	Prudential – Financial Risk	Operational Risk	Compliance and Conduct Risk	Business Risk
▪ Retail credit risk ▪ Commercial credit risk ▪ Wholesale credit risk	▪ Balance sheet management risk ▪ Collateral and encumbrance risk ▪ Fair value volatility risk ▪ Liquidity and funding risk ▪ Market risk ▪ Model risk ▪ Pension risk ▪ Provisioning risk	▪ Operational resilience ▪ Change risk ▪ Financial management, reporting and tax risk ▪ Fraud risk ▪ Information management risk ▪ Information security risk ▪ IT risk ▪ Payments risk ▪ People risk ▪ Premises risk ▪ Third party risk	▪ Complaints and redress risk ▪ Customer treatment risk ▪ Financial crime risk ▪ Reward and remuneration risk ▪ Product governance risk ▪ Sales suitability risk	▪ Capital risk ▪ Also includes a broader set of risk measurements already included elsewhere in this table

The Group operates risk management under a 'three lines of defence model' (3LOD) which has undergone further development in 2016. First line incorporates the risk management activity completed by the functions that own and manage the risks. Second line incorporates independent review and challenge to first line risk management as well as providing risk management frameworks and support to the first line. Third line comprises independent assurance generally provided by the internal audit function.

Details of our risk management infrastructure and approach, and emerging risks relevant to us are described in the Risk Management Report on pages 75 to 78.

Our risk profile evolves as we move through the economic cycle. Set out below are the principal business risks that currently impact the Group. We have also explained how we manage and measure the risk along with progress achieved in 2016:

CREDIT RISK: RETAIL AND COMMERCIAL

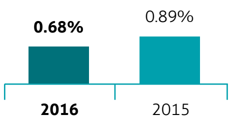
The risk that a borrower fails to pay interest or to repay principal on a loan on time.

Risk mitigation

- Retail and Commercial credit risk is constrained by a Board approved risk appetite, which is further governed through the Retail and Commercial Lending Policy.
- A robust credit risk framework helps to ensure that lending remains within risk appetite limits. Adherence is monitored regularly through governance committees.
- Stress testing confirms portfolio resilience.
- Credit risk metrics are benchmarked against competitors and industry averages.

Key risk indicators

Mortgage arrears
≥ 3 months by value



Commentary

- 2016 has seen continued improvements in arrears performance and favourable HPI movements.
- Investment has been made to embed our 3LOD principles for credit risk management including organisational changes to ensure appropriate resources exist across the first and second lines of defence.
- In 2017, the credit risk focus will be continued delivery of strong asset quality aligned to responsible growth of the mortgage book.

CREDIT RISK: WHOLESALE

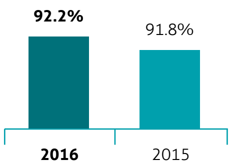
The risk of default on exposures arising from operational balances with other financial institutions, liquid asset holdings and the use of derivative instruments to manage interest rate and foreign exchange risk.

Risk mitigation

- Wholesale credit risk is constrained by a Board approved risk appetite, which is further governed through the Statement of Policy on Wholesale Credit Risk.
- Most of the Liquid Asset Buffer portfolio is invested in the highest quality assets.
- The majority of derivative contracts are subject to centralised clearing to minimise credit risk exposures to counterparties. Where this is not possible, derivative exposures are restricted to high quality counterparties which are subjected to regular review and scrutiny by the Group's Prudential Risk Committee.

Key risk indicators

Wholesale AA- or above



Commentary

- Each wholesale counterparty limit is reviewed at least on an annual basis or sooner if a risk event occurs in the interim.
- The size of the credit limit allocated per counterparty is driven by their credit status as determined by internal analysis and is calibrated to the size of the Group's capital position to ensure that the financial viability of the Group is not overly exposed to any single counterparty.

10. Principal Risks and Uncertainties continued...

LIQUIDITY AND FUNDING RISK

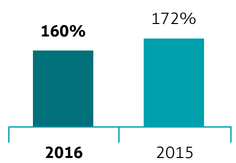
The risk of the Group having inadequate cash flow to meet current or future requirements and expectations.

Risk mitigation

- Liquidity and funding risk is constrained by a Board approved risk appetite, which is further governed through the Statement of Policy on Liquidity and Funding Risk.
- The risks and controls around the management of liquidity risk are outlined in the Internal Liquidity Adequacy Assessment Process (ILAAP) document which is approved annually by the Board.
- The Group operates a range of internal stress tests to ensure that sufficient liquidity is available at all times to address stress and business as usual requirements.
- The Group also manages to the external regulatory measure, the Liquidity Coverage Ratio (LCR).
- The Group is primarily funded through retail savings balances, supported by a strong franchise in key wholesale funding markets.

Key risk indicators

Liquidity Coverage Ratio



Commentary

- The LCR as at the end of 2015 was 172% with the position at the end of December 2016 at 160%. This has predominantly been driven by an increase in savings balances providing additional liquidity.

MARKET RISK

Interest Rate Mismatch:

The risk that the value of, or income derived from, the Group's assets and liabilities changes unfavourably due to movements in interest rates and foreign currency rates. Interest rate mismatch risk arises from the different re-pricing characteristics of the Group's assets and liabilities.

Basis Risk:

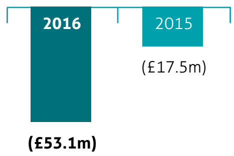
Basis risk arises from possible changes in spreads where assets and liabilities re-price at the same time, but move in differing amounts causing unfavourable impacts to earnings.

Risk mitigation

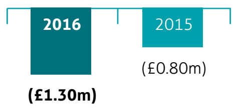
- Market Risk is constrained by a Board approved risk appetite, which is further governed through the Statement of Policy on Market Risk.
- The Group adopts a risk averse approach to interest rate mismatch although some scope for position taking is allowed in line with an agreed in house rate view, subject to the agreed risk appetite.
- The Group operates a wide range of measures and scenarios that review this risk in respect of both earnings and value.
- The Group's limits for basis risk include limits for sensitivities around isolated movements in underlying rates (LIBOR/SONIA), for overall mismatch ratios and for ensuring the Group has sufficient levels of margin management capability.

Key risk indicators

PV200 Market Value



SONIA Sensitivity



Commentary

- The PV200 (Market Value change on Group Balance Sheet of a parallel 2% increase in interest rates) has increased year on year (point position at year end) due to increased utilisation of risk limits against the approved internal rate view.
- The sensitivity to a 1bp isolated change in SONIA (overnight) has increased since year end 2015, primarily due to the maturity of a number of bank rate versus SONIA basis swaps in 2016.

10. Principal Risks and Uncertainties continued...

OPERATIONAL RISK

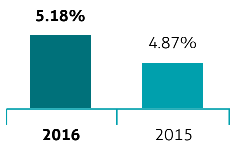
The risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems, and from external events.

Risk mitigation

- Operational risk is constrained by a Board approved risk appetite, which is further governed through the Enterprise and Operational Risk Policy.
- The Operational Risk Committee provides oversight across the Group's operational risk exposures.
- The Group's Risk Management Framework sets out how colleagues are expected to identify, assess, monitor, manage and report their risk exposures. A Control Self Assessment process outlines the controls that must be followed and the frequency of assurance.
- Other operational risk management processes include the recording and analysis of operational losses and monitoring of Key Risk Indicators. Extreme risks are also assessed through scenario analysis and stress testing.

Key risk indicators

Operational Losses
% of core operating profit



Commentary

- A benchmarking assessment of the Group's operational risk maturity against regulatory standards was completed in Q1 2016.
- Resourcing upgrades of the Operational Risk and Internal Control function were completed during 2016. Other key risk management appointments in the business included Heads of Risk in Customer Services and Customer Divisions respectively, and a Head of People Risk.
- An enhanced operational risk operating model was approved by Operational Risk Committee in Q4 2016. Each division is now developing their own implementation plans for delivery during 2017/18.

CONDUCT RISK

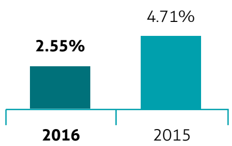
The risk that the Group fails to design and implement operational arrangements, products, systems and controls such that it can maintain legal and regulatory compliance, deliver fair customer outcomes and achieve a positive experience for customers.

Risk mitigation

- Conduct risk is constrained by a Board approved risk appetite, which is further governed through the Conduct Risk Strategy and Group Risk Management Policy.
- Key conduct risk metrics are in place through our conduct risk MI book to manage and monitor the key conduct risks within the Society.

Key risk indicators

Reportable Complaints
(per 1,000 customers)



Commentary

- A compliance monitoring plan, agreed with Group Risk Committee, has been completed during 2016 allowing robust oversight of the key areas of conduct risk with action plans agreed for all areas of weakness identified.
- Clear responsibilities have been determined in a revised governance model that established defined risk management and oversight accountability within the divisions and executive risk committees.

BUSINESS RISK

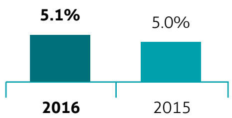
Risks that threaten the ability to remain a sustainable and independent mutual. In addition to risks already covered, this includes Capital Risk, the risk of the Group having inadequate capital or earnings to meet current or future requirements and expectations.

Risk mitigation

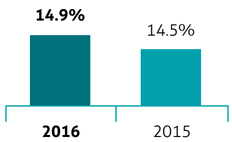
- Capital risk is constrained by a Board approved risk appetite, which is further governed through the Capital Strategy.
- Current and projected capital positions are regularly monitored and also considered in stress scenarios as part of the Internal Capital Adequacy Assessment Process (ICAAP).
- Specific details on capital management can be seen in the Group's Pillar 3 disclosures (available on the Group's website).

Key risk indicators

Leverage Ratio



CET1 Ratio



Commentary

- All key capital ratios including the leverage ratio increased from 2015 to 2016 and remain above both regulatory requirements and internal risk appetite levels.
- The Group maintains a strong capital position both currently and in forecast, while developing its capability to move to an Internal Ratings Based (IRB) method of calculating capital requirements for credit risk.

11. Outlook

THE RETAIL FINANCIAL SERVICES ENVIRONMENT REMAINS FAST-PACED AND CHALLENGING, WITH CUSTOMERS' NEEDS AND EXPECTATIONS CHANGING IN LINE WITH OTHER RETAIL SECTORS.

The most successful providers in the sector are balancing delivery, reacting to the changing demand and building increased focus on web and telephony channels whilst optimising existing channels. We expect the importance of digital channels to continue to increase but still need to balance that with the level of demand we have for our network of branches and agencies.

Political and economic uncertainty will continue to be a factor in the UK, with the potential to affect our markets adversely although the level of impact is not clear at present and is subject to a number of factors covered earlier in this report.

A significant amount of new regulation will impact the financial services industry over the next few years. We have already referred to work ongoing on some of these as they will also impact the Group. Whilst these requirements are intended to increase competition in the financial services market, reduce customer risk or mitigate organisational failure, the changes will incur cost to meet requirements and may also influence the way the market operates. This adds both a requirement for change and further uncertainty beyond that driven by the economic and political landscape.

Overall, the Board believes that 2016 showed a good year of progress with a number of tangible deliverables from our investment programme. Our performance was ahead of our plan set at the start of the year and we anticipate stable margins through 2017. We believe that 2017 will present additional challenges given the level of uncertainty in our markets but will also provide new opportunities. Furthermore, we are confident that we will be able to build on our solid foundations and manage both challenges and opportunities as they arise.

> *“We are confident that we will be able to build on our solid foundations and manage both challenges and opportunities as they arise.”*

12. Viability and Going Concern

The Directors confirm that they consider that the Group has adequate resources to continue in existence for at least 12 months from the date of signing these financial statements, and so the requirements of the principles surrounding going concern accounting requirements can be met. This confirmation is made after having reviewed assumptions about future trading performance, liquidity requirements, capital requirements and sustainability contained within our Corporate Plan. The Directors also considered potential risks and uncertainties in the business, credit, market and liquidity risks, including the availability and repayment profile of funding facilities. Based on the above, together with available market information and the Directors' knowledge and experience of the Group and markets, the Directors continue to adopt the going concern basis in preparing the accounts for the year ended 31 December 2016.

For the purposes of the viability statement, the Directors have determined three years to be the most appropriate period to consider, as this covers the typical term of a large proportion of our products and is the longest period over which the Board considers that it can form a reasonably firm view over the possible macroeconomic environment and associated key drivers of business performance.

The Directors have assessed the viability of the Group over a three year period to December 2019, taking account of the Group's current position and the potential impact of the risks documented elsewhere in the Strategic Report. The Group's financial planning process comprises a budget for the next financial year, together with a forecast for the following four financial years. Achievement of the one-year budget has a greater level of certainty and is used to set near-term targets across the Group. Achievement of the five-year corporate plan is less certain than the budget, but provides a longer term outlook against which strategic decisions can be made.

The financial planning process considers the Group's profitability, capital position, liquidity and other key financial metrics over the period. These metrics are subject to sensitivity analysis through the annual Group ICAAP (Internal Capital Adequacy Assessment Process) and ILAAP (Internal Liquidity Adequacy Assessment Process). The Group stresses its capital and liquidity plans, under "severe but plausible" stress test scenarios, in line with PRA requirements.

The ICAAP stress test ensures that the plan projections for capital requirements and capital generation are resilient to stresses should the environment deteriorate beyond the levels currently envisaged. The resulting potential erosion in the capital excess is held as a capital planning buffer to ensure that the Group can continue to meet its minimum capital requirements at all times.

The ILAAP stress test ensures that the Group holds adequate liquid assets in terms of both quality and quantity sufficient to meet both its business as usual liquidity needs and any increased requirement that could occur as a result of the Group entering into a period of stress. Planned liquidity levels meet the Group's key risk appetite measures over a period of three years.

The Board has undertaken a robust assessment of the principal risks and uncertainties that could threaten the business model, future performance, solvency or liquidity of the Group. These risks are described in section 10 of this Strategic Report. The Group's risk management framework and governance structure are described in the Risk Management Report.

Based on the assessment set out above, the Directors have a reasonable expectation that the Group will continue in operation and meet its liabilities as they fall due over the period to December 2019.

Robin Churchouse
Finance Director

27 February 2017

Corporate Responsibility

SOCIETY MATTERS

ybs.co.uk/societymatters

As a mutual organisation we have a rich heritage of making a positive difference to the communities in which our members and colleagues live and work.

In recent years the Group has made significant progress on our corporate responsibility ambitions and our achievements have been recognised through several prestigious awards – including being crowned Business of the Year at the 2016 Third Sector Business Charity Awards.

Our new Society Matters strategy aims to build on this legacy and create a lasting, positive impact on society, because we believe society matters.

In 2016 we identified 12 priorities key to achieving this vision and conducted surveys, interviews and workshops with our stakeholders, including customers, colleagues and suppliers, to gather their views and refine the priorities.

Based on the results of this research, we grouped the priorities together under Customer, People, Community and Environment, to create the Society Matters strategy.

Society Matters strategy

Focus areas	Vision	Priorities
Customer	**We will be market-leading for financial inclusion and deliver tailored outcomes for all customers.**	1 Enable all individuals to save by offering a variety of options to suit their specific needs. 2 Support people through every step of their journey to having a place to call home. 3 Provide adapted support to customers in challenging situations.
People	**We will be a leading employer, where colleagues feel respected, valued and proud to work for us.**	4 Develop our culture of supporting and engaging all colleagues, prioritising their wellbeing and promoting diversity. 5 Provide opportunities and support for every colleague to develop and reach their potential, celebrating their successes along the way.
Community	**We will be an active member of the communities we serve, using our expertise, passion and scale to maximise our impact.**	6 Deliver educational programmes to improve employability and financial literacy. 7 Provide life-changing support to people in the most challenging situations. 8 Meaningfully engage with our local communities to enable them to thrive and prosper.
Environment	**We will be respectful of our planet and continuously reduce our environmental footprint.**	9 Minimise our environmental footprint, through responsible procurement and reduction of our impacts across energy and water consumption, travel and waste. 10 Raise awareness and understanding of environmental risks and opportunities amongst colleagues and customers.
We will create a lasting, positive impact on our society – because society matters.		11 Choose partners, suppliers and corporate clients which share our purpose, values and ethics. 12 Embed Society Matters into the heart of everything we do and communicate transparently and regularly to stakeholders on our progress.

Leading our strategy

Each area of the Society Matters strategy is led by a member of the senior leadership team, who, alongside key Chief Officers, and led by our Chief Executive, form the Society Matters Committee. The Society Matters Committee is responsible for delivering the strategy, reporting on progress to the Board and communicating with our stakeholders.

CUSTOMER

In 2016:

66,000
customers joined the Society by opening savings accounts, including over 11,000 children and 6,000 regular savers.

23,000
customers bought a home of their own with the support of a YBS Group mortgage, including 10,000 who were getting on the property ladder for the first time.

20,000
customers who said they were in financial difficulty were supported, leading to a reduction in mortgage arrears by 15%.

23,000
customers were identified as being in vulnerable situations, allowing us to tailor the support we provide accordingly.

Specialist support

We have set up a specialist support team to give colleagues guidance on how best to meet the needs of all their customers and provide practical help. For instance we provide all branches and agencies with care kits, created in conjunction with the Royal National Institute for the Blind (RNIB). These feature useful equipment such as pen grips and magnifying glasses for customers with sight loss, arthritis and restricted mobility. We're also beginning to train our colleagues in how to identify and support customers with dementia or mental health difficulties.

2017 plans:

FLEXIBLE ISA

- We plan to launch a Flexible ISA, giving savers even more freedom to pay in and withdraw money as they wish whilst making the most of the tax benefits.

SUPPORT FOR CUSTOMERS

- We aim to offer customers will writing and funeral planning services to further support loved ones at difficult times.

HELP WHEN IT'S NEEDED MOST

- We will continue our efforts to help customers in potentially vulnerable situations by beginning to offer those coming to the end of an interest only mortgage term access to expert external advice.

PEOPLE

In 2016:

12
apprentices recruited to our head office and Bradford branch.

17,500
'Everyday Thanks' messages were sent between colleagues

77%
score achieved for colleague engagement[11].

6,100
claims on the health cash plan, which is provided free by the Group.

Apprenticeships

Mya Griffiths is the Group's first IT apprentice. Despite getting great results at A-level, Mya didn't want to study at university. So she chose to join us instead – and she's not regretting it.

"My manager, Andrew Hepworth, is a great manager. He's been very supportive. It means I love working here and I'd like to progress in the organisation."

2017 plans:

MORE APPRENTICES

- We plan to expand the apprenticeship scheme with up to 24 new apprentice positions being offered.

WORK-LIFE BALANCE

- We aim to introduce a formal wellbeing programme for all colleagues and further support to balance family life with work.

INCLUSION AND DIVERSITY

- We will work with colleagues and external experts to create a more inclusive and diverse workplace.

RECOGNITION

- We will be looking at ways to involve our customers in our recognition schemes, including introducing customer nomination of colleagues.

[11] As measured by Best Workplaces, as at November 2016. Great Place to Work® UK is part of a global research, consulting and training consultancy that helps organisations identify, create and sustain great workplaces through the development of high-trust workplace cultures. http://www.greatplacetowork.co.uk/ Our 2016 score is comparative to our previous Viewpoint survey results from 2015

COMMUNITY

In 2016:

64%
participation in our colleague volunteering programme, significantly increased from 35% in 2015, with 26,000 volunteering hours donated by colleagues.

£1.15M
raised over our 2½ year partnership with Marie Curie, funding over 57,500 hours of nursing care for terminally ill people.

£554,000
donated to local charities and good causes by Yorkshire Building Society Charitable Foundation, bringing the amount donated since 1999 to £7 million.

Growing skills by giving time

Our community programmes not only benefit our local communities, but also help to improve colleague engagement and skills development.

After carrying out volunteering activities, 86% of employees felt their teamwork skills had improved and over 72% said their communication skills had been enhanced. 73% reported increased sense of wellbeing and job satisfaction and 67% said it made them feel prouder to work for YBS, with 94% of colleagues saying they would volunteer again.

2017 plans:

END YOUTH HOMELESSNESS

- We will launch a new and exciting three-year partnership with End Youth Homelessness to enable over 700 homeless young people to live independently.

FINANCIAL LITERACY

- We plan to expand the reach of our financial literacy programme, Money Minds, focusing in particular on reaching schools in more deprived areas.

HELPING THE ELDERLY

- We aim to have at least 75 colleagues making regular calls to an isolated elderly person, as part of our support to the charity Silver Line.

ENVIRONMENT

In 2016:

8% reduction in our carbon footprint between 2012 and 2016, and CarbonNeutral®[12] status achieved.

3% reduction in our energy use (gas and electric combined) on top of the 5% we achieved in 2015.

90% of our waste is recycled and we have reduced our office paper use by 10%.

Solar power

A key emission reduction measure has been the installation of over 1,300 Solar panels at our Bradford and Peterborough offices with a generating capacity at peak of up to 350 MW – enough to continually operate 2,000 PCs or 50,000 energy efficient light bulbs, and reduce our carbon dioxide emissions by 160 tonnes per year.

2017 plans:

LOWER CARBON FOOTPRINT

- We aim to continue to reduce our carbon footprint to achieve a 20% reduction by 2020 (against a 2012 baseline).

REDUCED ENVIRONMENTAL IMPACT

- We plan to explore opportunities to work with our suppliers and customers to begin to reduce our environmental impact throughout our supply chain.

ZERO WASTE

- We plan to reduce our waste sent to landfill, aiming to completely eliminate it by 2020.

FIND OUT MORE BY VISITING YBS.CO.UK/SOCIETYMATTERS

[12] CarbonNeutral® is the registered trademark of Natural Capital Partners and is a global standard to certify that businesses are able to report net zero emissions for their company, products, operations or services in accordance with The CarbonNeutral Protocol. CarbonNeutral® status achieved in December 2016.

A CLOSER LOOK AT YOUR BOARD MEMBERS

Our directors have a range of skills and experience to ensure they are able to manage a major financial institution, with a mix of business experience as well as specialist skills.

The running of the Society is the responsibility of your Board of directors. Each year we ask our members to vote on the election of new directors appointed by the Board or re-election of existing directors at our AGM.

Non-Executive Directors

John Heaps LLB
Chairman

- Joined the Board in 2014 as Chairman Designate, becoming Chairman in 2015.
- Chair of the Board Governance and Nominations Committee.
- Member of the Law Society Business and Oversight Board, as well as the International Bar Association Audit and Constitutional Committees.
- Trustee of the Garden Bridge Trust.

John, a lawyer by training, has extensive commercial and leadership experience. He is the former Chairman of corporate law firm Eversheds from where he retired in April 2015. He served on its board from 2008, and was part of the senior management team since 1999. As Chairman, he was ultimately responsible for Eversheds' regulatory compliance. John contributed significantly to the development of the firm's long-term strategy and helped drive considerable change as it grew from a group of affiliated UK offices into a major international law firm.

Dame Kate Barker DBE, CBE

Independent Non-executive Director

Alison Hutchinson BSc, CBE

Independent Non-executive Director

Gordon Ireland BSc, FCA

Independent Non-executive Director

Dame Kate Barker

- Joined the Board in 2010.
- Member of the Group Risk Committee, the Remuneration Committee and the Board Governance and Nominations Committee; Trustee of the Society's pension scheme.
- Non-executive director of Taylor Wimpey Plc and Chairman of Trustees for the British Coal Staff Superannuation Scheme.

Kate was a member of the Bank of England's Monetary Policy Committee (MPC) from 2001 to 2010. Prior to this appointment, she was Chief Economic Advisor to the CBI. Kate also has a background in housing and is the author of major government policy reviews on housing supply and planning. In 2006 she was awarded a CBE for services to social housing, and was appointed a Dame in June 2014 for services to the economy.

Kate is due to retire from the Board at the conclusion of the Society's Annual General Meeting on 25 April 2017.

Alison Hutchinson

- Joined the Board in 2015.
- Member of the Audit Committee and Remuneration Committee.
- Chief Executive of The Pennies Foundation and a non-executive director of Aviva Life Holdings Ltd.

Alison has a strong background in both IT and financial services, having started her career at IBM where she became Global Director of Online Financial Services. In 2000, she joined Barclays Bank where she held senior management positions including Marketing Director of Barclaycard. In 2004 she moved to specialist mortgage provider Kensington Group, where she was Managing Director and then Group CEO, leading the successful sale of the business to Investec in 2008. In 2016, Alison was awarded a CBE for services to the economy and charities.

Gordon Ireland

- Joined the Board in 2015.
- Member of the Group Risk Committee.
- Non-executive director of Aspen Insurance Holdings Ltd (where he is Chair of the Audit Committee and member of the Risk Committee) and Aspen Insurance UK Ltd; non-executive director of Iccaria Insurance ICC Ltd.

Gordon is a chartered accountant and spent 36 years working for PwC, including 24 years as partner, where he specialised in the financial services sector. This included auditing many of the UK's leading insurance companies, as well as acting as an audit and review partner. His role included Vice Chairman on PwC's UK supervisory board and Chairman of the partner admissions panel and senior management remuneration committee. Gordon represented PwC on external technical advisory groups at UK and European level. Following this, he was CEO of a professional indemnity captive insurer of PwC's network.

Non-Executive Directors continued...

David Paige BSc, FCA
Independent Non-executive Director

- Joined the Board in 2006.
- Chair of the Group Risk Committee and a member of the Audit Committee; Chairman of the Society's pension scheme.
- Non-executive director of IFG Group Plc.
- Recently retired as a non-executive director of Willis Ltd where he was Chairman of the Audit Committee and a member of the Risk Committee.

David is a chartered accountant with considerable financial services experience within risk, finance and audit. He was a partner at Coopers & Lybrand in their financial services division before moving into senior executive positions with NatWest Bank Plc, Zurich Financial Services, Aviva Plc and Royal & Sun Alliance Insurance Group Plc where he was an executive director.

David is due to retire from the Board at the conclusion of the Society's Annual General Meeting on 25 April 2017.

Mark Pain BSc, FCA
Independent Non-executive Director and Vice Chairman

- Joined the Board in 2013, appointed Vice Chairman and Senior Independent Director in 2015.
- Chair of the Audit Committee, member of the Group Risk Committee and the Board Governance and Nominations Committee.
- Non-executive director of Aviva Insurance Ltd and Ladbrokes Coral Group Plc; Chair of London Square Developments (Holdings) Ltd and non-executive director of LSQ Management Ltd.

Mark has nearly 20 years' experience of director-level roles within FTSE 100 companies across the financial services and residential properties sectors. He spent 16 years with Abbey National Group, including roles as Group Finance Director, CEO of Abbey National Treasury Services and Customer Sales Director. Mark has held a number of non-executive positions across several sectors and was previously Group Finance Director at Barratt Developments Plc.

Guy Parsons BA
Independent Non-executive Director

- Joined the Board in 2013.
- Chair of the Remuneration Committee.
- Chief Executive of easyHotel Plc and easyHotel UK Ltd.

Guy has more than 25 years' experience of director-level roles in the leisure and hospitality industry, including director of Accor UK, where he was responsible for sales, marketing and operations for the Novotel hotel chain. He has also held director positions at Whitbread Plc where he was Managing Director for TGI Fridays. In 2004 he joined Travelodge, becoming CEO in 2010 and successfully growing the business to over 500 hotels in the UK, Ireland and Spain.

Executive Directors

Mike Regnier MEng, MBA
Chief Executive

- Joined the Board in 2014.
- Appointed Chief Executive on 1 January 2017.

Mike joined the Society in 2014 as Chief Commercial Officer and Executive Director and became Chief Customer Officer in December 2015, responsible for the Group's Branch Network, Product Development, Marketing, Customer Experience and Customer Relations functions. He is also a director of Accord Mortgages Ltd, the Society's intermediary lending subsidiary. Prior to joining the Society, Mike was with Lloyds Banking Group where he held a number of senior positions, including Personal Current Accounts and Credit Cards Director. Most recently, he was the Products and Marketing Director for TSB where he was responsible for the relaunch of the TSB brand on the UK high street in 2013. He has also held management positions at ASDA and the Boston Consulting Group.

Robin Churchhouse MA, ACA
Finance Director

- Joined the Society in 2004.

Robin joined the Society as Head of Finance before being promoted to the executive management team in 2006 with responsibility for Risk and Strategy. In 2010 he was appointed Finance Director. In January 2014 he took on additional responsibility for the Property and Shared Services function, and in late 2015 the Customer Service and Collections and Arrears functions until they were transferred to the new role of Chief Operating Officer in May 2016. Robin has responsibility for the Corporate Strategy and Planning, Finance and Capital Management functions and in December 2016 took responsibility for the Treasury and Asset and Liability Management functions on the departure of Andy Caton.

Before joining the Society, Robin gained a wide range of experience across a number of financial services organisations, including roles in finance, planning and strategy, management consultancy, corporate finance, risk management and prudential regulation.

Stephen White BComm
Chief Operating Officer and Executive Director

- Joined the Board in 2016.

Stephen is responsible for the Group's Operations functions, including Lending, Customer Services, Arrears and Collections, Property and Procurement, the Group's IT, Information Security and Change Management. Stephen has 20 years' experience in financial services, most recently as Group Chief Operating Officer at Allied Irish Bank. His previous roles also include Executive General Manager at National Australia Bank and management roles at Ernst & Young, Royal Bank of Scotland and Abbey National, where he started his career as a branch manager.

Other Chief Officers

Charles Canning
Chief Customer Officer (Interim)

- Joined the Society in 1987.

Charles was promoted to the leadership team in October 2005 when he was appointed Head of Branch Network. In January 2014 he was appointed Head of Distribution responsible for the branch network, telephony sales and the agency network and in November 2016 Charles was promoted to the senior Executive Team as Chief Customer Officer (Interim), succeeding Mike Regnier on his appointment as Chief Executive. He now has overall responsibility for the Distribution, Product Development and Marketing functions.

Charles is also a director of Accord Mortgages Ltd, the Society's wholly owned intermediary lending subsidiary.

Jane Hanson BA, MBA, MCIPD
Chief People Officer

- Joined the Society in 2013.

Jane has extensive experience within HR and financial services, having worked with Alliance & Leicester, HSBC and First Direct who regularly featured in the Sunday Times 'Top 100 Employers' list under her tenure. Jane leads the Human Resources, Internal Communications and Corporate Affairs functions.

Richard Wells FCIB
Chief Risk Officer

- Joined the Society in 2010.

Richard has extensive experience of risk management within the financial services industry including senior risk management roles at a number of the UK's major banks and building societies. Richard is responsible for ensuring that appropriate procedures and capability exists within the Group for the management of all of the risks that it has planned to take or that it encounters. He is also responsible for the Legal and Secretarial function.

“Mike has demonstrated a strong commitment to mutual values, considerable commercial command and an engaging style of leadership. These qualities, together with his clear strategic outlook, will ensure we continue to deliver long-term value and excellent service.”

John Heaps – Chairman

Directors' Report

The directors have pleasure in presenting their annual report, together with the Group Accounts and Annual Business Statement, for the year ended 31 December 2016.

This report is compiled to meet the requirements of the Building Societies Act 1986 (the Act) and includes disclosures not contained anywhere else in the Annual Report and Accounts.

Events after the reporting period

In January 2017, the Board announced its intention to close the current account offered through the N&P brand, close 48 branches and withdraw the N&P brand from our retail activities. This development is discussed in more detail in the Strategic report on page 15.

Business objectives and activities

The Group's vision is 'to be the most trusted provider of financial services in the UK'.

Further information on the Group's vision and strategy is given in the Strategic Report on pages 12 to 45.

Mortgage arrears

To comply with the Act, we disclose the following in respect of arrears performance.

Details of the Group's mortgage accounts which were 12 months or more in arrears at 31 December 2016 were as follows:

	2016	2015	**2016**	2015
			% of mortgage accounts/balances	
Number of accounts	**207**	259	**0.08**	0.10
Balances outstanding on accounts	**£30.1m**	£37.1m	**0.09**	0.11
Amount of arrears included in balances	**£4.2m**	£4.9m	**0.01**	0.01

Further details of the Group's arrears position are set out in the Strategic Report on page 36.

Note 39 on page 169 describes the various forbearance measures offered by the Group to borrowers experiencing difficulties in meeting their repayments.

Disclosure requirements under CRD IV country-by-country reporting

In compliance with the Regulations of Article 89 of the Capital Requirements Directive IV (CRD IV) country-by-country reporting (CBCR) we disclose the following information:

a) Name, nature of activities and geographical location

Yorkshire Building Society is the parent company and a list of the subsidiaries can be found in Note 10 of these accounts. The principal activities of the Group can be found in the Strategic Report on page 16 and in Note 12.

All Group companies operate in the United Kingdom except Yorkshire Guernsey Ltd which is registered in Guernsey and is in the process of liquidation.

b) Average number of employees

The average number of employees is disclosed in Note 7.

c) Annual Turnover

Net operating income is set out in the Group Income Statements.

d) Pre-tax profit or loss

Pre-tax profit is set out in the Group Income Statement.

e) Corporation tax paid

Corporation tax paid is set out in the Group Statement of Cash Flows.

f) Public subsidies received

No public subsidies were received in 2016.

Colleagues

Through our people practices, we aim to create a workplace where people can give their best and thrive. We believe that valuing our colleagues is critical to delivering our market leading customer experience. Consequently, we put significant effort into understanding our peoples' needs and what will lead to their enjoyment and commitment at work. For some years, we have been enhancing our infrastructure to reflect a modernising organisation, and in 2016 we made great progress on developing a leading people experience. Our colleague engagement levels have improved from 70% in 2015 to 77% in 2016, along with a reduction in resignation levels to 11.6%.

The Group is committed to fostering an inclusive environment where everyone connected to the brand can contribute to the Group's success; we seek to be a modern, diverse, friendly, trustworthy organisation and promote a culture that actively values difference. We recognise that people from different backgrounds and experiences enhance the way we work and reasonable adjustments for colleagues with a disability are taken into account.

In 2017 we will continue to listen and respond to our colleagues needs to deliver bespoke, relevant solutions in people practices. An important area for us in 2017 will be our commitment to building a balanced workforce that genuinely represents the best interests of our colleagues and customers; and fostering an inclusive environment where everyone connected to the Group can contribute to its success – this is our Diversity & Inclusion intent. In 2016, we chose not to sign the Women in Finance Charter as we want to initially build awareness and capability rather than target a specific ratio. We will review how we express this commitment externally as we build our capability internally. There is no doubt for us that this is a vital part of enhancing our talent programme.

Directors

The names of the directors of the Society who served during the year, their roles and membership of Board committees are described in the Corporate Governance Report on pages 61 to 70.

At the 2017 Annual General Meeting (AGM) all existing directors will retire and put themselves forward for re-election, with the exception of Kate Barker, Non-executive director, and David Paige, Non-executive director, who will both retire at the conclusion of the AGM. Biographical details of all directors are outlined on pages 52 to 55.

None of the directors had an interest in, or share of, any associated body of the Society at any time during the financial year.

The directors in 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 Group's auditor is unaware.

Director's responsibilities

The following statement, which should be read in conjunction with the statement of the Auditor's responsibilities on page 102, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The directors are required by the Act to prepare, for each financial year, annual accounts which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of the affairs of the Society and the Group as at the end of the financial year and which provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it.

The Act states that references to International Financial Reporting Standards (IFRS) accounts giving a true and fair view, are references to their achieving a fair presentation.

Directors' Report continued...

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

- Select appropriate accounting policies and apply them consistently.
- Make judgements and estimates that are reasonable and prudent.
- State whether the Annual Accounts have been prepared in accordance with IFRS.
- Prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

In addition to the Annual Accounts and this report, the Act requires the directors to prepare, for each financial year, an Annual Business Statement containing prescribed information relating to the business of the Society and its subsidiary undertakings.

The directors are responsible for the maintenance and integrity of statutory and audited information on the Society's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The directors are responsible for ensuring that the Society and its subsidiary undertakings:

- Keep accounting records in accordance with the Act.
- Take 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 Prudential Regulation Authority under the Financial Services Act 2012.

The directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

Auditor

The reappointment of Deloitte LLP as auditor is to be proposed at the AGM.

On behalf of the Board

John Heaps
Chairman
27 February 2017

Corporate Governance Report

CHAIRMAN'S STATEMENT

Dear Member

One of my responsibilities is to ensure that the Society maintains high standards of corporate governance which provides a clear framework for the way in which the Board (and the rest of the Group) operates. Good corporate governance is vital in providing effective leadership and in assisting the Society to continue as a successful organisation run for the benefit of its current and future members in a legal, ethical and transparent manner.

As stated in previous reports, the Board's approach to corporate governance is influenced by the following considerations:

- The Board is accountable to the Society's members for the conduct and performance of the business.
- The interests of members are at the heart of the Board's decision-making.
- The interests of other parties, including all our customers, colleagues, suppliers and the communities in which we operate, are also taken into account.
- The Society should be managed in a prudent and efficient manner with effective decision making and robust risk management.
- The effectiveness of the Board is vital to the financial strength and future success of the Group.

This approach is based on the principles and provisions of the UK Corporate Governance Code published by the Financial Reporting Council (FRC) to the extent that they are relevant to a building society. A revised Code was published in June 2016 (the Code) which does not take effect until reporting year 2017, however the Society has chosen to adopt this version of the Code earlier than formally required. A copy of the Code is available at www.frc.org.uk. In the interest of transparency, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) also encourage each building society to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code.

During the year I have spent considerable time reviewing how the Board operates to ensure that it remains effective; further details are set out on pages 65 to 67 of this report. One of my key responsibilities is to lead the development of the Society's culture; how things get done and how each of our people behave is just as important as what gets done. I believe the Society has a positive culture; its values are well understood, our people are warm, friendly and passionate about what they do. Crucially having a strong and appropriate culture provides a framework for our risk management strategy and our strong financial control and customer focus. To further understand our culture and to reinforce the behaviour that we expect of all our people, in 2016 we appointed an external partner to work with us on developing our culture in line with our strategy and vision. This work has initially centred on the formal definition of a target culture, with input from a wide range of colleagues at all levels from branch colleagues to the non-executive directors. Your Board will continue to be fully engaged in this work throughout 2017.

As reported in the 2015 Corporate Governance Report, the new regulatory Accountability Regime came into effect on 7 March 2016. This is known within the Group as 'our Trust Code' and comprises three components: the Senior Managers' Regime which includes the allocation of functions and responsibilities to executive and certain non-executive directors and other senior management, the introduction of a new Certified Regime for relevant colleagues (requiring us to certify them as 'fit and proper') and the introduction of revised Conduct Rules. A substantial amount of work was undertaken to ensure that we were prepared for the implementation of the regime in March 2016. Since then further work has been undertaken to embed the Trust Code further within the organisation including the following:

- A review of our policies and processes to ensure that we met the requirements of the regulation.
- The introduction of a mandatory 'eLearning' module to promote a consistent Group-wide understanding of the new regulation, including the Conduct Rules with additional support to customer-facing business areas to identify and report any Conduct Rules' breaches.
- The completion of our first 'Fit and Proper' review in May 2016, involving the certification of all colleagues in advance of the regulatory deadline of 7 March 2017.
- Stress-testing our processes and ensure they had been embedded successfully.
- The commencement of on-going reviews to ensure that all Fit and Proper certificates remain appropriate.

I am pleased to report that during 2016 the Society complied with the Building Societies Association guidance on the Code. This report sets out below how the Board has operated in 2016 and applied the relevant provisions using the Code's main themes.

John Heaps
Chairman
27 February 2017

Corporate Governance Report continued...

THE UK CORPORATE GOVERNANCE CODE

Leadership

The role of the Board

The Society is headed by the Board which is accountable to the members of the Society. It operates under formal Terms of Reference (with a schedule of matters reserved to the Board) which include:

- Being collectively responsible for the success, including the long term success, of the Group and for acting in the best interest of the Society and its members as a whole (both current and future). The Board may also consider the interests of other customers, colleagues, suppliers and the wider community.
- Having responsibility for the overall management of the Group within a framework of risk management which supports and directs financial security, fair outcomes and a Group built on trust.
- Establishing a sustainable business model and setting the strategy of the Group consistent with that model.
- Developing the culture of the Group and setting a 'tone from the top' to ensure that the desired values and behaviours are Board led.
- Having oversight of the Group's operations ensuring the following are in place:
  - Competent and prudent management.
  - Sound planning and risk management.
  - Adequate systems of internal control.
  - Adequate accounting and other records.
  - Compliance with statutory and regulatory obligations.
  - Adequate financial resources.
  - The fair treatment of all customers.
  - Appropriate risk aligned remuneration systems.
- Reviewing the performance of the Group in the light of the strategy and Corporate Plan and ensuring that any necessary corrective action is taken. An essential part of this is the review of the Board management information.

Reserved matters to the Board

As referred to above, the Board maintains a schedule of reserved matters (which is reviewed at least annually) in order to ensure that it exercises control over the business of the Group. These include the approval of:

- The Annual Report & Accounts and the interim financial results.
- The strategic aims of the Group, including mergers and other acquisitions and disposals.
- The Corporate Plan.
- The core strategies (i.e. Customer, Corporate Responsibility, Financial, IT, People and Operational).
- Certain policies including the Anti-bribery & Corruption, Commercial & Retail Lending and Vulnerable Customers policies.
- The Group's Risk Appetite.
- Other matters which must be approved by the Board under legislation and the Society's Rules.
- The appointment of Directors and Chief Officers.

The Board delegates implementation of the strategy and the day-to-day management of the Group to the senior Executive Team which is led by the Chief Executive Officer. It delegates certain other responsibilities to Board committees as set out in the committees' Terms of Reference.

A copy of the Board's Terms of Reference and schedule of Reserved Matters is available on request from the Group Secretary or can be found on the Society's website at ybs.co.uk/board.

Board committees

As referred to above, certain matters are referred to Board committees in order that they can be considered in more detail by those directors with the most relevant skills and expertise. Details of the Board committees are:

Audit Committee

Details including membership and responsibilities are contained in the Audit Committee Report on pages 71 to 74.

Board Governance and Nominations Committee

The members of the committee (who are all non-executive directors) are:

- John Heaps (Chairman of the Committee)
- Mark Pain
- Kate Barker

The committee is responsible for:

- Reviewing the structure, size and composition of the Board including the required skills, knowledge, experience and diversity and making recommendations to the Board on any changes to the Board and any changes to the membership of Board committees.

- Considering the succession planning for directors and other senior executives (unless this is considered by all of the non-executive directors in respect of executive directors).
- Leading the appointment process for director roles for approval by the Board.
- Approving the Directors' Conflicts of Interest policy and monitoring any potential conflicts.
- Approving the Board diversity policy including setting any target for the underrepresented gender on the Board.
- Reviewing other governance arrangements and making recommendations to the Board as appropriate.

In 2016 the committee met five times with key matters discussed being director recruitment and diversity. Further details on these matters are contained on pages 63 to 64.

Group Risk Committee

Details including membership and responsibilities are contained in the Risk Management Report on pages 75 to 77.

Remuneration Committee

Details including membership and responsibilities are contained in the Directors' Remuneration Report on pages 91 to 92.

Chairman's Committee

The members of the committee are:

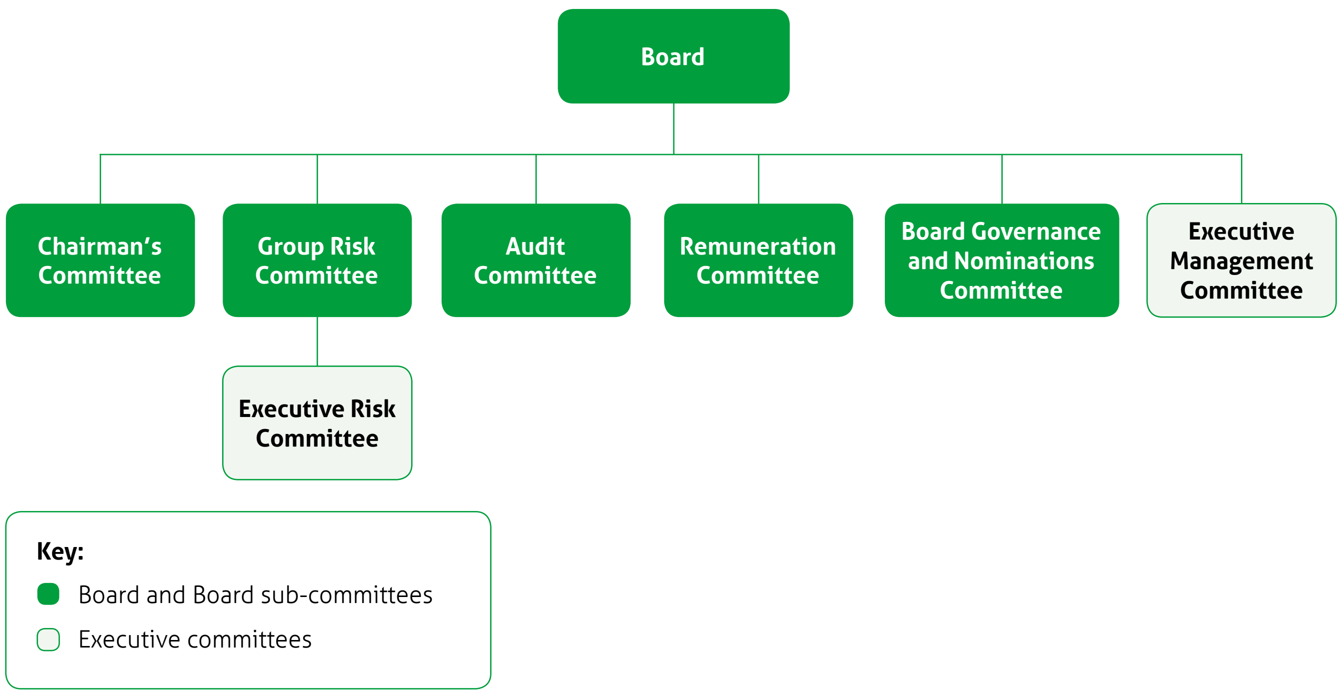
- The Chairman (John Heaps)
- The Vice Chairman (Mark Pain)
- The Chief Executive (Chris Pilling in 2016. Mike Regnier from 1 January 2017)

Other directors may be co-opted onto the committee, as agreed by the Board, to consider specific matters. The committee's main function is to consider any matter which the Board has specifically delegated to it.

The Terms of Reference of the committees are available on request from the Group Secretary or on the Society's website at ybs.co.uk/committees. The chair of each committee reports to the subsequent Board meeting on the matters discussed at each committee meeting. The minutes of each committee meeting are circulated to all directors unless it is considered inappropriate to do so.

The Board and executive committee structure is set out below. In addition there is a suite of sub committees that report into the Executive Management and Executive Risk Committees.

Board and Executive committees



Corporate Governance Report continued...

Board meetings

The Board held 10 scheduled meetings in 2016 together with an additional three meetings which were convened at short notice to consider ad hoc matters including the appointment of a Chief Executive to replace Chris Pilling. The attendance record of each director at these meetings and at relevant Board committee meetings is set out on page 70. Where a director is unable to attend a meeting then he/she will provide feedback on the agenda items to the Chairman prior to the meeting. To provide focus on the development of strategy, twice a year (in June and September) the Board has specific strategy sessions outside of the usual Board meetings.

The Board generally meets in West Yorkshire (either in Leeds or Bradford) but at least one meeting each year is held in a location outside of West Yorkshire where the Group has an administrative centre. In October 2016 the meeting was held at the administrative office in Peterborough where the directors, in particular the non-executive directors, had an opportunity to meet colleagues and answer any questions they had in Q&A sessions held prior to the Board meeting.

Board agenda items

The key matters considered by the Board are planned on a rolling 12 month basis with additional ad hoc items included throughout the year as appropriate. At each Board meeting, the Board receives a comprehensive management information pack covering business performance including financial and non-financial information and scorecards to monitor progress against key performance indicators (including customer and people metrics) and the business risk appetite. The Board pack also incorporates a report on the external and competitive environment which now includes a range of potential economic indicators arising out of the expected exit from the EU following the referendum held in June 2016. Where appropriate the relevant executive director or Chief Officer provides an oral update to the Board on the particular aspects of performance and highlights any emerging issues. In addition, the Board agenda includes the following:

- Minutes of Board committee meetings held since the previous Board meeting and oral updates from the chairs of Board committees on the main issues discussed and matters agreed. This ensures that all Board members are aware of the key discussions and decisions made by the committees.
- Minutes of the meetings of the monthly Executive Management Committee.
- A report from the Chief Executive which highlights the current trading and financial performance and any other relevant matters he wishes to bring to the attention of the Board.
- A quarterly report on risk including performance against the agreed risk appetite and compliance/monitoring reports undertaken.
- A quarterly report on the progress of the key strategic priorities.
- Items for decision and key matters which need to be debated. For example, in 2016 the matters that the Board considered included the following:
  - approval of the 2015 Annual Report & Accounts and the 2016 Interim Financial Statements.
  - the distribution strategy including a review of the Group's brands and branch network.
  - review of the N&P current account and potential Group wide current account offering.
  - interest rates and the response to the Bank of England rate change.
  - the management of conduct and prudential risk including regulatory dialogue and correspondence.
  - results of the colleague annual survey.
  - a revised Corporate Plan covering the next five years including the funding strategy and in particular the proportional use of wholesale funding.
  - the Corporate Responsibility Strategy.
  - management of cyber security.
  - senior executive succession planning.
  - director and senior executive appointments.
  - the approach to culture and diversity updates.
  - consideration of the Group's basis risk position and its management.
  - review of the Group's approach to interest rate transfer pricing in product management and improvements to it.
  - the impact of the Internal Ratings Based (IRB) approach to capital requirements on the Group's capital and credit risk management.
  - the setting of, and the adherence monitoring of, the Group's Risk Appetite.

If a major item requires further detailed consideration then the Board may delegate this to an appropriate Board Committee.

As referred to above, the Board holds two separate strategy sessions each year. In 2016 these sessions included detailed reviews of a number of matters including the customer, distribution, brand and product strategies and the change portfolio.

Non-executive directors

In addition to playing their part on the Board as a whole, the non-executive directors are responsible for bringing independent judgement to Board debate and decisions using their own experience and skills, and for constructively challenging the Executive Team.

The non-executive directors meet without the executive directors present to discuss relevant matters. In 2016 the non-executive directors met four times and such discussions included Board agenda topics, the content and format of management information received by the Board, succession planning and the overall performance of the Executive Team.

The Vice Chairman, who is also the Society's Senior Independent Director, deputises for the Chairman when appropriate and provides support and guidance to him. He would also act, if required, as an intermediary for the other directors. As Senior Independent Director, the Vice Chairman is also the main point of contact for members should the normal channels of communication with the Chairman, Chief Executive or other executive directors fail or be inappropriate.

The roles of the Chairman and the Chief Executive

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose.

The Chairman is responsible for leadership of the Board and for ensuring that the Board acts effectively, promoting high standards of corporate governance. He is also responsible for leading the development of the Group's culture by the Board and thus setting the 'tone from the top'.

The Chief Executive has overall responsibility for managing the Society and its subsidiaries and for implementing the strategies and policies agreed by the Board, supported by the Executive Team and through a suite of management and risk committees.

Effectiveness

Composition of the Board and succession planning

As at the date of this report, the total number of directors is 10 consisting of three executive directors and seven non-executive directors. The size and composition of the Board and the Board committees are kept under constant review by the Chairman and are also reviewed at least annually by the Board Governance and Nominations Committee. This is to ensure that there is adequate and orderly succession planning for executive and non-executive directors and that there is the optimum mix of skills and experience on the Board for the direction of the Group's activities and to populate and chair the Board committees. The Board accepts that there needs to be flexibility in the number of directors (particularly in the number of non-executive directors), to take into account any future skills or experience gaps, either due to changes in the Group's business activities or as part of succession planning and recruitment.

Non-executive director succession planning:

The Board Governance & Nominations Committee reviews a skills matrix of the non-executive directors each year; this consists of a schedule of desired skills within the non-executive population and a self-evaluation of the level of experience against each skill gained outside of the Group. The Committee also reviews at each meeting the anticipated retirement date of each non-executive director and the impact on Board committee membership. These processes assist in the forward recruitment planning including the skills and experience required of the successful candidate.

Kate Barker, Non-executive director, and David Paige, Chair of the Group Risk Committee, retire immediately after the 2017 AGM. In 2016, non-executive director recruitment commenced to identify a successor for David Paige, the aim of which was also to strengthen further the risk and retail banking experience and also to give regard to greater diversity on the Board. The recruitment process was (and continues to be) overseen by the Board Governance & Nominations Committee. It is supported by an independent search agency, JCA, which has no other connection with the Society. A role specification was drawn up for this position with a long list of candidates considered by the Committee. For the purpose of this recruitment, Alison Hutchinson, Non-executive director, joined the committee members to form a selection panel which then conducted interviews with the selected short listed candidates. This included an assessment of the candidates against the agreed specification including the cultural fit. The process also includes the obtaining of references and other checks to assist in the assessment of the candidate's fitness and propriety to undertake the role. In early February 2017, on the recommendation of the selection panel, the Board approved the appointment of a new Chair of Risk Committee to replace David Paige subject to regulatory approval under the Senior Managers Regime. At the date of this report the regulatory approval process remained ongoing.

Executive director and senior management succession planning:

An annual review is undertaken by the non-executive directors of the succession plan status for roles within the Executive Team (i.e. the executive directors and other Chief Officers). During 2016 the senior leader development activity has been aligned to this succession plan. This will continue into 2017 as we adapt and enhance the capability of our senior leaders. Succession plans are also reviewed by each Chief Officer for their division on an annual basis to ensure plans are considered for critical roles and to ensure development opportunities are put in place.

Corporate Governance Report continued...

Chief Executive succession

In June 2016, Chris Pilling, Chief Executive, announced his intention to step down at the end of 2016. Following this announcement, the Board Governance & Nominations Committee led a rigorous recruitment process. An external executive search agency, Egon Zehnder, was engaged to support an extensive external market review and the selection process generally. The extensive search produced a short list of strong candidates, both external and internal. An initial assessment of these candidates was undertaken by Egon Zehnder which was followed by an interview with the Committee together with an assessor from Egon Zehnder to ensure consistency throughout the process. On the recommendation of the Board Governance & Nominations Committee, the Board approved the appointment of Mike Regnier who was an internal candidate and held the position of Chief Customer Officer & Executive Director. Following regulatory approval under the Senior Managers Regime, Mike Regnier took up the position on 1 January 2017. Egon Zehnder has no other connection with the Society.

Details of the Society's directors are set out on pages 52 to 55.

Changes to the Board

During 2016 there were a number of Board changes:

- Chris Pilling, Chief Executive, stepped down from the Board on 31 December 2016. He was succeeded by Mike Regnier who had previously joined the Society in June 2014 as Chief Commercial Officer and Executive Director, and became Chief Customer Office in December 2015. Further details about the recruitment of Chris Pilling's successor are set out above.
- Stephen White joined the Board on 24 February 2016 as Chief Operating Officer and Executive Director. The recruitment process was undertaken in 2015 and was set out in the 2015 Corporate Governance Report.
- Andy Caton, Chief Treasury & Corporate Affairs Officer & Executive Director stepped down from the Board on 9 December 2016. Mr Caton's executive responsibilities have currently been split between the Finance Director (Robin Churchouse) and the Chief People Officer (Jane Hanson).

Diversity

When recruiting directors, the Board gives consideration to all aspects of diversity, including gender, although it continues to adopt the principle that all appointments should be based on merit. In November 2013 the Board approved a recommendation of the Board Governance & Nominations Committee that there should be an aspirational target to have 25% female directors by the end of 2015. This aspirational target was reviewed by the Committee in November 2016 following which the Board approved a recommendation to increase it to 30% female directors in the medium term to bring it more into line with the latest Hampton-Alexander Review recommendation of 33% of females on the boards of FTSE 350 companies by 2020. The Committee also agreed that search and specialist recruitment agencies for director appointments should only be engaged if they have signed up to the Standard Voluntary Code of Conduct for Executive Search Agencies with a preference to use those signed up to the Enhanced Code.

The percentage of females on the Society's Board at 31 December 2016 was 20% (2015 – 18.2%). The above mentioned revised aspirational target was therefore not met during 2016. As indicated in the 2015 Corporate Governance Report, the percentage is expected to fluctuate during the ongoing recruitment process.

As mentioned in this report, the non-executive director recruitment currently underway at the date of this report is taking into account the diversity issue. Subject to regulatory approval of the successful candidate and following the retirements of David Paige and Kate Barker on 25 April 2017, it is anticipated that the percentage of females on the Board will be 22%.

The Group's ambition is to foster an inclusive environment where everyone is able to contribute to the Group's success; it is also intended to work towards the goal of achieving 'Investors in Diversity' standard in 2017/18. Work is also ongoing to build on our network and understanding through membership of 'Creating Inclusive Cultures'; a collaboration of employers who are committed to realising, and to take advantage of, the benefits of diversity and inclusion. A number of focus groups were held internally in 2016 across the business to understand our colleagues' views which will shape the direction of the Diversity and Inclusion strategy to ensure we implement a colleague-led approach. To assist in the promotion and understanding of all aspects of diversity and inclusion across the Group, during the second half of 2016 a strategy and action plan was formed and a specialist experienced Diversity and Inclusion Manager appointed.

By way of further information and in keeping with the Society's focus on diversity, as at 31 December 2016 there were the following percentages of female colleagues in the Group:

- 33% of the Executive Team (excluding executive directors). This reduces to 16.7% if executive directors are included.
- 27% of the next level of senior managers (i.e. the senior leadership team).
- 65% of all colleagues (including executive directors).

Performance evaluation

Board evaluation

Board effectiveness is a matter not just for consideration on a once a year basis, rather it is under continuous review. As a result, Mr Heaps has continued with his focus on the operation of the Board (from an interaction as well as an administration perspective) and, with the assistance of an external consultant, in depth discussions took place in the second half of 2016 between small groups of directors and other Chief Officers regarding how the Board operates. In addition, an internal Board Evaluation review was conducted in the final quarter of 2016 through a questionnaire completed by all directors and other Chief Officers. This included a review of Board focus and appropriate level of engagement on a number of key matters, Board and Society culture, Board composition including diversity, Board processes (including the adequacy of information referred to the Board) and training requirements.

The outcome of the above two exercises were considered by the Board at its meeting in early February 2017 and an action plan for 2017 agreed in order to ensure that the Board is strong and effective with a culture and behavioural characteristics that reflect the agreed values and ethical approach of the Society. These actions include:

- Strengthening succession planning for executive and non-executive directors, taking a longer term view.
- Recommendations to be made on the Board monitoring of culture within the organisation.
- Review of the number and timing of Board meetings including the number and content of strategy days.
- At each Board meeting the Board reviews draft agendas for the next two meetings (in addition to the annual Board runway) to ensure the balance between strategic, operational and monitoring items is appropriate.
- Review of the timing of delivery of Board meeting packs and the current secure application used to ensure it is the optimal solution.
- Continue to review the Board Management Information.
- Identify appropriate external speakers on relevant topics.
- Strengthen the feedback to the Board on member engagement activities.

The Board last undertook an external Board review in 2014. In late 2015 a number of actions resulted from a review of Board effectiveness undertaken by Mr Heaps following his appointment as Chairman in April 2015. These actions were progressed in 2016 and included the review and implementation of revised Board management information reports and review of the Board agenda to ensure there was sufficient time for debate on key matters.

In 2016 internal performance evaluations of the Audit and Remuneration Committees were carried out through the means of a questionnaire completed by all relevant committee members and any appropriate improvements were identified for action. An external review of the effectiveness of the Group Risk Committee was undertaken by Grant Thornton the results of which were reviewed by the committee and an action plan agreed which was also referred to the Board; further details are contained in the Risk Management Report on page 76. An internal review of the Board Governance and Nominations Committees is currently being undertaken.

Individual director evaluation

In the latter part of 2016 individual evaluation of directors was undertaken through the completion of internal feedback questionnaires which concluded that all directors continued to perform effectively. Each non-executive director was reviewed by all other directors and Chief Officers. The written results of the questionnaire were given to each such director by the Chairman in appraisal meetings held in early 2017. The Vice Chairman conducted the appraisal meeting with the Chairman.

The non-executive directors reviewed the performance of each executive director (and also other members of the Executive Team) through the completion of an internal questionnaire. This was used as part of the year end performance appraisal meetings of the executive directors with the Chief Executive, Chris Pilling. As Mr Pilling resigned on 31 December 2016, he has not undergone a formal year end appraisal.

Conflicts of interest

One of the criteria which the Board takes into consideration when recruiting a non-executive director is his/her ability to have sufficient time to take on the position. In addition, during the term of their directorship with the Society any other external positions that a director takes up have to first be referred to the Board so that the time commitment and any potential conflict of interest can be considered. The Board has a Conflict of Interest policy which sets out procedures for regularly reviewing, through the Board Governance and Nominations Committee, and if appropriate, authorising any potential conflicts as they arise. This applies to executive as well as non-executive directors.

Corporate Governance Report continued...

The letters of appointment of non-executive directors give an indication of the time commitment required although this will change depending on whether he/she is chair and/or member of any Board committee(s). The commitment will also increase, inevitably, when a significant transaction or development is being considered.

Copies of the letters of appointment of each of the non-executive directors are available for inspection on request from the Group Secretary.

The Board is satisfied that all of the non-executive directors are independent based upon the guidance set out in the Code, including the Chairman on appointment.

Induction and development

The Chairman ensures that, on appointment, non-executive directors receive a comprehensive tailored induction programme on the Group's business and regulatory environment which is monitored by the Board Governance & Nominations Committee. All non-executive directors update their skills, knowledge and familiarity with the Group through internal presentations by senior managers, relevant external and internal presentations and training and through branch visits and attendance at member events which are referred to below and on page 64. In November 2016, for example, Deloitte LLP presented to a number of Executive and non-executive directors on the subject of hedge accounting. The Board also had a number of training sessions on capital management (including the use of Return on Capital in product pricing and transfer pricing) and IRB. Individual training requirements for non-executive directors are discussed as part of the performance evaluation process and a personal development plan was drawn up for each non-executive director. A training record for each non-executive director is maintained by the Group Secretary.

Non-executive directors are encouraged to contact individual members of the Executive Team to discuss any queries that they may have and to undertake branch and department visits on an ad hoc basis in order to deepen their understanding of the business.

All directors have access to independent professional advice if required and have the benefit of appropriate liability insurance cover at the Society's expense. In addition, they have access to the advice and services of the Group Secretary who is responsible for ensuring that Board procedures are complied with and for advising the Board, through the Chairman, on governance matters.

Accountability

The Board is responsible for the system of internal control. The Audit Committee Report on pages 71 to 74 sets out the internal control framework which is designed to safeguard member and Group assets and to facilitate the effectiveness and efficiency of operations which helps to ensure the reliability of internal and external reporting and assists in compliance with applicable laws and regulations.

The Board is also responsible for setting the Risk Appetite of the Group and ensuring that there is a robust system for risk management in place to ensure the security of members' funds. The Group's risk management framework is set out in the Risk Management Report on page 75.

The Board has delegated to the Audit Committee oversight of the relationship with the external auditor to ensure that they remain independent and objective. Further details can be found in the Audit Committee Report on page 74.

Remuneration

The Board has delegated to the Remuneration Committee the policy on remuneration for the Chairman, the executive directors and other members of the Executive Team and the senior leadership team. A review of its activities and the remuneration policy is set out in the Directors' Remuneration Report on pages 79 to 93.

Relations with members

Member engagement

The Society's owners are its individual members who are made up of its savers and borrowers (subject to a small number of exceptions). This 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.

This feedback takes various forms, including member 'Question Time' meetings which give members the opportunity to meet and ask questions of the Chief Executive, the senior management team and local branch colleagues. In 2017 we are looking to extend the reach of our Question Time programme through online and social media channels, ensuring members can engage with us whichever way they prefer.

The Society also operates My Voice, our online research community. My Voice gives customers the opportunity to feedback on a variety of topics that really matter through regular collaborative discussions, quick polls and surveys. It enables the Society to have a two way dialogue with our customers about what they want, what we could do better and what they want us to keep doing and to help shape the future of the Group.

In addition, a monthly customer perception tracker with over 2,500 customers across all Group brands is undertaken to monitor the strength of the relationship customers have with the Group. The results provide a key performance indicator of customer advocacy (called the Net Promoter Score®) which is monitored by the Board on a monthly basis. We also contact approximately 30,000 members every year through our customer experience and brand tracker surveys to understand how they perceive the organisation and how we can improve our products and services.

The Annual General Meeting (AGM)

At the AGM, the Chairman, Chief Executive and Finance Director give presentations on the previous year's trading and financial performance and on future plans. At the 2016 AGM, the Chair of the Remuneration Committee also gave a presentation on the directors' remuneration. The meeting also provides an opportunity for members to question the Chairman, Chief Executive and other directors on the resolutions to be proposed at the meeting and on any other aspect of the Society's business. All directors attend the AGM (unless their absence is unavoidable) including the chairs of all of the Board committees.

All members who are eligible to vote at the AGM receive a proxy voting form, which includes a 'vote withheld' option, and a pre-paid reply envelope (unless they have opted to receive the AGM pack by email) to encourage them to exercise their vote through the appointment of a proxy if the member cannot attend and vote at the meeting. Members are also able to appoint a proxy online.

At the AGM, the Chairman calls for a poll on all resolutions so that all proxy votes are recorded. The results of the proxy votes, and the votes cast at the AGM, are published on the Society's website and in branches. A separate resolution is proposed on each matter, including a resolution on the Annual Report and Accounts.

Relations with other investors

The Society also places great importance on maintaining a frequent dialogue with its providers of external capital and funding. As part of the annual results publication process, the Society conducts a series of investor meetings to provide a detailed briefing on its financial performance. These briefings are held with a wide range of institutional investors and analysts and are not restricted to existing providers of wholesale funds or capital. The presentation materials are available throughout the year on the Society's website. In addition, representatives of the Society's treasury team conduct regular face-to-face meetings with external stakeholders, including rating agencies, throughout the year in order to provide updates on the Society's performance and respond to market queries.

Corporate Governance Report continued...

Board and committee attendance record 2016

Set out below are details of the directors during 2016 and their attendance record at Board meetings and relevant Board committee meetings in the year. The figure in brackets indicates the number of meetings that the director was eligible to attend as a member of the Board and relevant committee(s) during 2016. In the case of Chris Pilling and Andy Caton this excludes any meeting which has been convened to discuss their resignation and subsequent succession plans/replacement appointment due to potential conflicts of interest.

Director	Board Meetings	Board Committees			
		Audit	Nominations	Remuneration	Risk
John Heaps					
Chairman	13(13)	–	5(5)	–	–
Dame Kate Barker					
Non-executive Director	13(13)	–	5(5)	6(6)	6(6)
Andy Caton					
Chief Treasury & Corporate Affairs Officer & Executive Director (resigned 09.12.2016)	11(11)	–	–	–	–
Robin Churchouse					
Finance Director	11(13)	–	–	–	–
Alison Hutchinson					
Non-executive Director	11(13)	6(7)	–	6(6)	–
Gordon Ireland					
Non-executive Director	10(13)	–	–	–	5(6)
David Paige					
Non-executive Director	11(13)	7(7)	–	–	6(6)
Mark Pain					
Vice Chairman/SID	12(13)	7(7)	4(5)	–	6(6)
Guy Parsons					
Non-executive Director	12(13)	–	–	6(6)	–
Chris Pilling					
Chief Executive	10(11)	–	–	–	–
Mike Regnier					
Chief Customer Officer & Executive Director	13(13)	–	–	–	–
Stephen White					
Chief Operating Officer and Executive Director (appointed 24.02.2016)	12(12)	–	–	–	–

Notes:

- As referred to on page 64 of this report, there were 10 scheduled Board meetings and three additional meetings which were convened at short notice to consider ad hoc matters.
- The Chairman's Committee did not meet in 2016.
- The written resolution procedure under the Society's Rules was used on seven occasions by the Board, on one occasion by the Chairman's Committee, on two occasions by the Remuneration Committee and on one occasion by the Group Risk Committee to conduct business.

On behalf of the Board

John Heaps
Chairman
27 February 2017

Audit Committee Report

Membership and attendees

The Audit Committee is appointed by the Board and comprises three independent non-executive directors. Membership and attendance at meetings during 2016 is shown on page 70.

Alison Hutchinson, David Paige and I have recent, relevant financial experience gained through either current or previous roles, other current non-executive directorships and our relevant qualifications. This experience along with these directorships and qualifications mean that the committee as a whole has both competence relevant to the sector in which the Group operates and experience of corporate financial matters. More information on the skills, qualifications and experience of the committee members can be found in the Directors' Biographies on pages 52 and 55.

David Paige is due to retire from the committee at the 2017 AGM. I would like to take the opportunity to thank David for his outstanding contribution and guidance to the committee before, during and since the financial crisis.

During the year, where appropriate, committee meetings began with a private session between executive management and the committee members. Also, where fitting, the meetings concluded with a private session between the committee and both the internal and external auditors.

The committee invites the presence of Chief Officers and the Senior Leadership Team when it is felt that this would help it discharge its duties.

Roles and responsibilities

The roles and responsibilities of the committee are set out in its Terms of Reference which are reviewed and approved by the Board each year. They can be found in the Your Society section of our website ybs.co.uk/your-society/inside-your-society/corporate-governance/committees. We have reviewed the Financial Reporting Council (FRC) guidance for Audit Committees dated April 2016 and the changes to the UK Corporate Governance Code and approved changes to our Terms of Reference as appropriate.

Financial reporting issues and judgements

Our role in monitoring financial reporting issues is key to ensuring that all our stakeholders maintain their trust in our activities and reporting. Whilst we remain responsible for setting key accounting policies and forming opinions on key judgements, we utilise our external auditor, Deloitte LLP (Deloitte), to help ensure that suitable accounting policies have been implemented and appropriate judgements have been made by the Chief Officers and the Senior Leadership Team.

During 2016, management undertook a comprehensive review of the Group's approach to accounting policies and estimates. The committee concluded that the approach was both prudent and appropriate.

We considered the following main issues during 2016:

- Strategic initiatives. The Group has continued its significant investment in the strategic initiative programme. The committee has considered the approach being taken to cost allocation and is satisfied that the capitalisation of costs associated with the initiatives is appropriate.
- Revenue recognition. The Group recognises income in relation to the provision of mortgages on an effective interest rate basis. Fees and commissions are spread over the expected behavioural life of the mortgage. The committee agreed with the assumptions used and concluded that revenue was fairly stated.
- IFRS9. The committee has received regular progress updates regarding the Group's readiness to comply with IFRS9, and is satisfied with the level and speed of progress that's being made. The committee has received training previously on IFRS9 with further training planned for 2017. The committee will continue to develop its understanding of the implications of IFRS9 for the Group during 2017.
- Loan loss provisions. Management has reviewed the outputs of the loan loss provisioning models and subjected the results to additional provisioning overlays where they believed that the underlying credit risk facing the Group wasn't being reflected fully. The committee reviewed the approaches used, assumptions adopted and the overlays applied by management and agreed with the overall level of provisions held.

Audit Committee Report continued...

- Other provisions. Management reviewed other provisions throughout the year with key changes reflecting an increase in the PPI provision as well as a number of other, individually immaterial, customer remediation provisions. The committee reviewed these provisions and agreed with the overall level held.
- Run-off of fair values associated with acquired books. The Group has mortgage books which were acquired following the mergers with Chelsea Building Society and Norwich & Peterborough Building Society where the fair value inclusive of lifetime losses of these books on acquisition was estimated by management. As these acquired assets run off over time, any adjustments to their fair values are recognised in the Income Statement. The committee reviewed all the judgements made in this regard and discussed these at length with Chief Officers and the Senior Leadership Team and the external auditors. As a consequence, the committee is comfortable that a cautious but appropriate approach has continued to be taken.
- Hedge accounting. The Group holds derivative financial instruments to mitigate various risks as set out in Note 34 on pages 150 to 153. Where the requirements of hedge accounting are met, the changes in the value of these instruments, recognised in the Income Statement, may be offset by the corresponding changes in the value of the hedged items. The committee has overseen management's control activities in this area including commissioning an independent examination of these activities by external specialists. This insight resulted in Chief Officers and the Senior Leadership Team undertaking a set of actions to adjust their control activities. This oversight activity enables the committee to be confident that amounts recognised in the Income Statement are fairly stated and that appropriate disclosures have been made.
- Viability and going concern. When preparing the Group's Annual Report and Accounts the directors are required to confirm that the Group is a going concern, unless it is inappropriate to presume that the Group will continue in business. In addition, the directors are also required to confirm the longer-term viability of the Group as set out in the Strategic Report on page 45. The committee reviewed and challenged papers prepared by Chief Officers and the Senior Leadership Team and was in a position to recommend to the directors that the Annual Accounts should be prepared on a going concern basis and that there is a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the next three years.

The Group's Annual Report and Accounts are required to be fair, balanced and understandable as well as providing the necessary information for members to assess the Group's performance, business model and strategy. The process to draft and review the Annual Report and Accounts is undertaken alongside the external audit undertaken by Deloitte.

The committee is satisfied that, taken as a whole, the Annual Report is fair, balanced and understandable.

Internal controls

The Board recognises the importance of sound systems of internal control in the achievement of its objectives and the safeguarding of member and Group assets. Internal control also facilitates the effectiveness and efficiency of operations, helps to ensure the reliability of internal and external reporting and assists in compliance with applicable laws and regulations.

The Group operates in a dynamic business environment and, as a result, the risks it faces are continually changing. The internal control framework has been designed to ensure thorough and regular evaluation of the nature and extent of risk and the Group's ability to react accordingly. It is the Board's responsibility to develop policies on risk and control. All colleagues have responsibility for internal control as part of their accountability for achieving objectives. Colleague training and induction is designed to ensure that they are clear on their accountabilities in this area and are competent to operate and monitor the internal control framework.

An effective control framework is vital to manage risk and to maintain the trust of all our stakeholders particularly as the Group looks to deliver a significant strategic change programme. We review this framework through regular reporting from Chief Officers, the Senior Leadership Team, Internal Audit and our external auditors who set out the views of management as well as their own independent opinions. The committee works closely with the Group Risk Committee to ensure the risk assurance framework is operating effectively throughout the business.

Further details of actual risk management practices are provided in the Risk Management Report on pages 75 to 78.

The main internal control areas considered and reviewed in detail during 2016 were:

- Internal audit reports. The committee approved the Internal Audit plan for the year, the proposed revisions to that plan and the resources needed to support it. It received reports on the outcomes from the delivery of the plan. The committee considered an annual report giving an overall assessment of the effectiveness of internal control.
- Our external auditors provide us with internal control reports in respect of key financial reporting processes and systems arising from the external audit review. During the year, Deloitte did not highlight any material control weaknesses.
- We review regular updates on the status of issues raised in control reports, both from our internal and external auditors. The volume and age profile of control issues has remained within tolerable limits.

The committee has received regular reports on the use of the confidential reporting channels in the Group to enable effective oversight of any concerns raised by colleagues and stakeholders.

The information considered by the Committee provided assurance that in 2016 the Group maintained an adequate control framework that met the principles of the UK Corporate Governance Code and that there were no material breaches of control or regulatory standards. However, there were a number of control improvements identified by management that will be actioned in 2017 and monitored by Audit Committee.

Oversight of Internal Audit

The committee receives regular reports from Internal Audit setting out the results of their assurance activity including their performance against a range of measures. The function reports annually on the skills and resources necessary to discharge its role.

The Internal Audit function is governed by a Charter which is reviewed annually by the committee and was reapproved in July 2016. A copy of the Charter can be found on the Group's website ybs.co.uk/committees. In 2015, a concise version of the Charter was approved to help communicate the important role of Internal Audit in the Group.

The Internal Audit function has deployed an internal quality assurance programme that meets the requirements of the Chartered Institute of Internal Auditors' Guidance for Internal Audit in the financial sector. The committee has previously also commissioned an external expert assessment of Internal Audit. The committee considered the outputs from these sources which have assisted its ongoing assessment of the effectiveness, quality, experience and expertise of the Group's Internal Audit function and its approach.

Through Quality Assurance processes and the ongoing five year strategic plan for the function, we continue to develop Internal Audit to ensure it remains appropriate for the role it plays in an increasingly complex Group risk environment.

Oversight of external audit and the external audit process

Each year the committee approves the proposed audit plan presented by the external auditor including a discussion of key risk areas to ensure that there is agreement on the focus of work and materiality measures.

The external auditor provides regular reports to the committee on their work on the Interim Financial Statements and the Annual Report and Accounts prior to the committee recommending approval.

The committee carries out an assessment of the effectiveness of the external audit process each year. This follows a process based on practice aid guidance from the FRC. The assessment is informed by the perceived value extracted from engagement with the external audit team and process.

The committee takes into account the performance of the external auditor when considering their reappointment as well as their length of tenure and the date of rotation of the audit partner. Deloitte were appointed in July 2009 following a competitive tender process and the external audit partner rotated off the audit following the 2013 year end. Peter Birch, the current external audit partner, rotated onto the engagement for the 2014 year end.

During 2016, the committee considered and concluded that a further competitive tender was not necessary given the performance of Deloitte and the level of change within the Group. The committee reviewed this decision in September and recommended that Deloitte be reappointed at the 2017 AGM for that year.

Corporate Governance Code requirements mean that the audit contract should be put out to tender at least every ten years. Under the transitional arrangements, this means that the contract will need to be re-tendered no later than 2019.

Audit Committee Report continued...

External auditor objectivity and independence

The Group has a policy on the use of the external auditor for non-audit work which is overseen by the committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor. The policy sets out examples of services which the external auditor can and cannot perform. Fees for individual assignments which exceed pre-defined limits require prior notification to the Chair of the Audit Committee who then considers whether formal committee approval is required. The level of fees incurred is regularly monitored, and the committee is satisfied that the Group has operated in compliance with the policy during 2016. There are no significant non-audit engagements that require explanation as to why the external auditor was used.

Details of the fees paid for non-audit services during the year can be found in Note 7 on page 118.

Audit Committee effectiveness

The effectiveness of the committee is assessed annually. A self-assessment exercise, co-ordinated by Internal Audit, is performed and the results are reported to the Board. The 2016 review concluded that the committee operated effectively during the year.

Committee members are expected to undertake relevant training as part of their ongoing development as an individual Board member. Each year, as well as undertaking individual training as members consider appropriate, the committee as a whole receives training on current topics. In 2016, this comprised updates on: Internal Ratings Based (IRB) calculations, Capital and Leverage, Sustainability, Funds Transfer Pricing and Hedge accounting.

On behalf of the Board

Mark Pain
Chair of the Audit Committee
27 February 2017

Risk Management Report

2016 was my first full year as Chair of the Group Risk Committee (GRC). I was encouraged that the external effectiveness review of this committee concluded that it was operating effectively. The three lines of defence model is in operation and the Group continues to build on its robust risk management framework and strategy.

Introduction and Framework

The Group's vision "to be the most trusted provider of financial services in the UK" is at the heart of ensuring that we are responsible in the way that we take risks. "Most trusted" means that we cannot take irresponsible risks that would either lead to poor customer outcomes, or threaten the Group's sustainability.

We identify, monitor, control and manage risk using our Risk Management Framework. The Risk Management Framework gives structure to a single approach to managing risk. It is reviewed and approved annually by the Group Risk Committee. It consists of:

- A Risk Vision that provides high level direction around which managers of risk can rally.
- A Risk Management Strategy that sets out separately how that Vision will be achieved.
- A Risk Appetite that directs the extent to which strategically compliant risks can be taken.
- Policies that direct how those acceptable risks should be taken.
- Controls to identify whether risks beyond those approved are being taken (or likely to materialise).
- Finally, it covers the need for appropriate and competently resourced risk operating models to ensure that risk management is efficient, and provides a link to colleague Performance Goals to ensure that poor risk management is not incentivised.

The Risk Management Strategy sets out the capability upgrades necessary to ensure that risk capability is aligned to the ambitions of the Group's Plan. This ensures that the Group's customers are not exposed to unfair outcomes, or the Group to unplanned financial outcomes.

The amount of risk that the Group is prepared to take or retain in pursuit of value (our 'Risk Appetite') is there to protect the Group and our customers by constraining the amount of risk that the business is taking to those areas where it has capability, including appropriate systems and controls.

Three Lines of Defence

The Group operates a Three Lines of Defence (LoD) model as follows:

First Line of Defence (Responsible):

- Day-to-day responsibility for running the business.
- Develop a clear risk and control framework, including responsibility for initiating risk appetite, policy, controls and outcome testing with the capability to identify, assess, control, mitigate and report risk.

Second Line of Defence (Accountable):

- Accountability for ensuring competent risk management across the Group within risk appetite and the reporting of risks to Board.
- Support, coach, facilitate, independently monitor, challenge, report and if necessary give direct instruction.
- Manage regulatory relationships and brief the Board.
- Oversee the effectiveness of the Three Lines of Defence model.

Third Line of Defence (Internal Audit):

- Help the Board and Executive Team protect the assets, reputation and sustainability of the organisation by independently assessing whether all significant risks are identified and appropriately reported by the Senior Leadership Team and the Risk function to the Board and Executive Team.
- Independently assess whether the risks are adequately controlled.
- Challenge the Executive Team to improve the effectiveness of governance, risk management and internal controls.

During 2016 the focus has been on strengthening the first LoD and ensuring clear understanding of the delineation of roles and responsibilities between the three lines of defence.

Governance

The Board is ultimately responsible for every aspect of the Group's activities. In particular, one of its roles is to focus on the Group's strategy and ensure that the necessary resources are in place to meet its objectives and to ensure that robust financial controls and systems of risk management are in place. To assist the Board, the Group Risk Committee considers all risk matters relating to the Group, including credit risk, operational risk,

Risk Management Report continued...

market risk, liquidity risk, funding risk, business risk and regulatory risk (including prudential and conduct) requirements. As Chairman of the Committee, I provide regular updates to the Board on matters considered by the Committee.

The Group maintains an independent second line risk management function (Group Risk) that is responsible for ensuring that appropriate risk management techniques and measures are deployed that remain commensurate with the Group's strategic aims, its appetite for risk and the actual risks it faces at any time. The Group Risk function provides periodic independent reports on risk positions and risk management activities for consideration by the Group Risk Committee, its sub-committees and the Board. The Group's Chief Risk Officer provides a formal update to Board on a quarterly basis covering all areas of risk management, including routine reporting and ad hoc issues.

The Group Risk Committee oversees the Group's risk management framework and oversees an enterprise-wide perspective on all risk matters. It normally meets four times a year, but will meet more frequently when the need arises. Its membership comprises four non-executive directors: David Paige (Committee Chair), Dame Kate Barker, Mark Pain and Gordon Ireland. It is also attended by members of the Executive Team including the Chief Executive Officer, the Chief Operating Officer, the Chief Customer Officer, the Finance Director and the Chief Risk Officer. Details of attendance are set out on page 70. The committee invites the presence of certain members of the Executive Team and the Senior Leadership Team when it is felt that this would help it discharge its duties. The committee's Terms of Reference are available from the Corporate Governance section of our website: (ybs.co.uk/committees).

During 2016 the Committee met seven times and the matters considered included:

Approval of:

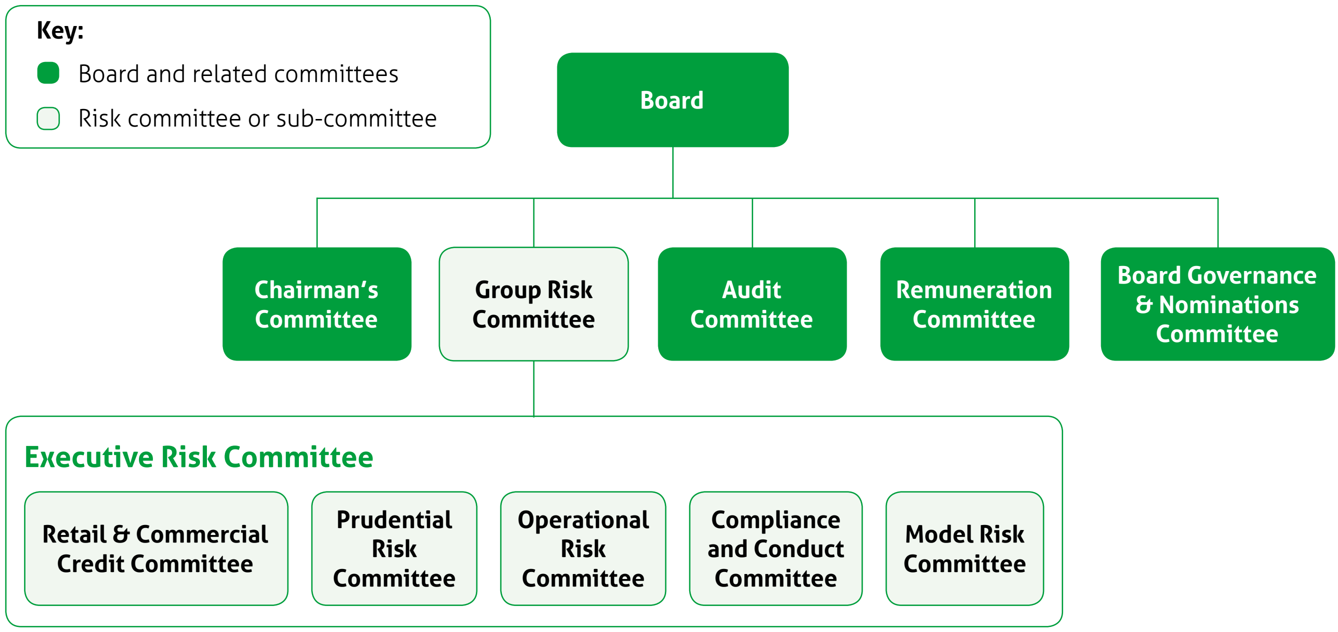
- The risk management framework and strategy.
- The Group's risk appetite ahead of approval by Board.
- The Group's risk universe.
- The regulatory capital submission (ICAAP) ahead of approval by the Board.
- The regulatory liquidity submission (ILAAP) ahead of approval by the Board.
- Reverse stress tests.
- The regulatory Recovery Plan and Resolution Packs.
- Second LoD oversight plans for Compliance and Conduct Risk, Prudential Risk and Operational Risk.
- Risk Overlay Process for Material Risk Takers' Bonus.
- Money Laundering Reporting Officer's annual report.
- Delegation of mandates to sub-committees.

Monitoring of:

- Economic, political, market and cyber risks and their potential impact on risk appetite.
- The Group Risk Map including the Horizon Risk Register.
- Risk appetite adherence.
- Second LoD monitoring of compliance and conduct risk, prudential risk and operational risk.
- The project to implement Internal Ratings Based (IRB) approach to capital requirements for retail credit risk.
- Effectiveness of the Three LoD Model, including resourcing and capability of the first and second lines of defence.
- A cyclical programme of deep dives into key areas, including credit risk, commercial lending and operational risk.
- In addition to the deep dives, specific ad hoc topics are considered at the request of the committee. In 2016 these included:
  - Operational resilience.
  - Potential impact of the UK exiting the EU.
  - Balance sheet structure including interest rate risk.
  - Fund Transfer Pricing.
  - Credit Provisioning cycle factors.
  - Cyber security.
  - London property market.

In 2016 the Committee commissioned an external review of its effectiveness. The review was undertaken by Grant Thornton and concluded that "GRC appears to be functioning effectively with no major concerns with its structure, membership or operational effectiveness".

The Executive Risk Committee (ERC), which is a sub-committee of the GRC, acts as an umbrella for five sub-committees. ERC meets once a month (except the Model Risk Committee), making risk management oversight a focus of attention for the Group. The diagram on page 77 shows the structure for Board, Board Committees (including Group Risk Committee) and ERC.



During 2016 the structure and responsibilities of the ERC and its sub-committees were changed to better reflect the maturing three LoD framework. The operational drive behind the change has been to make executive level committee governance more effective and more efficient. Business areas have been provided with the autonomy to operate within the risk appetites agreed by Board, without the requirement to have these decisions re-approved at ERC unless:

- There is an explicit requirement to do so articulated in the ERC Terms of Reference.
- The decision would be outside of risk appetite.
- The decision could take the Group outside of risk appetite in future years.
- The Division, even though within risk appetite, would prefer to have ERC involvement in the decision.

ERC and its sub-committees now fulfil their role as second line of defence governance committees focussing on oversight, with fewer decision papers.

The Board believes that these changes enable more efficient and agile risk decisions, thereby improving the ability to respond to customer requirements, whilst simultaneously protecting the sustainability of the Group.

Stress Testing

Stress testing is a risk management tool used throughout the Group to better understand potential vulnerabilities in our business model. Group Risk Committee approves key stress tests. The key uses of stress testing are:

- To test the robustness of the Group's financial plan.
- To support regulatory returns, the Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment Process (ILAAP).
- Scenario analysis in the Group's recovery plan.
- Daily stress testing of liquidity and market risk.
- The Group's annual reverse stress tests.

Reverse stress tests start from the identification of a predefined outcome, that being the point at which the firm's business model becomes unviable, or at which the firm can be considered to be failing because the market has lost confidence in it. They are helpful in contingency planning and to reveal weaknesses which may not be evident from other forms of stress testing.

Principal Risks and other risk references

- Principal risks are described in the Strategic Report on page 38.
- The Pillar 3 disclosure report contains details on capital requirements, including Pillar 1 requirements and descriptions of risks considered for Pillar 2 requirements.
- Further information is also provided in the following notes to the accounts: Conduct Risk (Note 28), Capital Risk (Notes 30 and 31), Liquidity and Funding Risk (Note 35), Market Risk (Note 36) and Credit Risk (Notes 38 and 39).

Risk Management Report continued...

Emerging Risks

The Group recognises that the environment within which it operates and the nature of the threats which it faces are continually evolving. Consequently, the Group continues to invest in its risk management capability in order to ensure that emerging and evolving risks continue to be closely monitored and that timely and appropriate action is taken to protect the interests of the Group and its customers. Horizon risks are regularly reviewed through the senior risk committees and are considered as part of the Group's planning process.

The most significant emerging risks currently facing the Group can be summarised as follows:

1. Macroeconomic

Potential impact of the UK exiting the EU.

Notwithstanding some market volatility in the immediate aftermath of the vote to exit the European Union, the UK financial system has remained stable. However, the nature and terms of the subsequent exit agreement may yet result in significant disruption to the UK economy.

Market pressures on core business.

Sustained historically low interest rates continue to constrain margins and may impact consumer attitudes towards saving in the longer term. This, coupled with ongoing concerns in the housing market regarding affordability and the continued fall in the percentage of the population who are (or who aspire to be) home owners, may impact the Group's business model.

Deterioration in the global economy.

Geo-political uncertainty, notably in the US, coupled with a continued slowdown in the emerging economies, may in turn impact growth in the UK and delay the expected increases in the base rate.

2. Cyber Security and resilience

New and rapidly evolving cyber security threats.

The increasing use of technology and the pace of technological change expose the UK financial services sector to ever increasing and evolving cyber security threats. Resilience to such threats and an ability to effectively respond in the event of an attack are essential in order to protect the Society, maintain the trust of our customers and the confidence of our regulators.

Ensuring the provision of resilient services.

Digital technology continues to change customer behaviour and drive demand for accessibility and convenience. At the same time, customer tolerance for service disruption continues to reduce. A number of operational and IT failures in the retail banking sector has meant that operational resilience is receiving increasing scrutiny from Regulators, Boards and other stakeholders.

Maintaining and enhancing resilience controls will safeguard the Group's reputation, meet the expectations of Regulators and avoid or reduce the costs associated with service failures. However, the continued provision of a highly reliable service, coupled with the need to effectively respond to customer expectations may mean that maintaining IT systems and infrastructure becomes increasingly time-consuming and expensive.

3. Conduct and compliance

Changing regulatory landscape.

As set out within our trust code, conduct and compliance is central to our values and behaviours. The Group maintains a strong customer-focused conduct culture covering all customer interactions from product design, through to sales and post sales servicing. It is nonetheless recognised that ongoing focus is required in order to ensure that the Group continues to effectively adapt to the nature and extent of changing regulation.

Change outpacing regulation.

As noted previously, the rapidly changing technological environment and associated demands and expectations of our customers, may mean that industry developments need to be progressed ahead of regulatory change. This may result in uncertainty and require careful management in order to ensure that fair customer outcomes continue to be delivered.

4. Changing market for financial services

Challenge from established and new competitors.

Changes within the financial services market may increasingly threaten our core service propositions. Traditional banking competitors may pose an increasing threat to the Group's core markets as the requirement to ring-fence their retail operations leads them to refocus their activities. Challenger banks and Fin Tech firms may impact product pricing and accelerate changes in customer expectations.

New technology and business models.

It is recognised that the Group must respond effectively to the challenges and opportunities presented by new technologies in order that it might retain the trust of its customers and continue to meet their expectations, particularly in relation to ease of use and accessibility of services. However, the cost of delivering the level of change necessary to keep pace with rapidly changing technology may prove unsustainable and require investment choices which may not fully meet these expectations. In addition, the emergence of new business models, such as peer-to-peer lending, may erode traditional markets and undermine the economics of branch distribution.

On behalf of the Board

David Paige
Chair of the Group Risk Committee
27 February 2017

Directors' Remuneration Report

LETTER FROM THE CHAIRMAN OF THE REMUNERATION COMMITTEE

Dear Member,

I'm pleased to share the Remuneration Committee's report, including details of the directors' pay, for the year ended 31 December 2016.

Our Policy

We recognise that the way colleagues are rewarded and motivated is a cornerstone of a leading people experience and supports our vision of being the most trusted financial services provider in the UK. Our approach to remuneration is designed to reflect the values of our organisation and extends to all colleagues. At the 2016 AGM, our Directors' Remuneration Policy was approved by our members (through advisory vote), and it continues to set the framework for our directors' remuneration. A summary of the policy is set out in this report.

Chief Executive Officer change

In June 2016, our Chief Executive Chris Pilling announced his intention to step down from his position after having led the Group for five years. We thank Chris for his successful leadership, dedication to the Group's trust agenda and his passion for customer service. Chris leaves the Group in a strong position and in the careful stewardship of our incoming Chief Executive, Mike Regnier (previously Chief Customer Officer for the Group). Mike assumed the position of Chief Executive on 1 January 2017. Details of Chris Pilling's leaving arrangements and the remuneration package for Mike Regnier are outlined in this report.

Other Executive Director changes

In February 2016 we welcomed Stephen White to the Group as our Chief Operating Officer.

In December 2016 our Chief Corporate Affairs and Treasury Officer, Andy Caton, left the Group after 25 years' service. Andy has been at the forefront our 'Locally Famous' strategy, which we are now embedding as part of the wider Leading People Experience strategy, as well as overseeing our Treasury function. Following Andy's exit, responsibility for the Treasury function will be held by our Finance Director, Robin Churchouse.

Full details regarding the remuneration impact of the above changes are included in this report.

How the Group has performed

Our industry continues to experience significant change and a challenging trading environment. The Group has responded to these changes, while continuing to work towards our vision of being the most trusted provider of financial services in the UK. As set out earlier in the Annual Report, 2016 was a solid year for the Group. We remain committed to putting the needs of our members at the heart of everything we do. In recent years, this attention has seen the Group successfully move up the 'leading customer experience' league table run by KPMG/Nunwood from 112th to 27th in 2016. For most of 2016, the Group was ranked as the third most trusted provider of savings and mortgages according to a survey conducted by You Gov. At the same time, our financial focus throughout 2016 has been on sustainability; our profit was in line with expectations and the balance sheet remained robust, retaining a strong capital position.

The impact of performance on directors' pay

The Group's results have been reflected in the directors' remuneration awarded for 2016. The remuneration of our executive directors reflects their contribution to, and is aligned with, the success of the Group. The Committee has carried out a comprehensive review of the remuneration outcomes of the executive team, whilst considering these in the context of wider colleague pay in the Group. In 2016, (on average) an eligible executive director achieved 76.2% of their maximum bonus opportunity, with all eligible colleagues on average receiving 60.4% of their maximum opportunity. The Group's bonus is awarded on successful achievement of financial and customer performance measures and individual performance. Further details of how payments have been calculated for executive directors are outlined in this report.

We've made some changes within the body of this report to support increased transparency and help members understand the context of the executive director remuneration policy and how it works in practice. I hope you'll find the 'at a glance' summary introduced to outline what our directors' earned in relation to the 2016 performance year easy to understand.

Directors' Remuneration Report continued...

Base salary increase for employees in 2016

Across the Group (including all executive directors), the average base salary increase was 2.7%.

Base salary increases for executive directors in 2016

Our executive directors received an average base salary increase in line with the average employee increase: Andy Caton (Chief Corporate Affairs and Treasury Officer) received 2.0%, Robin Churchouse (Finance Director) received 2.6% and Chris Pilling (Chief Executive Officer) received 3.0%.

As part of Mike Regnier's appointment to the larger Chief Customer Officer role in 2015, it was agreed that a further pay award would be made subject to performance in his new role. The Committee is comfortable that Mike has performed to the required level; consequently a pay award of 9.1% was made in 2016.

As Stephen White (Chief Operating Officer) was appointed on 24 February 2016, he did not receive an increase to base salary.

Reporting requirements

This report discloses information in line with the Building Societies (Accounts and Related Provisions) Regulations 1998; and the Pillar 3 disclosure requirements relevant to a Proportionality level 2 firm (relating to the European Banking Authority's CRD IV requirements). The Group also voluntarily complies, where possible, with disclosure requirements of the Large and Medium-sized Companies (Accounts and Reports) Regulations 2008.

Looking ahead to 2017

Our focus remains on providing value to our members in terms of customer service and building a sustainable business for the future. This is supported by our current remuneration policy, which will largely be in line with that seen in 2016.

I trust that members will agree that the performance of the Group and its leaders in 2016 warrants their continued approval of the Annual Report on Remuneration. On behalf of the Remuneration Committee, I recommend that you endorse the report.

Guy Parsons
Chair of the Remuneration Committee
27 February 2017

At a Glance Summary of 2016

The summary below outlines the structure of the Group's bonus scheme, 'Your Bonus' and the performance measures taken into account to calculate executive director bonus award.

The Group's Performance used for bonus calculations

The PBT figure for 'achieved' is different to the figure stated on page 30 of the Annual Report and Accounts. This figure is adjusted to reflect underlying profit and is in line with agreed principles which are outlined on page 87 of this report. The NPS measures how likely customers are to recommend us and is a combination of customer and broker NPS, resulting in an achieved NPS of +33 – note that this is calculated on a different basis to the purely customer NPS score, of +31, referred to elsewhere in the Annual Report and Accounts.

The scheme design is the same for all colleagues, with varying on-target award levels for colleague and senior managers. Bonus is awarded on successful achievement of financial and customer performance measures and individual performance. 'On-target' achievement of Group performance and individual performance criteria of 'met/met' results in a bonus of 30% of base salary for the executive directors. The maximum bonus available to executive directors is 50% of base salary.

The Remuneration Committee retains the discretion to make adjustments to the profit figure to ensure that it reflects a true view of underlying performance prior to payment of the bonus. In line with our directors' remuneration policy, the Committee undertakes a risk overlay process on bonus based on a series of agreed principles. These are detailed in the report.

How much have our Directors earned in 2016?

The summary below illustrates Executive Director total earnings for 2016 performance year.

	Base Salary £000	Other Fixed Pay** £000	Bonus*** £000	Total Earnings £000
Andy Caton	312	53	–	365
Robin Churchouse	338	67	85	490
Chris Pilling	590	111	–	701
Mike Regnier	376	72	177	625
Stephen White*	340	79	144	563

* Stephen White joined on 24 February 2016 and his payments reflect his length of service with the Group. As part of his joining arrangements, a location allowance was agreed and is incorporated into other fixed pay.

** Fixed pay includes pension allowance, taxable benefits and any location allowance.

*** Andy Caton and Chris Pilling will not receive a bonus in relation to the 2016 performance year due to their resignations.

In 2017 base salary, fixed pay and bonus earning opportunity will continue to operate in the same way.

Directors' Remuneration Report continued...

Remuneration Policy in Practice

The Group's directors' remuneration policy is aligned to our current strategic priorities. The policy supports the Group in delivering its strategy by enabling the Group to recruit and retain talent, to focus on our customers and by being compliant from a regulatory perspective. The remuneration policy is regularly reviewed to ensure it continues to support the delivery of business strategy.

The Group's approach to remuneration recognises the executive directors for their contribution to the organisation's success. Executive directors and non-executive directors are not involved in deciding their own remuneration. A key principle in developing the Group's remuneration policy is to focus the executive directors and non-executive directors on the delivery of key business and customer outcomes.

The remuneration policy was approved by members at the 2016 AGM and remains in force for 2017. A summary of the remuneration policy is set out below. The approved directors' remuneration policy is in the 2015 Annual Report and Accounts, available at ybs.co.uk. A summary of the Group's wider remuneration principles and policy is available at ybs.co.uk/your-society/inside-your-society/corporate-goverance/committees

	Purpose and link to strategy	Operation	Opportunity
Base pay	Reflects the contribution of executive directors in their role as defined by the combination of: ■ Skills, knowledge and experience. ■ Performance. ■ Demonstrating the Group's behaviours and values.	Base pay is typically reviewed annually in line with the range of increases for all colleagues, and determined with reference to: ■ Role, experience and individual performance. ■ Affordability – the economic environment and overall financial state of the Group. ■ Comparison to the external market, supported by reference to the Group's grading structure, the Career Framework.	n/a

	Purpose and link to strategy	Operation	Opportunity
Bonus ('Your Bonus')	Rewards annual performance against challenging financial and customer measures as well as key individual objectives.	• Key measures within the Corporate Plan have to be achieved for 'on target' pay out, and considerably exceeded for maximum pay out. • The profit figures utilised for pay out may be adjusted at the discretion of the Remuneration Committee in line with approved principles to ensure a true and fair view of performance is applied. • Bonuses for executive directors will be subject to the relevant disclosures. • The committee reserve the right to apply a malus adjustment (reduce bonus or lapse deferred elements) and to apply clawback (recover bonus payments already made) as applicable. • Awards are subject to clawback for up to a maximum of ten years.	All colleagues participate in the same scheme. • 'On-target' achievement of Group performance criteria results in a bonus of 30% of base salary for the executive directors. The maximum bonus available to executive directors is 50% of base salary.
Benefits	Executive directors receive benefits to ensure their total package is in line with market practice to enable the attraction and retention of executive directors of the required calibre.	Benefits include car benefits, healthcare, private medical insurance, life cover and insured sick pay.	All benefits are provided in line with the Group's grading structure, the Career Framework.
Pension	The Group's pension arrangements support the recruitment and retention of executive directors through the provision of competitive retirement benefits.	Executive directors are eligible to participate in the Group's defined contribution pension scheme. Where contributions exceed the annual or lifetime allowance, executive directors may be permitted to take a cash supplement instead of contributions to the plan.	Executive directors receive a contribution (or cash allowance) equal to a maximum of 16% of base salary.

Directors' Remuneration Report continued...

Approach to new hires and leavers

Provision	Policy
New hires	■ When agreeing a remuneration package for the appointment of executive directors, the committee will apply the following principles: ■ The packages will be sufficient to recruit individuals of the required calibre to lead the business and effectively execute the strategy for members. ■ The committee will look to align the remuneration package offered with the Group's broader remuneration policy. ■ The committee will ensure that the level of pay is necessary but not excessive. ■ The committee has discretion within the policy to make remuneration decisions where it considers it appropriate to do so. In determining remuneration arrangements, the committee will consider similar positions in the market, the structure of the remuneration package and the experience of the candidate. This ensures that arrangements are in the best interests of both the Group and its members without paying in excess of what is necessary to recruit an executive director of the required calibre.
Notice Period	The standard notice period is 12 months from the Group and 12 months from the executive directors. In normal circumstances, executive directors will be required to work their notice period. In the event executive directors are not required to fulfil their notice period, they will receive a payment in lieu of notice (PILON) based on fixed elements of pay, or they may be placed on garden leave.
Termination Payment	Typically, termination payments will consist of basic salary and other contractual benefits for the notice period, the emphasis being to not reward failure.
Bonus – leaver provision	On termination of office, the leaver provisions as set out below will apply. These are also outlined in the Group's bonus plan rules: ■ In the event of retirement or redundancy, ill-health or disability, any bonus will be pro-rated to reflect the time served during the performance period. Any deferred payments due remain subject to future performance conditions and are payable at the end of the corresponding performance periods. They are also subject to the Group's risk overlay process, and therefore subject to the Group's malus and clawback provisions. ■ In the case of death, any bonus payments will be pro-rated to reflect the time served during the performance period. Payment of any deferred amounts, including deferred amounts from previous years, is accelerated and payable at the next payment date. ■ Subject to committee discretion, in the event of resignation, any eligibility to participate in the current year's bonus scheme will cease. Leavers under these circumstances will be eligible to receive deferred bonus payments earned in previous years, subject to the Group's risk overlay process. ■ Where deferred awards continue, they remain subject to the Group's risk overlay process, malus and clawback provisions. Under resignation circumstances, the SEI value will remain at the original allocated amount.

Chairman and Non-Executive Remuneration

	Operation	Opportunity
Chairman Fees	Normally reviewed and approved by the Remuneration Committee on an annual basis.	Fee levels take into account time commitment for the role and practice at other organisations.
Non-executive director fees	Normally reviewed and approved by the executive and the Chairman on an annual basis. ■ Non-executive directors receive a basic fee. ■ An additional supplement is paid for serving on or chairing a Board Committee. ■ Non-executive directors do not participate in any performance pay or pension arrangement.	

Annual Report on Remuneration

Executive Directors' Remuneration

The table below shows the remuneration of the executive directors of the Group for the years ended 31 December 2016 and 2015. This is audited information.

	Base Salary £000	Fixed Remuneration Taxable Benefits £000	Pension Allowance £000	Bonus £000	Total Remuneration £000
Executive Director					
Year ended 31 December 2016					
Andy Caton	312	3	50	–	365
Robin Churchouse	338	12	55	85	490
Chris Pilling	590	15	96	–	701
Mike Regnier	376	11	61	177	625
Stephen White	340	26	53	144	563
Year ended 31 December 2015					
Ian Bullock	301	10	48	83	442
Andy Caton	306	12	80[1]	56	454
Robin Churchouse	331	11	53	91	486
Chris Pilling	571	15	92	177	855
Mike Regnier	322	11	51	99	483

In line with the aim of increased transparency, the presentation of the 'single figure' table of remuneration reflects the full amount executive directors earned in relation to the 2016 performance year. The figures include deferred elements, which will be paid in line with deferral requirements outlined on pages 87 to 88. The 2015 figures have been restated in this manner, and in line with regulation, to be shown on a consistent basis.

[1] Andy Caton was participating in a defined benefit scheme until 31 December 2015, when the scheme was closed to future accrual. In 2016, Andy received a cash allowance in lieu of pension contributions in line with other executive directors and prevailing tax restrictions.

Directors' Remuneration Report continued...

Base salary

Executive directors' salaries are reviewed each May at the annual pay review. The 2016 awards were in line with those received by the wider colleague group which, for all colleagues, ranged from 0.5% to 4.5%. Individual increases are based on performance, relative position to market and affordability, with the aim of retaining talent in a challenging environment.

Additional pay awards were also made for the wider colleague group to recognise high performance, address any gender differences in relation to pay and respond to market movements – this resulted in some awards at circa 10%. As a result, in 2016, the average pay award for all colleagues was 2.7%, including all executive directors.

The table below sets out the base pay levels for executive directors, incorporating increases which were awarded during the annual pay review in May 2016.

Executive Director	Base Salary at 1 May 2015 £000	Base Salary at 1 May 2016 £000	Increase %
Andy Caton	308	314	2.0%
Robin Churchouse	333	341	2.6%
Chris Pilling	579	596	3.0%
Mike Regnier*	355	387	9.1%
Stephen White**	–	400	–

* Mike Regnier assumed additional responsibilities when appointed to the role of Chief Customer Officer on 1 December 2015. It was agreed that Mike would receive a two-stage increase linked to performance in role; an increase in 2015 and a further increase in 2016. The Committee was comfortable that Mike has performed to the required level and subsequently an increase of 9.1% was awarded in 2016.

** Stephen White was appointed as an executive director on 24 February 2016, with a joining salary of £400,000, resulting in ineligibility for the 2016 pay review in May. There were no bonus buy out arrangements agreed on appointment.

Base salary in 2017

Mike Regnier was appointed to the position of Chief Executive Officer with effect from 1 January 2017. His remuneration package has been set at a level slightly below that received by Chris Pilling, reflecting the fact that it will be his first year in role. In line with Group policy (to position ourselves broadly at market median for total remuneration), he will receive a base salary of £550,000. From 1 January 2017 Robin Churchouse assumed additional responsibilities following the departure of Andy Caton. As a result of this change, and again in line with our remuneration policy, his base salary increased to £375,500. The next pay review for both Mike and Robin will be in 2018.

Stephen White's base salary will be reviewed in May 2017 in line with the 2017 annual pay review process.

Bonus

In 2016 the Group introduced a new bonus scheme, entitled 'Your Bonus'. It is anchored to the core business objectives of financial performance, customer experience and risk management. The scheme design is the same for all colleagues, with varying on-target awards for all colleagues and senior managers. Bonus is awarded on successful achievement of financial and customer performance measures and individual performance. A risk overlay process is also carried out to ensure the Group hasn't been exposed to unnecessary risk. 'On-target' achievement of Group performance criteria results in a bonus of 30% of base salary for the executive directors. The maximum bonus available to executive directors is 50% of base salary. The payment of bonus is subject to the discretion of the Remuneration Committee, and all executive director bonuses are subject to the relevant deferral periods.

Payments will be reduced or forfeited if the sustainable level of capital required to support the Group's growth rate is not generated each year. This is done via a scale adjustment measured against a minimum level of Return on Mean Assets (ROMA) for each year based upon the growth achieved. The 2016 ROMA target for the Group was 33%. The 2016 performance year ended with a ROMA position of 29.4%, which was in the desired parameters.

The risk overlay process considers the management of specific business risk appetite measures and payment can be amended where material breaches are identified. Following a rigorous process where business controls processes were reviewed and assessed, it was deemed that no action was required to adjust the bonus outturn for the 2016 performance year.

Under the terms of the Your Bonus scheme, scope is given to make adjustments to the calculation of profit underpinning payment of the scheme. The following principles are applied when identifying potential adjustments:

- Where an unexpected or unplanned item arises that is not part of the core, business as usual, running of the Group; for example one-off investments or projects that were not included in the plan profit number against which actual performance is judged.
- Adjustments also include removing both positive and negative impacts from non-core actions that do not reflect management of the underlying Group, for example any unplanned profits (or losses) on the sale of property are not included in the PBT figure used to calculate bonus outturn.

The profit before tax (PBT) figure used as part of the bonus scheme also excludes certain 'Day 1 fair value releases' but includes a Financial Services Compensation Scheme (FCSC) provision. The Committee retains the discretion to make any adjustments required to the profit figure to ensure that it reflects underlying profit. In line with the above, the overall PBT figure was adjusted to produce an achieved position of £131.4m against a reported figure of £151.5m. This has performed above target and set the bonus earning potential for the financial element.

The second performance measure is the customer 'Net Promoter Score' (NPS), which unlocks the bonus award. The NPS measures how likely our customers are to recommend us and we obtain this through customer and broker surveys. The results are combined, at a ratio of 90% customer and 10% broker, to create the 'combined NPS' for Your Bonus. To pay an 'on-target' bonus, the target NPS for the year was +31. At the end of 2016, the NPS was at +33 – note that this is calculated on a different basis to the purely customer NPS score, of +31, referred to elsewhere in the Annual Report and Accounts.

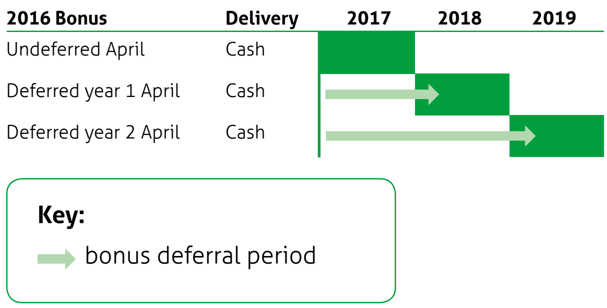
For 2016 performance year, 99.1% of eligible colleagues will receive a bonus. On average an eligible executive director achieved 76.2% of their maximum opportunity, with all eligible colleagues on average receiving 60.4% of their maximum opportunity.

Bonuses for executive directors remain subject to malus and clawback, with bonus subject to clawback for up to ten years.

Deferral and Share Equivalent Instrument (SEI)

In line with the Remuneration Code, all bonus awards for executive directors are subject to deferral. Bonus deferral ensures that the Group delivers variable pay in a manner that prevents undue risk taking and achievement of sustainable performance.

Annual bonus awards will normally be delivered as cash and paid over three years: 50% of any bonus is paid out in the year following the performance year; the remaining 50% is deferred with 25% released in year two and 25% released in year three.



For executive directors designated as 'Senior Managers' under the Senior Manager Regime and over the 'de-Minimis'* limit, bonus awards require a longer deferral period or a larger percentage to be deferred in line with regulations. Where also required by regulation, 50% of a payment will be delivered via a share equivalent instrument (SEI) and is subject to a retention period. For 2016 performance year, an executive director that reaches the de-minimis limit will receive 40% in cash in 2017 and the remaining 60% is deferred over seven years.

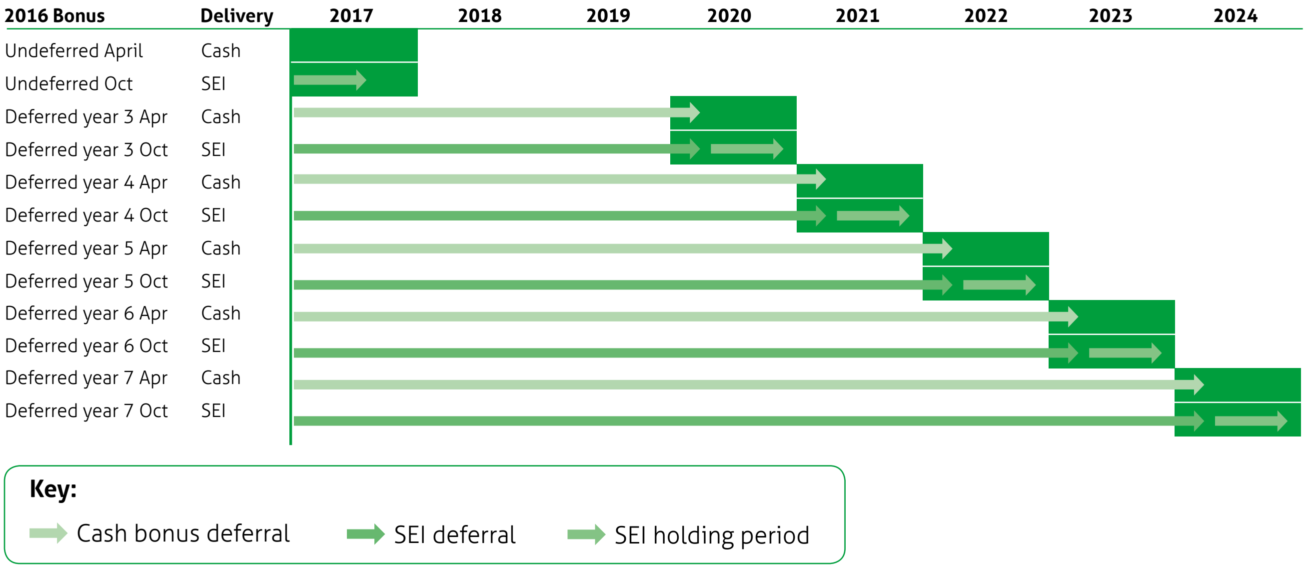
(*A de-Minimis limit level is set by regulation, in relation to the level of bonus deferral applied, and impacts colleagues whose total remuneration is greater than £500,000 per annum and/or where variable remuneration is more than 33% of their total remuneration.)

For example:

- Year One – 40% of any bonus earned is paid out in the year following the performance year. Half of this amount is paid in cash and the other half is delivered in a SEI and subject to an additional retention period prior to revaluation and payment.
- Deferral Years – the remaining 60% is deferred for seven years and paid equally each year from three years after the award. Each year, the award is split in two, with half the amount paid in cash and the second half held in a SEI and subject to an additional retention period prior to revaluation and payment. SEI valuations continue every six months until the bonus schedule is complete.

Directors' Remuneration Report continued...

Length of time variable pay is at risk



How did bonus deferral look for our Executive Directors?

	Total Bonus	% Deferred	Deferral Period	SEI
Robin Churchouse	85	50%	2 years	N
Mike Regnier	177	60%	7 years	Y
Stephen White	144	60%	7 years	Y

In 2016, we released deferred bonuses to executive directors in respect of previous years' performance. These were re-valued in line with the SEI process (where applicable) and resulting payments are outlined below:

Performance Year	Ian Bullock £000	Andy Caton £000	Robin Churchouse £000	Chris Pilling £000	Mike Regnier £000
2012	29	28	28	83	-
2013	34	9	30	49	-
2014	29	24	10	55	18
2015	41	28	46	76	50
Total	**133**	**89**	**114**	**263**	**68**

As we've changed the way we report on the single figure table of remuneration, full bonus payments (irrelevant of deferral period) will be reported in that table for future years.

Taxable Benefits

The taxable benefits awarded to executive directors are in line with the wider colleague offering, comprising a company car (or equivalent allowance), private medical insurance, permanent health insurance and any location allowances. Executive directors, like all colleagues, can also participate in a concessionary mortgage scheme which is subject to a maximum concessionary amount of £160,000; no executive directors have taken up this mortgage scheme. No significant changes to the construct of the executive directors' benefits entitlement are planned for 2017.

Pensions

In line with the policy approved by members at the 2016 AGM, until the end of 2015 the executive directors were either eligible to participate in the contributory defined benefit section (on a career average revalued earnings basis) or the defined contribution section of the Group's pension scheme. From 1 January 2016, the contributory defined benefit section of the pension scheme was closed to future accrual for all colleagues. Andy Caton was the only executive director participating in the defined benefit section, and ceased on-going participation at that date.

At 1 January 2017 all executive directors are members of the Group's defined contribution scheme; a contribution of up to 16% of base salary is paid for this population. Where prevailing tax restrictions limit pension contributions, the remainder is paid as a cash allowance.

The pension scheme also provides a lump sum of six times' pensionable salary on death in service.

Executive Director Pension Arrangements

Andy Caton's accrued defined benefit pension as at 31 December 2016 is £152,000.

Change in CEO pay

The table below sets out the percentage change in salary from the prior year at pay review for the CEO compared to all other colleagues, including the executive directors. Details are also provided in relation to the relative bonus achievement of CEO vs the wider colleague population.

Pay Review Percentage Change 2016	2016 Change
CEO	3.0%
Colleague average (including executive directors)	2.7%
Bonus Comparison	**2016 Change**
CEO	(100.0%)
Colleague average (including executive directors)	36.7%
Overall change in CEO pay (including salary, bonus, benefits and pension) in 2016	(18.0%)

Payment for loss of office

In June 2016 Chris Pilling advised the Board of his intention to step down from the role of CEO on 31 December 2016. All payments made to him in respect of his service during 2016 are reported in the single figure of remuneration table. Chris is contracted to a 12 month notice period but will not work for the remainder of his notice period and will receive the remaining payment as 'payment in lieu of notice' (PILON), subject to certain mitigating provisions. He will receive this in monthly instalments for the remainder of his notice period ending in June 2017.

Andy Caton stepped down from the Board on 9 December 2016. As with Chris, all payments made to him in respect of his service during 2016 are reported in the single figure of remuneration table above. Andy will receive the payment of his total notice period as PILON over a 12 month notice period ending in December 2017. PILON payments are made up of base salary and benefits only. This payment is also subject to mitigating provisions.

Directors' Remuneration Report continued...

Neither Chris nor Andy will receive a bonus for the 2016 performance year.

In line with the remuneration policy and the bonus scheme rules, the Committee considered it appropriate to allow the deferred portions of their outstanding variable pay awards to subsist in full. These payments will be subject to continued performance adjustment requirements and payments will be made on the normal dates. Regulatory requirements relating to risk adjustments, malus and clawback will continue to apply to all deferred bonus awards in the same way as if Chris and Andy had remained in employment. The total amount of bonus deferred from previous performance years is £250,007 for Chris and £71,253 for Andy.

The Group paid £8,000 to Chris and £4,000 to Andy to obtain independent legal advice.

All payments made in respect to Chris and Andy's leaving arrangements are in line with the Executive Directors Remuneration Policy.

Payments to past directors

In 2016, payments were made to Ian Bullock in respect of bonus deferred from 2012, 2013, 2014 and 2015 performance years. This equated to £133,027.

Executive pay relative to the wider colleague population

The committee approves executive pay against the Remuneration Policy and in the wider context of colleague remuneration. Colleagues have the opportunity to share their views on subjects such as the remuneration policy via the annual colleague 'Best Workplaces' survey and regular 'Let's Talk' sessions with members of the management team.

Chairman and non-executive directors

In line with the annual review of Chairman and non-executive director fees, the fee levels were reviewed in June 2016 and came into effect on 1 July 2016. Non-executive directors' basic fees were generally increased by 2.6% in July 2016. This change took into account external market data, the skills and the time commitment required for the role as well as wider colleague salary increases. Fees for members of the Remuneration Committee and non-executive director pension trustee members' fees were increased by 11.3% (from £5,392 to £6,000). This change was recommended to reflect comparable market data and nearest peer comparators.

Non-executive director fees (annual equivalents)	Overall Fees 2015 £	Overall Fees 2016 £	Uplift %
Chairman's basic fees	180,000	184,680	2.6%
Vice-Chair basic fees	67,290	69,040	2.6%
Non-executive Director basic fees	47,232	48,460	2.6%
Additional fee for:			
Audit Committee – Chair	19,595	20,105	2.6%
Audit Committee – Member	8,103	8,314	2.6%
Remuneration Committee – Chair	16,000	16,417	2.6%
Remuneration Committee – Member	5,392	6,000	11.3%
Group Risk Committee – Chair	19,595	20,105	2.6%
Group Risk Committee – Member	8,103	8,314	2.6%

Single total figure of Remuneration for each non-executive director

The non-executive directors' basic and committee fees for 2016 are outlined below. Note that the Group's non-executive directors do not receive any benefits. Non-executive directors are reimbursed for any expenses incurred, such as travel and subsistence. Any tax due is the responsibility of individual non-executive directors.

Non-executive director	Basic Fees £000	Committee Fees £000	Total £000
John Heaps (Chairman)	182	–	182
Kate Barker*	48	19	67
Alison Hutchinson	48	14	62
Gordon Ireland	48	8	56
David Paige*	48	51	99
Mark Pain (Vice Chairman)	69	28	97
Guy Parsons	48	16	64
Total	490	137	627

* The Committee fees for David Paige and Kate Barker include their duties as Chairman and Trustee respectively of the Yorkshire Building Society Pension Scheme in 2016.

Remuneration Committee Terms of Reference

The Remuneration Committee has specific responsibility for ensuring we have the right policies in place for our most senior roles and setting the tone for the wider organisation. Its purpose is to oversee the remuneration policy in place for YBS Group, making sure it aligns to the Group's business strategy and any regulatory compliance requirements, with a specific focus on the risks posed by remuneration policies and practices. This includes approving the design of, and determining the performance targets for, any discretionary performance pay plans operated by the Group.

The Committee's Terms of Reference were reviewed and updated in March 2016. The full Terms of Reference are available on the Group's website, ybs.co.uk/your-society/inside-your-society/corporate-goverance/committees

The members of the Remuneration Committee are all independent non-executive directors and include a member of the Group's Risk Committee. During the year the Committee members were: Guy Parsons (Chair of the Remuneration Committee), Kate Barker and Alison Hutchinson.

The Committee met six times during the year and covered the following activities:

- A strategic review of the Group's Reward strategy.
- Agreeing the Group's bonus scheme 'Your Bonus' structure and targets.
- Ongoing work in relation to the Prudential Regulation Authority's (PRA) Remuneration Code and how it applies to YBS Group as a mutual.
- Agreeing the approach for executive base salary increases in 2016.
- Agreeing the remuneration package for the new Chief Executive Officer.

The Committee is supported by the Chief People Officer, the Head of Reward & Benefits and where appropriate the Chairman and Chief Executive Officer are invited to attend to provide further background and context to assist the Committee in discharging its duties.

The Remuneration Committee draws on the advice of independent external consultants to support in performing its duties. During the year, the Committee sought advice on executive director salaries, variable pay structures and regulatory matters from PwC. The Committee is satisfied that the advice received is objective and independent. PwC's fees for advice provided to the Committee in 2016 were £99,900 (including irrecoverable VAT).

Directors' Remuneration Report continued...

Statement of Member Voting

The Group remains committed to ongoing member dialogue and takes an active interest in voting outcomes. The following table sets out actual voting in respect of the resolution to approve the Directors' Remuneration Report and Remuneration Policy at the Society's Annual General Meeting (AGM) in 2016.

Resolution	Votes for	Votes against	% in favour	Votes withheld
To approve the Directors' Remuneration Report	152,796	13,503	91.88	3,431
To approve the Directors' Remuneration Policy	151,417	14,692	91.16	3,628

As noted in the committee Chairman's letter, there will be an advisory vote on the Annual Report on Remuneration at the 2017 AGM.

On behalf of the Board

Guy Parsons
Chair of the Remuneration Committee
27 February 2017

Aggregate remuneration data

In accordance with the Capital Requirements Regulation as part of CRD IV, which requires the disclosure of the aggregate remuneration data for senior managers and Material Risk Takers (MRTs), the Group's data is set out as follows:

	Senior Management[1] £000	Other MRTs £000	Total £000
Aggregate remuneration data			
Fixed Pay	9,528	723	10,251
2016 Variable Pay (undeferred)	1,225	59	1,284
2016 Variable Pay (deferred)	1,411	–	1,411
2016 Variable Pay due via SEI	232	–	232
Deferred variable pay to be paid 2017	919	–	919
Outstanding deferred variable pay from previous years	605	–	605
Total	13,920	782	14,702
Aggregate bonus buyout and severance payments			
Bonus Buyout Payments – 2016	513	–	513
Severance Payments – 2016	–	–	–
Total	513	–	513

	Senior Management	Other MRT	Total
Number of MRT colleagues	53	9	62

[1] Senior managers and colleagues whose actions have a material impact on the risk profile (including executive and non-executive directors). Non-executive directors' fees are included under fixed pay. No variable pay was awarded to non-executive directors.

Ratios between fixed and variable pay

YBS Group's fixed:variable pay ratio is not affected by the CRD IV cap on variable pay as the variable component of total remuneration to the fixed component does not exceed 1:1. The maximum variable pay award for any colleague is 50% of base salary and therefore variable pay will not exceed the CRD IV cap.

Independent Auditor's Report
to the members of Yorkshire Building Society

Opinion on financial statements of Yorkshire Building Society

In our opinion the financial statements:

- Give a true and fair view, in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2016 and of the Group's and the Society's income and expenditure for the year then ended; and
- Have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise the Group and Society Income Statements, the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Financial Position, the Group and Society Statements of Changes in Members' Interests, the Group and Society Statements of Cash Flows, and the related Notes 1 to 42.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Summary of our audit approach

Key risks	The key risks that we identified in the current year were: - Fair value adjustments - Loan loss provisioning - Hedge accounting and derivatives - Revenue recognition - Valuation of defined benefit pension assets
Materiality	The materiality that we used in the current year for the Group was £7.1m which was determined on the basis of income before tax adjusted for fair value volatility as per the consolidated income statement. In the current period the Group have seen an increase in the fair value volatility of derivative fair value and hedge accounting adjustments impacting the Income Statement.
Scoping	As in the prior year, our Group audit scope involved performing full audits on the Group's parent and main subsidiaries which accounted for more than 98% of the Group's net assets and 99% of the Group's profit before tax. These audits were performed directly by the Group audit team and executed at levels of materiality applicable to each individual entity which were lower than Group materiality and ranged from £3.6m to £4.6m.

Going concern and the directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group

We have reviewed the directors' statement regarding the appropriateness of the going concern basis of accounting contained within Note 1 to the financial statements and the directors' statement on the longer-term viability of the Group contained within the Strategic Report on page 45.

We are required to state whether we have anything material to add or draw attention to in relation to:

- The directors' confirmation on page 45 that they have carried out a robust assessment of the principal risks facing the Group including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures on pages 75 to 78 that describe those risks and explain how they are being managed or mitigated;
- the directors' statement in the Strategic Report about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and
- the directors' explanation on page 45 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We confirm that we have nothing material to add or draw attention to in respect of these matters.

We agreed with the directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Independence

We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards.

We confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

Independent Auditor's Report
to the members of Yorkshire Building Society continued...

Our assessment of risks of material misstatement

The assessed risk of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

These key risks are consistent with those identified in the prior year with the addition of that relating to the defined benefit pension assets, its inclusion this year is driven by the significance of the change in valuation and prevailing economic conditions and uncertainties.

Risk description	How the scope of our audit responded to the risk	Key observations
Loan loss provisions The Group holds £45.0m of impairment provisions at year-end (2015: £49.0m) against total loans and advances to customers of £33.5bn (2015: £32.9bn). Determining impairment provisions against loans to customers is a judgemental area requiring an estimate to be made of the losses incurred within the residential mortgage, buy to let and commercial lending portfolios. This requires the formulation of assumptions relating to potential impairment indicators, customer default rates, property values and movements, and likelihood of repossession, all of which may be sensitive to changes in the economic environment. There is a risk that arrears-driven loan loss provision models do not capture all values of impairment in the portfolios and where this is the case, Management may use overlay models to quantify the additional provision required. Management identified a population of over-indebted customers in the loan portfolio that has not been triggered as impaired and designed a separate model to quantify an appropriate provision. Loan loss provision balances are detailed within Notes 16 and 39. Management's associated accounting policies are detailed on page 113 with detail about judgments in applying accounting policies and critical accounting estimates on page 114.	We understood Management's loan loss provisioning process by undertaking a walk-through to identify the key controls, data flows and input sensitivities. We assessed the design and implementation and tested the operating effectiveness of controls on the lending cycle used to derive the data used for the loan loss provision model. We also assessed the design and implementation of the governance review of key judgments over inputs to the model. Our risk assessment identified the most significant judgments which included house price forecasts, probability of possession and the level of impairment relating to over-indebted customers. We also assessed the completeness of Management's consideration of potential impairment indicators as impairment trigger events for overlay provisions. We benchmarked significant judgements and model outputs including Management's use of overlays against internal and external data calculating an independent range of expected provision levels. Our range was determined by using reasonably plausible alternatives, in particular around the probability of possession rate and house price forecast, using alternative historical averages and forward-looking information taking into consideration the uncertainty in the current economic and political environment and the impact this could have on the housing market. We also tested the accuracy and completeness of the core provision calculation and overlay models through independently re-performing Management's provision calculation engaging our IT and data specialists. For commercial loans, we performed detailed file reviews of a sample of properties across the book, including identifying any impairment indicators using our own risk assessment tool and assessing whether these had been properly reflected within provision calculations by Management. We tested the valuation of the underlying property collateral using our property valuation specialists.	We found that the impairment model assumptions were determined and applied appropriately, the calculations are mechanically accurate, and the recognised provision was reasonably stated.

Risk description	How the scope of our audit responded to the risk	Key observations
Fair value adjustments The Group's assessment of the utilisation of the fair value adjustments that were established upon the merger of the Society with Norwich & Peterborough Building Society and Chelsea Building Society in prior years is an area that requires the use of significant judgement. The primary judgement relates to the level of lifetime losses that are expected from the acquired loan books, in particular the forecast for house price movements and losses arising from the interest only portfolio. The future expected losses are compared with those anticipated at the dates of the mergers with any reduction in the required provision being reflected in the effective interest rate and any additional provision required reflected as an incurred loss impairment where appropriate. Management's associated accounting policies are detailed on page 111 with detail about judgements in applying accounting policies and critical accounting estimates on page 114.	We understood Management's fair value adjustments process by undertaking a walk-through to identify the key controls, data flows and input sensitivities. We assessed the design and implementation of the governance review control in respect of key judgements over model inputs. We identified the most significant judgements made by Management in the calculation of the lifetime probability of default, the estimation of future property values, and the probability of interest-only customers having a repayment vehicle on maturity of their loan. We benchmarked the key assumptions against internal, external and industry data where available, and calculated an independent range of values. Our acceptable range for the fair value estimate was determined by using reasonably plausible alternative assumptions, in particular around the house price forecasts and the interpretation of responses to a customer contact programme relating to the availability of a repayment vehicle at the maturity of interest-only accounts. We tested the mechanical accuracy of the related models, engaging our IT and data specialists to independently recalculate the expected lifetime losses from data that was tested for accuracy and completeness.	We found that the fair value adjustments were materially correct.

Independent Auditor's Report
to the members of Yorkshire Building Society continued...

Risk description	How the scope of our audit responded to the risk	Key observations
Revenue recognition The recognition of revenue on loans using an effective interest rate method requires significant judgement by Management to determine key assumptions related to the expected life of each loan and the cash flows relating thereto. Such assumptions are also sensitive to changes in the economic environment. The loans and advances to customers of £34.1bn (2015: £33.3bn) presented in the Statement of Financial Position are adjusted for unamortised origination fees and expected early redemption charges which will be amortised over the expected life of the associated loan portfolios. Management's associated accounting policies are detailed on page 109 with detail about judgements in applying accounting policies and critical accounting estimates on page 114.	We understood Management's process for recognising revenue using the effective interest rate method by undertaking a walk-through to identify the key controls, data flows and input sensitivities. We identified the key area of judgement to be the run-off curves based upon the behavioural lives of similar products. We assessed the key controls for design and implementation including the challenge and approval of judgements made by Management through governance review. We re-performed Management's calculation to derive the behavioural life run- off curves for a sample of products and reviewed the Group's revenue recognition policy to assess whether it is in line with the accounting standard. We tested the mechanical accuracy of the effective interest rate model and reconciled the current balances and fee inputs to underlying data that we have tested, and that the behavioural life run-off curves used for each product had been allocated correctly.	We determined the accounting for revenue to be acceptable.

Risk description	How the scope of our audit responded to the risk	Key observations
Hedge accounting and treasury valuations The Group holds derivative financial instruments in order to mitigate the risks associated primarily with interest rate and basis risk, and eliminating where possible certain foreign currency exposures. The net fair value of all derivatives at year-end totals £192.5m asset (2015: £160.8m liability) as disclosed in the Statements of Financial Position on page 105. The hedge accounting requirements are complex and require significant skilled input and oversight by Management, as well as robust systems and controls particularly due to the number and type of hedge arrangements in the Group. The fair value of certain derivatives are calculated using complex models and judgemental (including unobservable) inputs. Management's associated accounting policies are detailed on pages 109 to 110 with detail about judgements in applying accounting policies and critical accounting estimates on page 114.	We performed a walk-through of the Group's treasury and hedge accounting processes to understand Management's process for trading in derivatives and the data flows that underpin and inform hedge accounting and valuation decisions. Once we had identified the key controls we performed an assessment of the design and implementation of such controls. We tested Management's application of hedge accounting which comprised testing hedge documentation for compliance with the requirements of the accounting standards, and independently re-performing a sample of hedge effectiveness tests conducted by Management during the year. We independently calculated the fair value of a sample of more complex derivatives, applying a range analysis to assess the use of unobservable inputs and hedged items. We also reviewed the completeness and appropriateness of the disclosures related to the use of unobservable inputs. We also used analytics tools to identify other derivatives and hedge relationships which were outliers in the population to focus our testing. We independently valued a sample of such instruments using our financial instruments valuation specialists and tools.	We agree that the implementation of hedge accounting requirements and specifically the designation of derivatives into hedge relationships and the assessment of the effectiveness of hedge relationships are appropriate and in line with supporting documentation. We are also satisfied that the valuation of complex derivatives is reasonable.

Independent Auditor's Report
to the members of Yorkshire Building Society continued...

Risk description	How the scope of our audit responded to the risk	Key observations
Valuation of Defined Benefit Pension Scheme Assets The Group holds a defined benefit pension surplus on the Statement of Financial Position of £42.0m (2015: £61.7m). The value of assets held within the defined benefit pension scheme total £991.3m (2015: £796.9m) as disclosed in note 26 on pages 139 to 143. In the current year the macroeconomic uncertainties caused by the UK's vote to leave the EU has significantly impacted the valuation of pension asset investments, even more than it has impacted the value of the defined benefit pension obligation. The Group's investment portfolio includes derivatives to mitigate macroeconomic risks, and it is the valuation of certain of these derivative instruments within this portfolio that we have focused our audit attention on. Management's associated accounting policies are detailed on page 112 with detail about judgements in applying accounting policies and critical accounting estimates on page 115.	We understood Management's process for recognising the defined benefit pension scheme surplus in the financial statements by undertaking a walk-through to identify the key controls, data flows and input sensitivities. We challenged the appropriateness of Management's reliance on third party custodian valuations of the investments and derivatives within the pension scheme and assessed the design and implementation of key controls. We obtained external confirmations from relevant counterparties, and compared these valuations to those reported by Management. We selected a sample of investments and derivatives included in the pension scheme assets and engaged financial instrument specialists to independently value them.	We conclude that the valuation of defined benefit pension assets is reasonable.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows;

Group materiality

£7.1m (2015: £8.9m).

Basis for determining materiality

5% of profit before tax adjusted for fair value volatility (2015: 5% of profit before tax). The value of fair volatility used for the adjustment is shown in the Income Statement on page 103.

Rationale for the benchmark applied

The accumulation of profits is critical to maintaining and building capital for regulatory purposes and allowing the Group to invest in activities for its members. This was a key factor in why we determined that profit before tax was the most appropriate benchmark for determining materiality, consistent with the prior year.

In the current period the Group have seen an increase in the fair value volatility of derivative fair value and hedge accounting adjustments impacting the Income Statement. In order that materiality was not artificially inflated we have removed such volatility from the Group's profit before tax to determine our materiality as this does not reflect the operational performance of the Group.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £150,000 (2015: £150,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assetssing the overall presentation of the financial statements.

An overview of the scope of our audit

As in the prior year, our Group audit scope involved performing full audits on the Group's parent and main subsidiaries which accounted for more than 98% of the Group's net assets and 99% of the Group's profit before tax. These audits were performed directly by the Group audit team and executed at levels of materiality applicable to each individual entity which were lower than Group materiality and ranged from £3.6m to 4.6m.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

- The Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986.
- The information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the accounting records and the financial statements.
- 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.

Opinion on other matters prescribed by the Capital Requirements (Country-by-Country Reporting) Regulations 2013

In our opinion the information given on page 59 for the financial year ended 31 December 2016 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

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 Society financial statements are not in agreement with the accounting records;
- or we have not received all information and explanations and access to documents we require for our audit.

We have nothing to report in respect of these matters.

Independent Auditor's Report
to the members of Yorkshire Building Society continued...

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

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.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Peter Birch FCA
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Leeds
27 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	3	**1,178.8**	1,260.1	**1,102.5**	1,213.5
Interest payable and similar charges	4	**(703.2)**	(725.5)	**(765.7)**	(806.0)
Net interest income		**475.6**	534.6	**336.8**	407.5
Fees and commissions receivable		**32.3**	33.3	**23.5**	25.4
Fees and commissions payable		**(23.4)**	(22.5)	**(16.2)**	(16.3)
Net fee and commission income		**8.9**	10.8	**7.3**	9.1
Income from investments	10	**12.2**	–	**62.2**	100.0
Net gains/(losses) from fair value volatility on financial instruments	5	**0.9**	(6.5)	**(12.7)**	(6.7)
Net realised profits		**1.8**	2.1	**1.8**	2.1
Other operating income	6	**15.2**	7.2	**63.8**	51.6
Total income		**514.6**	548.2	**459.2**	563.6
Administrative expenses	7	**(323.3)**	(323.2)	**(323.1)**	(323.0)
Depreciation and amortisation		**(22.7)**	(22.9)	**(22.7)**	(22.9)
Operating profit before provisions		**168.6**	202.1	**113.4**	217.7
Impairment (charge)/releases on loans and advances to customers	9	**(0.1)**	(12.8)	**1.4**	0.5
Provisions for liabilities and charges	28	**(17.0)**	(16.0)	**(17.0)**	(16.1)
Impairment (charge)/releases on investments in subsidiaries	10	**–**	–	**(0.3)**	1.4
Operating profit and profit before tax		**151.5**	173.3	**97.5**	203.5
Tax expense	11	**(37.3)**	(34.8)	**(19.0)**	(20.5)
Net profit		**114.2**	138.5	**78.5**	183.0

Net profit arises from continuing operations and is attributable to members.

The notes on pages 108 to 180 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
Net profit		**114.2**	138.5	**78.5**	183.0
Items that may subsequently be reclassified to profit and loss:					
Available for sale investments:					
Valuation gains taken to equity		**9.0**	12.3	**9.0**	12.3
Amounts transferred to Income Statement (included in net realised profits)		**(0.7)**	(10.6)	**(0.7)**	(10.6)
Tax on available for sale securities	11	**(2.3)**	(0.3)	**(2.3)**	(0.3)
Effect of change in corporation tax rate	11	**0.3**	–	**0.3**	–
Cash flow hedges:					
(Losses) / gains taken to equity		**(25.7)**	7.5	**(25.7)**	7.6
Amounts transferred to Income Statement (included in net realised profits)		**46.0**	7.1	**46.0**	7.1
Tax on cash flow hedge reserve	11	**(5.7)**	(3.0)	**(5.7)**	(3.0)
Effect of change in corporation tax rate	11	**0.3**	1.9	**0.3**	1.9
Subtotal		**21.2**	14.9	**21.2**	15.0
Items that will not be reclassified subsequently to profit and loss:					
Re-measurement of net retirement benefit obligations	26	**(27.0)**	(9.5)	**(27.0)**	(9.5)
Tax relating to retirement benefit obligations	11	**7.6**	1.9	**7.6**	1.9
Effect of change in corporation tax rate	11	**–**	(3.3)	**–**	(3.3)
Effect of change in corporation tax rate on prior year movements in general reserves	11	**–**	2.1	**–**	2.1
Subtotal		**(19.4)**	(8.8)	**(19.4)**	(8.8)
Total comprehensive income for the year		**116.0**	144.6	**80.3**	189.2

The notes on pages 108 to 180 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					
Liquid assets					
Cash in hand and balances with the Bank of England	13	**3,525.0**	3,439.3	**3,525.0**	3,439.3
Loans and advances to credit institutions	14	**542.8**	695.9	**257.2**	270.3
Debt securities	15	**608.1**	269.5	**5,226.0**	4,253.4
Loans and advances to customers	16	**34,103.3**	33,321.7	**17,604.1**	18,076.7
Derivative financial instruments	34	**540.5**	180.1	**303.4**	102.0
Investments	10	**10.3**	1.4	**17,964.5**	16,762.5
Intangible assets	17	**34.1**	37.3	**34.1**	37.3
Investment properties	18	**15.0**	16.6	**14.8**	16.4
Property, plant and equipment	19	**129.3**	137.9	**128.9**	137.5
Current tax assets		**–**	–	**9.6**	5.0
Deferred tax assets	20	**16.3**	28.5	**12.3**	27.1
Retirement benefit surplus	26	**42.0**	61.7	**42.0**	61.7
Other assets	21	**28.8**	28.7	**39.6**	42.1
Total assets		**39,595.5**	38,218.6	**45,161.5**	43,231.3
Liabilities					
Shares	22	**28,693.2**	27,396.4	**28,693.2**	27,396.4
Amounts owed to credit institutions	23	**3,120.8**	3,302.4	**3,111.4**	3,293.0
Other deposits	24	**434.7**	544.3	**6,898.8**	6,442.9
Debt securities in issue	25	**4,361.4**	4,108.8	**3,706.8**	3,447.5
Derivative financial instruments	34	**348.0**	340.9	**351.8**	320.9
Current tax liabilities		**12.8**	5.8	**–**	–
Deferred tax liabilities	20	**16.2**	18.9	**15.8**	17.2
Other liabilities	27	**54.7**	77.6	**53.0**	77.1
Provisions	28	**29.1**	25.8	**29.0**	25.8
Subordinated liabilities	29	**297.0**	286.1	**297.0**	286.1
Subscribed capital	30	**6.7**	6.7	**6.7**	6.7
Total liabilities		**37,374.6**	36,113.7	**43,163.5**	41,313.6
Total equity attributable to members		**2,220.9**	2,104.9	**1,998.0**	1,917.7
Total equity and liabilities		**39,595.5**	38,218.6	**45,161.5**	43,231.3

The accounts on pages 103 to 180 were approved by the Board of directors on 27 February 2017 and were signed on its behalf by:

John Heaps — Chairman
Mark Pain — Vice Chairman
Mike Regnier — Chief Executive

The notes on pages 108 to 180 form part of these accounts.

Statements of Changes in Members' Interest
for the year ended 31 December 2016

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Group				
At 1 January 2016	**2,123.0**	**(23.0)**	**4.9**	**2,104.9**
Reallocation of tax*	**3.0**	**–**	**(3.0)**	**–**
Current year movement net of tax	**94.9**	**14.9**	**6.2**	**116.0**
At 31 December 2016	**2,220.9**	**(8.1)**	**8.1**	**2,220.9**
At 1 January 2015	1,993.6	(36.8)	3.5	1,960.3
Current year movement net of tax	129.4	13.8	1.4	144.6
At 31 December 2015	2,123.0	(23.0)	4.9	2,104.9

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Society				
At 1 January 2016	**1,935.8**	**(23.0)**	**4.9**	**1,917.7**
Reallocation of tax*	**3.0**	**–**	**(3.0)**	**–**
Current year movement net of tax	**59.2**	**14.9**	**6.2**	**80.3**
At 31 December 2016	**1,998.0**	**(8.1)**	**8.1**	**1,998.0**
At 1 January 2015	1,761.8	(36.8)	3.5	1,728.5
Current year movement net of tax	174.0	13.8	1.4	189.2
At 31 December 2015	1,935.8	(23.0)	4.9	1,917.7

*Taxation relating to the Available for sale reserve has been reallocated to match the underlying transactions.

The hedging reserve relates to fair value adjustments on derivative financial instruments designated as cash flow hedges. It is expected that the forecast transactions will largely occur over the next five years and the amount deferred will be recognised over this period.

The notes on pages 108 to 180 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		**151.5**	173.3	**97.5**	203.5
Working capital adjustments	42	**7.0**	26.6	**6.8**	10.5
Net increase in operating assets	42	**(766.8)**	(1,220.2)	**(519.2)**	(2,099.6)
Net increase in operating liabilities	42	**1,005.6**	22.4	**1,571.1**	630.7
Taxation paid		**(20.7)**	(24.6)	**(9.8)**	(4.9)
Net cash flows from / (used in) operating activities		**376.6**	(1,022.5)	**1,146.4**	(1,259.8)
Cash flows from investing activities:					
Purchase of property, plant and equipment and intangible assets and investment properties		**(17.8)**	(27.4)	**(17.8)**	(27.4)
Proceeds from sale of property, plant and equipment		**20.4**	1.6	**20.4**	1.6
Purchase of debt securities		**(502.4)**	(202.1)	**(2,502.4)**	(1,452.1)
Proceeds from sale and redemption of debt securities		**173.9**	461.2	**1,539.8**	1,717.4
Net cash flows (used in) / from investing activities		**(325.9)**	233.3	**(960.0)**	239.5
Cash flows from financing activities:					
Redemption of securities		**(804.3)**	(624.4)	**(500.0)**	(433.1)
Issue of securities		**700.0**	1,306.0	**400.0**	1,257.0
Redemption of subordinated capital		**–**	(10.0)	**–**	(10.0)
Interest paid on subordinated liabilities and subscribed capital		**(16.0)**	(16.2)	**(16.0)**	(16.2)
Net cash flows (used in) / from financing activities		**(120.3)**	655.4	**(116.0)**	797.7
Net (decrease)/increase in cash and cash equivalents		**(69.6)**	(133.8)	**70.4**	(222.6)
Opening balance		**4,085.8**	4,219.6	**3,660.2**	3,882.8
Total closing cash and cash equivalents		**4,016.2**	4,085.8	**3,730.6**	3,660.2
Cash and cash equivalents:					
Cash and balances with central banks		**3,473.4**	3,389.9	**3,473.4**	3,389.9
Loans and advances to credit institutions	14	**542.8**	695.9	**257.2**	270.3
		4,016.2	4,085.8	**3,730.6**	3,660.2

The Statements of Cash Flows has been prepared in compliance with IAS 7 'Statements of Cash Flows' and has been presented under the indirect method.

For the purposes of the Statements of Cash Flows, cash and cash equivalents comprise cash and other financial instruments with original maturities of less than three months.

The notes on pages 108 to 180 form part of these accounts.

Notes to the Accounts

Introduction

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations (IFRICs) in issue, that have been endorsed by the European Union (EU) and are effective at 31 December 2016, and with those parts of the Building Societies Act 1986 and the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) applicable to societies reporting under IFRS.

The financial statements have been prepared on the historical cost basis, as modified by the revaluation of certain financial instruments measured at fair value at the end of each reporting period.

The financial statements have been prepared on the going concern basis as discussed in the Strategic Report on page 45, under the heading, 'viability and going concern'.

The preparation of financial statements under IFRS requires the use of certain critical accounting estimates and judgement. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are set out in Note 2.

Accounting developments

The following Accounting Standard amendments became effective for periods commencing on or after 1 January 2016 and have been adopted in the current year:

- Amendments to IAS 1 'Disclosure Initiative' which provide guidance on the application of the concept of materiality. The application of this amendment did not have a material impact on the financial statements.
- Amendments to IAS 16 and IAS 38 'Clarification of Acceptable Methods of Depreciation and Amortisation' which prohibit entities from using a revenue-based depreciation method for items of property, plant and equipment except in limited circumstances. The application of this amendment did not have a material impact on the financial statements.
- Annual improvements to IFRSs 2012-2014 Cycle included amendments to the following standards which are relevant to the Group: IFRS 7 'Financial Instruments: Disclosures', IAS 19 'Employee Benefits' and IAS 34 'Interim Financial Reporting'. The application of these amendments did not have a material impact on the financial statements.
- Amendments to IFRS 11 'Accounting for Acquisitions of Interests in Joint Operations' which provide clarification on how to account for the acquisition of an interest in a joint operation in which the activities constitute a business. The application of this amendment did not have a material impact on the financial statements.

The following Standards which have not been adopted in these financial statements were in issue but not yet effective for the 2016 year end. Except where otherwise stated, the adoption of the following new or amended standards are not expected to have material impact on the financial statements.

- IFRS 9 'Financial Instruments' published in July 2014 is effective for periods beginning on or after 1 January 2018, with early adoption permitted. This standard replaces the existing guidance in IAS 39 'Financial Instruments: Recognition and Measurement' and includes revised guidance on:
  - Classification and measurement

    Financial assets will be classified as amortised cost, fair value through other comprehensive income, or fair value through profit or loss, depending on the entity's business model and the contractual cash flow characteristics of the instruments. The application of the classification and measurement requirements is not expected to materially impact the financial statements.
  - Impairment of financial assets

    Impairment will be based on a more forward looking expected credit loss (ECL) approach for financial assets classified as amortised cost and fair value through other comprehensive income, rather than the incurred loss approach applied under IAS 39. This will result in a larger population of financial assets to which a lifetime credit loss is calculated as it will apply to all assets where there has been a significant increase in credit risk since initial recognition rather than just for those assets where there is objective evidence of impairment under IAS 39.
  - The Group has an on-going IFRS 9 implementation project which is focussed on developing impairment models in order to test and perform parallel running during 2017. The key drivers of these models will be probability of default, loss given default, exposure at default and the discount rate used to give a net present value. Until the impairment models are more fully developed and tested, the Group is not able to disclose a potential impact on the financial statements.

Introduction continued...

– Hedge Accounting

In general, hedge accounting will be simplified and applicable to a wider population of economic hedge relationships. The impact on the Group has yet to be fully assessed in order to determine whether to adopt the hedge accounting aspects of IFRS 9, or continue to apply IAS 39 hedge accounting guidance as a permitted accounting policy choice under IFRS 9.

The Group is in the process of assessing the impact of adopting IFRS 9 but the calculation of impairment of financial assets on an expected credit loss basis is expected to result in an overall increase in loan loss provisioning.

- IFRS 15 'Revenue from Contracts with Customers' is effective for periods beginning on or after 1 January 2018, with early adoption permitted. IFRS 15 introduces a framework for determining whether, how much and when revenue is recognised and it replaces the existing guidance in IAS 18 'Revenue'. The Group is assessing the potential impact of adopting IFRS 15; however it is not expected to have a material impact on the financial statements.
- IFRS 16 'Leases' is effective for periods beginning on or after 1 January 2019, with early adoption permitted. IFRS 16 eliminates the distinction between operating and finance leases, with virtually all leases recognised on balance sheet. The Group is assessing the potential impact of adopting IFRS 16 which is expected to result in an increase in lease assets and financial liabilities.

1. Significant Accounting Policies

Basis of consolidation

The Group financial statements consolidate the financial statements of the Society and its subsidiary undertakings. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Inter-company transactions and balances are eliminated upon consolidation.

Investments in subsidiary undertakings are stated in the Society accounts at cost less any provisions for impairment.

Interest income and expense

Interest income and expense on all financial instruments are recognised within interest receivable or payable on an effective interest rate basis.

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

Fees and commissions

Fees payable and receivable in relation to the provision of loans are accounted for on an effective interest rate basis. Other fees and commissions are recognised on an accruals basis when the relevant service is provided.

Derivative financial instruments and hedge accounting

Derivative financial instruments
The Group enters into a variety of derivative financial instruments to manage its exposure to interest rate, foreign exchange and equity risk. Further details of derivative financial instruments are disclosed in Note 34.

Derivative financial instruments are held at fair value with movements in fair value being recognised in the Income Statement. Fair values of derivatives are measured using valuation techniques including discounted cash flow models.

Embedded derivatives
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 and the host instrument is not measured at fair value. These embedded derivatives are measured at fair value with movements in value being recognised in the Income Statement. Where the Group is unable to value the embedded derivative separately, the entire instrument is measured at fair value with changes in value being taken to the Income Statement.

Hedging
All derivatives entered into by the Group are for the purposes of providing an economic hedge. Full details of hedging strategies are contained in Note 34. Hedge accounting is applied when the specific rules and conditions in IAS 39 are fulfilled. The Group has classified the majority of its derivatives as fair value and cash flow hedges in order to reduce volatility in the Income Statement.

Fair value hedges
Where the fair value hedging requirements are met, changes in the fair value of the hedged item arising

Notes to the Accounts continued...

1. Significant Accounting Policies continued...

from the hedged risk are taken to the Income Statement thereby offsetting the effect of the related movements in the fair value of the derivative. Where the hedge no longer meets the criteria, or is terminated for any other reason, the adjustment to the hedged item is released to the Income Statement, over its remaining life, using the effective interest rate method.

Cash flow hedges
Where a derivative financial instrument is designated as a hedge of the variability in the cash flows 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 and recycled to the Income Statement over the life of the forecast transaction. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. 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.

Impairment of financial assets
At each reporting date the Group assesses whether or not there is objective evidence that individual financial assets (or groups of financial assets with similar credit characteristics) are impaired. In determining whether an impairment loss should be recognised, the Group makes judgements as to whether there is any evidence indicating a measurable decrease in the future cash flows expected from a financial asset, or group of financial assets, resulting from an event (or events) that have occurred after initial recognition of the asset, but before the reporting date.

Loans and advances to customers

Individual assessments are made of all loans and advances on properties which are in possession or in arrears by three months (2015: two months) or more for residential loans and three months (2015: two months) or more and/or other qualitative factors for commercial loans. The change during 2016 from individually assessing loans and advances after being in arrears by two months to three months did not have a material impact on the impairment provision. All other loans and advances are grouped according to their credit characteristics and a collective review is undertaken of any evidence of impairment. In all cases, future cash flows are estimated on grouped credit characteristics. The collective impairment provision includes an allowance against the risk of customer indebtedness arising from circumstances in existence at the reporting date, as these customers may be able to maintain their repayments only whilst interest rates remain low.

Where there is objective evidence of impairment or that trigger events exist at the reporting date, then the impairment loss is calculated as the difference between the assets' carrying value and the present value of the estimated cash flows from those assets. In assessing these cash flows a number of factors are taken into account, including; the Group's historic default experience, historic and current loss emergence periods, the effect of changes in house prices, credit bureau data and adjustments to allow for ultimate forced sale discounts.

The Group grants concessions to assist borrowers who experience difficulties in meeting their obligations to pay their mortgage (referred to as forbearance) as described in Note 39. Forbearance is included in the loan loss provision similar to other debt, whereby debt which is more than three months in arrears is treated as individually impaired. Debt which is less than three months is included in the calculation of the collective impairment provision.

Any increases or decreases in projected impairment losses are recognised through the Income Statement. If a loan is ultimately uncollectable, then any loss incurred by the Group on extinguishing the debt is written off against the provision for loan impairment. Any subsequent recoveries of amounts previously written off are recognised through the Income Statement.

Debt instruments

At each reporting date the Group assesses whether or not there is objective evidence that individual debt instruments are impaired. In determining whether there is any objective evidence of impairment the Group takes into account a number of factors including:

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

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

1. Significant Accounting Policies continued...

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

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

Segmental reporting

The chief operating decision maker has been identified as the Board of directors, which reviews the Group's internal reporting and is responsible for all significant decisions.

Financial information provided in the segmental reporting note is consistent with that which is presented to the Board.

No segmental information is presented on geographical lines because substantially all of the Group's activities are in the United Kingdom.

Business combinations between mutual organisations

Identifiable assets and liabilities were measured at fair value on merger. Intangible assets are amortised through the Income Statement over their estimated useful lives, being between one and 10 years.

Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash and cash equivalents comprise cash and other financial instruments with less than three months original maturity.

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

Financial assets

The Group classifies its financial assets into the following categories:

Loans and receivables
Loans and receivables are predominantly mortgage loans to customers and money market advances held for liquidity purposes. They are initially recorded at fair value adjusted for any attributable costs or fees and are subsequently held at amortised cost less any impairment losses other than where an adjustment is made as part of a fair value hedging arrangement. Income is recognised on an effective interest rate basis.

Financial assets at fair value through profit and loss
These comprise assets that have been specifically designated as such at inception and certain structured investments containing embedded derivatives where the Group has been unable to separately calculate the fair value of the embedded derivative. Where the embedded derivative has not been separated from the host instrument the entire (hybrid) instrument has been recorded at fair value. Gains and losses arising from changes in fair value are recognised in the Income Statement. Interest income arising from financial assets measured at fair value through profit and loss is recognised on an effective interest rate basis.

Held to maturity
These comprise assets which the Group has both the intention and ability to hold to maturity. This category contains certain assets that have been specifically designated at inception and other assets that have been reclassified where we have the intention and ability to hold to maturity. They are initially recorded at fair value adjusted for any attributable costs or fees and are subsequently held at amortised cost less any impairment losses. Income is recognised on an effective interest rate basis.

Available for sale financial assets
Available for sale financial assets are securities held for liquidity and investment purposes. They comprise all non-derivative financial assets that are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit and loss. These are recorded at fair value with changes in value being taken to reserves. Interest is recognised on an effective interest rate basis. Where the asset is disposed of, the cumulative gain or loss previously recognised in reserves is reclassified to the Income Statement.

Financial liabilities

The Group initially records all of its financial liabilities at fair value less directly attributable transaction costs, and subsequently measures them at amortised cost, other than derivative financial instruments and where an adjustment is made as part of a fair value hedging arrangement. Interest expense is recognised on an effective interest rate basis.

Joint ventures

Joint ventures are those entities over whose activities the Group has joint control, established by contractual agreement and requiring unanimous consent for strategic, financial and operating decisions. The results and assets and liabilities of the joint ventures are included in these consolidated financial statements using the equity method

Notes to the Accounts continued...

1. Significant Accounting Policies continued...

of accounting. The investment in the joint venture is recognised in the Statement of Financial Position at cost and is adjusted to recognise the Group's share of profit or loss and other comprehensive income of the joint venture, less any impairment losses in respect of the Group's investment in the joint venture.

Investment properties, property, plant and equipment

Investment properties
Investment properties comprise freehold properties and parts of freehold properties that are not used in the business. These properties are generally flats and offices ancillary to branch premises and earn rental income. Investment properties are stated at cost less accumulated depreciation and any recognised impairment loss.

Property, plant and equipment
Buildings, major alterations to office premises, fixtures and fittings, equipment and other tangible fixed assets are stated at cost less accumulated depreciation and any recognised impairment loss. Costs incurred after the initial purchase of assets are expensed unless it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Repairs and maintenance are treated as an expense.

Depreciation
Depreciation is recognised so as to write off the cost (other than land) less the residual value by equal instalments over estimated useful economic lives as follows:

Freehold/long leasehold buildings (including investment properties) – 50 years

Short leasehold property – Life of lease

Equipment, fixtures, fittings and vehicles – 3 to 20 years

Land is stated at cost less accumulated impairment losses and is not depreciated.

Impairment
The carrying values of investment properties and property, plant and equipment are reviewed for impairment where there is an indication that events or circumstances may mean that the carrying amount is not recoverable. Where the recoverable amount of the asset is estimated to be less than the carrying amount, the carrying amount is written down immediately to the recoverable amount.

Any impairment in the value of assets is dealt with through the Income Statement as it arises.

Intangible assets

Computer software
Computer software includes construction in progress, purchased software and internally generated assets as shown in Note 17.

Costs incurred in the development of computer software for internal use are capitalised as intangible assets where the expenditure leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group. Purchased software is classified as an intangible asset where it is not an integral part of the related hardware. Computer software costs are amortised over their estimated useful lives, which are generally three to five years.

Computer software is tested for impairment at each reporting date or when there is an indication of impairment. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

The recoverable amount is the higher of fair value less costs of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value. If the recoverable amount of the asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Any impairment in the value of these assets is recognised in the Income Statement as it arises.

Other intangibles
Other intangibles, which largely represent core deposit intangibles acquired by the Group, are amortised using the straight line method over their estimated useful lives of between one and ten years.

Employee benefits – Pension obligations

Defined contribution plans
Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement as incurred.

Defined benefit plans
The asset or liability recognised in respect of the defined benefit pension scheme is the present value of the defined benefit obligation at the reporting date less the fair value of plan assets, together with adjustments for unrecognised past service costs. The asset is only recognised to the extent that it is recoverable by the Group, being the present value of available refunds and reductions in future contributions to the scheme.
The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. Projected benefit obligations are discounted to present value using the rate of return available on high quality corporate bonds of equivalent currency and term to the obligations. Actuarial gains or losses are recognised in full in the period in which they occur in the Statement of Comprehensive

1. Significant Accounting Policies continued...

Income. Past service costs are recognised immediately in the Income Statement to the extent that benefits are already vested and otherwise are amortised on a straight-line basis over the average period until the benefits become vested.

Scheme surplus
The Group has received a legal opinion that it can recover in full any surplus valuation of the scheme.

Tax

Tax comprises current tax and deferred tax. Tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case the tax is recognised in the Statement of Comprehensive Income.

Current tax is the expected tax payable on the taxable profits for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised for temporary differences arising between the carrying amount of certain assets and liabilities for accounting purposes and for taxation purposes. Deferred tax is provided using tax rates enacted or substantively enacted at the reporting date, depending on the date at which they are expected to reverse.

The following temporary differences are not provided for:

- The initial recognition of assets or liabilities that affect neither accounting nor taxable profit.
- Differences relating to investments in subsidiaries, to the extent that the parent is able to control the reversal of temporary differences, and it is probable they will not reverse in the foreseeable future.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available, against which temporary differences can be utilised. The carrying amount of the deferred tax assets is reviewed at the reporting date, and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. The asset is recorded in the Statement of Financial Position within 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. Depreciation is provided by the Group to write off the cost over the estimated useful economic life of the asset. Future instalments under such leases, net of finance charges, are included within payables. Rent payable on finance leases is apportioned between the finance element, charged to the Income Statement, and the reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. Operating lease rentals are expensed to the Income Statement on a straight-line basis over the period of the lease agreement.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

Foreign currency

Assets and liabilities denominated in foreign currencies are translated into Sterling at the appropriate rates of exchange prevailing at the reporting date and exchange differences are recognised in the Income Statement as they arise. All income and expense is translated into Sterling at the rate of exchange on the day of receipt or payment.

Derecognition of financial assets and liabilities

Financial assets are only derecognised when the contractual rights to receive cash flows from the financial assets have expired, or when the Group has transferred substantially all risks and rewards of ownership. The Group has not derecognised the loans securing its issue of covered bonds and securitisations because substantially all the risks and rewards are retained. Collateralised borrowing is recognised for the proceeds received. Financial liabilities are only derecognised when the obligation is discharged, cancelled, or has expired.

Notes to the Accounts continued...

2. Critical Accounting Estimates and Judgements in Applying Accounting Policies

The Group makes judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition estimates and assumptions are used which could affect the reported amounts of assets and liabilities in the next financial year. The most critical estimates and judgements are described below.

As explained on page 72, the Audit Committee has confirmed that the accounting estimates and judgements applied are considered to be appropriate.

Impairment of loans and advances to customers

The creation of impairment provisions for a portfolio of mortgage loans is inherently uncertain and requires the exercise of a significant degree of judgement. Provisions are calculated using historic default and loss experience but require judgement to be exercised in predicting future economic conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time before impairments are identified (emergence period). In relation to retail mortgages the most critical estimate is the future level of house prices where a fall of 5 percentage points (from -10% to -15% in 2017) equates to an increase in the provision by £5.4m. Retail mortgages account for 97% of our loan book and 93% of our impairment provision. As such, sensitivities around our commercial book and other loans would not have a significant impact on the provision.

Effective interest rate

IAS 39 requires that all of the cash flows directly associated with financial instruments held at amortised cost must be recognised in the Income Statement through the interest margin using the effective interest rate method. When this approach is applied to a mortgage portfolio, judgements must be made to estimate the average life of that portfolio. These judgements are applied to segments of the mortgage portfolio, taking into account factors including the terms of the particular products, historic repayment data and economic conditions. These estimates are updated in each reporting period to reflect the portfolio's actual performance. The most critical estimate is the estimated proportion of the number of customer balances that will remain with the Group for one year following the end of the initial product deal period. A 1% increase in this estimate would increase the value of the loans by less than £1m.

Fair values arising from business combinations

As described on page 111, identifiable assets and liabilities are initially measured at fair value. Such estimates are highly judgemental, particularly where a fair value is measured in respect of the critical judgements noted above for expected credit losses and the average life of the portfolio. The amount recognised reflects management's best estimate. On the basis that both the Chelsea and Norwich & Peterborough mergers are outside of the measurement period, the impact of identified changes in underlying assumptions is recognised immediately in the Income Statement. Management has been through an extensive evaluation to identify any significant changes in expected credit losses and the average life of the portfolio, with any material changes being reflected in the year end results.

One of the critical accounting estimates used in the calculation of the fair value provision for the impairment of retail mortgage assets is the future level of house prices. An immediate reduction in future house price growth of 5 percentage points (from -10% to -15% in 2017) would increase the losses expected to arise in 2017 by £2.7m.

Regulatory and other provisions

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Note 28 provides details of regulatory and other provisions which include amounts provided in relation to customer redress claims totalling £17.9m (including fair value adjustments made on the merger with Norwich & Peterborough and Chelsea building societies). The customer redress provision is in respect of a range of customer claims and is calculated using management's estimate of the complaint volumes, redress payments, referral levels to the Financial Ombudsman Service, complaint handling costs and other costs. None of these assumptions are expected to be individually material to the provision.

2. Critical Accounting Estimates and Judgements in Applying Accounting Policies continued...

Financial Services Compensation Scheme (FSCS) levy

The FSCS levy in respect of failed financial institutions is calculated using the Group's share of industry protected deposits, historic interest rates and projected forward interest rates. A 100bps increase in the future interest rate assumption would increase the provision by £3.9m.

More details of the FSCS and the Society's provision are contained in Note 28.

Pensions

The Group operates a defined benefit pension scheme. Significant judgements (on areas such as future interest and inflation rates, membership levels and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of its net surplus/deficit. These are outlined in Note 26. The impact of a 1.0% decrease in the rate used to discount the future value of the liabilities (from 2.6% to 1.6%) would be to decrease the surplus by £1.4m. The impact of a one year increase in each of the quoted life expectancies at age 60 would be to decrease the surplus by £33.2m.

3. Interest Receivable and Similar Income

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
On assets held at amortised cost				
Loans secured on residential property	**1,050.8**	1,146.4	**552.4**	627.0
Connected undertakings	**–**	–	**411.7**	455.4
Other loans	**18.6**	17.2	**18.6**	17.2
Other liquid assets/cash and short-term funds	**15.2**	17.0	**14.8**	16.3
On available for sale securities	**7.1**	3.3	**7.1**	3.3
On held to maturity securities	**–**	0.4	**38.5**	40.2
On financial instruments held at fair value through the Income Statement				
Derivatives	**87.0**	75.7	**59.3**	54.0
Other assets	**0.1**	0.1	**0.1**	0.1
Total interest receivable	**1,178.8**	1,260.1	**1,102.5**	1,213.5

Included within interest receivable and similar income is interest earned on individually impaired loans: Group £4.2m, Society £1.7m (2015 – Group £10.4m, Society £5.0m). The 2015 comparatives have been revised to reflect the updated definition of impaired balances to three months arrears (previously two months).

Notes to the Accounts continued...

4. Interest Payable and Similar Charges

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
On liabilities held at amortised cost				
Shares held by individuals	**384.7**	405.2	**384.7**	405.2
Deposits from banks	**21.7**	16.2	**21.7**	16.2
Deposits from connected undertakings	**–**	–	**38.5**	34.6
Other deposits	**0.7**	2.2	**0.7**	2.2
Debt securities in issue	**86.2**	89.2	**79.8**	78.8
Subordinated liabilities	**15.7**	15.9	**15.7**	15.9
Subscribed capital	**0.3**	0.3	**0.3**	0.3
Other interest payable	**0.5**	1.4	**0.5**	1.4
On financial instruments held at fair value through the Income Statement				
Deposits from connected undertakings	**–**	–	**30.8**	42.6
Derivatives	**193.4**	195.1	**193.0**	208.8
Total interest payable	**703.2**	725.5	**765.7**	806.0

5. Net Gains/(Losses) from Fair Value Volatility on Financial Instruments

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Assets held at fair value	**(0.2)**	0.5	**(0.2)**	0.5
Embedded derivatives	**0.8**	(1.1)	**0.8**	(1.1)
Derivatives and hedging	**0.3**	(5.9)	**(13.3)**	(6.1)
Net gains/(losses) from fair value volatility on financial instruments	**0.9**	(6.5)	**(12.7)**	(6.7)

Assets held at fair value relate to structured assets containing profit participation features that meet the definition of embedded derivatives. The Society is unable to separate the value of the embedded derivative from the host item and so has to treat the whole asset as held at fair value through the Income Statement in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'.

The embedded derivative category relates to synthetic features contained in certain structured investments which can be valued separately from the host instruments.

The derivative and hedging category relates to changes in fair value of derivatives that provide effective economic hedges but where the Group has not achieved hedge accounting.

6. Other Operating Income

Other operating income primarily comprises income from fixed assets, and the payment and recharge of administrative expenses from subsidiaries.

Within other operating income an amount of £12.1m relates to the sale of branches in the year, with the sales of our Kings Road, Croydon and Westminster branch properties making up the majority of the proceeds.

7. Administrative Expenses

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Staff costs				
Salaries and wages	**141.5**	134.2	**141.5**	134.2
Social security costs	**14.2**	12.8	**14.2**	12.8
Pension costs – defined benefit plans	**(0.9)**	3.9	**(0.9)**	3.9
Pension costs – defined contribution plans	**12.4**	7.6	**12.4**	7.6
Other staff costs	**0.7**	2.0	**0.7**	2.0
Operating lease rentals	**9.7**	10.3	**9.8**	10.5
Professional consultancy costs	**22.9**	23.5	**22.9**	23.5
Other expenses	**122.8**	128.9	**122.5**	128.5
	323.3	323.2	**323.1**	323.0

The Society operates a salary sacrifice scheme whereby the employee agrees to a reduction in salary in return for the Society making pension contributions that were previously paid by the employee. The amount shown above under Salaries and wages includes the headline salary (i.e. before the salary sacrifice deduction) and Pension costs excludes the additional contributions made by the Society as a result of the salary sacrifice scheme.

The Society's operating lease rentals include payments it makes to subsidiary companies which own properties and equipment.

The 2015 comparatives have been revised to reflect a re-allocation of £5.4m relating to the salary sacrifice scheme from other expenses into salaries and wages to allow for comparison to the current year.

Notes to the Accounts continued...

7. Administrative Expenses continued...

Remuneration of the auditor and their associates

	Group		Society	
	2016 £000	2015 £000	**2016 £000**	2015 £000
Audit Fees for the Group and Society statutory audit	**461**	324	**461**	324
Fees payable for other services:				
Audit of Group Subsidiaries	**65**	64	**–**	–
Audit-related assurance services	**147**	172	**147**	172
Total audit and audit related assurance services	**673**	560	**608**	496
Other non-audit services	**19**	65	**19**	65
	692	625	**627**	561

The above figures, relating to auditor's remuneration, exclude value added tax. Details of the Society's policy on non-audit work, which is implemented by the Audit Committee, is given in the Audit Committee Report on page 74.

Staff numbers
The average number of persons employed by the Group during the year (including executive directors) was as follows:

	2016		2015	
	Full time	**Part time**	Full time	Part time
Central administration	**2,530**	**539**	2,552	516
Branches	**971**	**502**	1,051	457
	3,501	**1,041**	3,603	973

8. Remuneration of and Transactions with Directors

Full details of directors' remuneration, bonuses and pensions are given in the Directors' Remuneration Report on pages 79 to 93. In addition, past directors' pensions in respect of services as directors (closed scheme) amounted to £19,000 (2015 – £18,000).

None of the directors had any interest in the shares or debentures of any connected undertaking of the Society at any time during the financial year. Details of transactions with directors and loans held by directors and connected persons are disclosed in Note 41.

A register is maintained at the head office of the Society containing details of loans, transactions and arrangements between the Society and its directors and connected persons. A statement containing the details for 2016 will be available for inspection at the head office for a period of 15 days up to and including the Annual General Meeting.

9. Impairment

Loans and advances to customers

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
At 1 January				
Collective	**33.3**	23.3	**5.7**	6.1
Individual	**15.7**	23.0	**0.8**	0.9
	49.0	46.3	**6.5**	7.0
Amounts written off during the year				
Collective	**–**	–	**–**	–
Individual	**(6.3)**	(12.4)	**(0.2)**	(0.2)
	(6.3)	(12.4)	**(0.2)**	(0.2)
Impairment adjustment for the year				
Collective	**1.0**	10.0	**–**	(0.4)
Individual	**1.3**	5.1	**(0.1)**	0.1
	2.3	15.1	**(0.1)**	(0.3)
At 31 December				
Collective	**34.3**	33.3	**5.7**	5.7
Individual	**10.7**	15.7	**0.5**	0.8
	45.0	49.0	**6.2**	6.5
The charge/(release) for the year comprises:				
Impairment adjustment for loans and advances	**2.3**	15.1	**(0.1)**	(0.3)
Recoveries relating to amounts previously written off	**(2.2)**	(2.3)	**(1.3)**	(0.2)
Net provision charge/(release) for the year	**0.1**	12.8	**(1.4)**	(0.5)

The interest arising from the unwind of the discount of expected future recoveries is not material.

None (2015 – none) of the £45.0m (2015 – £49.0m) provision balance shown above, and none (2015 – £1.6m release) within the £0.1m (2015 – £12.8m) net provision charge/(release), relates to the commercial lending portfolio.

Notes to the Accounts continued...

10. Investments

Income from investments

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Income from subsidiary undertakings	**–**	–	**50.0**	100.0
Other	**12.2**	–	**12.2**	–
	12.2	–	**62.2**	100.0

During 2016, Accord made a dividend payment of £50.0m to the Society (2015 – £100.0m).

Other income relates to consideration, in cash and Visa Inc. preferred stock, from the sale of Visa Europe – see below.

Investments

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Equities	**10.3**	1.4	**10.3**	1.4
Joint ventures	**–**	–	**0.3**	0.3
Subsidiaries	**–**	–	**17,953.9**	16,760.8
	10.3	1.4	**17,964.5**	16,762.5

Investment in equities
The Group holds equity investments relating to participation in banking and credit card service operations which are classified as available for sale assets.

This includes shares received as part of the consideration from the sale of Visa Europe to Visa Inc. where the Group had a small percentage holding as a result of being a member of Visa Europe through our trading activities. For more information see page 32 of the Strategic report.

Investment in joint venture
The Society does not have material investments in joint ventures. The Society has a 50% interest in a joint venture, MutualPlus Ltd, a branch sharing company incorporated the United Kingdom and registered in England and Wales. The carrying amount of the investment at 31 December 2016 and 31 December 2015 was £0.3m, however the joint venture was placed into Members' Voluntary Liquidation on 15 December 2016.

Investment in subsidiaries
Society

	Shares £m	Loans £m	Total £m
Cost			
At 1 January 2016	**106.3**	**16,655.0**	**16,761.3**
Additions	**–**	**2,001.6**	**2,001.6**
Repayments	**(0.8)**	**(807.4)**	**(808.2)**
At 31 December 2016	**105.5**	**17,849.2**	**17,954.7**
Impairment losses			
At 1 January 2016	**(0.5)**	**–**	**(0.5)**
Written off	**–**	**(0.3)**	**(0.3)**
Released in the year	**–**	**–**	**–**
At 31 December 2016	**(0.5)**	**(0.3)**	**(0.8)**
Net book value			
At 31 December 2016	**105.0**	**17,489.9**	**17,953.9**
Cost			
At 1 January 2015	106.3	14,300.7	14,407.0
Additions	–	3,039.3	3,039.3
Repayments	–	(685.0)	(685.0)
At 31 December 2015	106.3	16,655.0	16,761.3
Impairment losses			
At 1 January 2015	(0.5)	(1.4)	(1.9)
Written off	–	–	–
Released in the year	–	1.4	1.4
At 31 December 2015	(0.5)	–	(0.5)
Net book value			
At 31 December 2015	105.8	16,655.0	16,760.8

All loans are charged interest which is included within the net interest margin.

Notes to the Accounts continued...

10. Investments continued...

The Society has the following principal subsidiary undertakings, all of which are audited and consolidated.

Subsidiary	Principal activity
Accord Mortgages Ltd	Mortgage lending
BCS Loans and Mortgages Ltd	Non-trading
YBS Properties (Edinburgh) Ltd	Property holding
YBS Properties Ltd	Non- trading
Yorkshire Building Society Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Yorkshire Key Services Ltd	Non-trading
Brass No. 2 PLC	Funding vehicle
Brass No. 2 Mortgage Holdings Limited	Holding company
Brass No. 3 PLC	Funding vehicle
Brass No. 3 Mortgage Holdings Limited	Holding company
Brass No. 4 PLC	Funding vehicle
Brass No. 4 Mortgage Holdings Limited	Holding company
Brass No. 5 PLC	Funding vehicle
Brass No. 5 Mortgage Holdings Limited	Holding company
Norwich and Peterborough Estate Agents Ltd	Non-trading
Norwich and Peterborough Insurance Brokers Ltd	Non-trading
Norwich and Peterborough (LBS) Ltd	Mortgage finance
Tombac No. 1 PLC	Funding vehicle
Tombac No. 1 Mortgage Holdings Limited	Holding company
Tombac No. 2 PLC	Funding vehicle
Tombac No. 2 Mortgage Holdings Limited	Holding company

For certain subsidiaries, the Group has taken advantage of the audit exemptions available for small and dormant subsidiaries under Sections 479 and 480 of the Companies Act 2006. The Group has adopted such audit exemptions for the following subsidiary undertakings which are largely non-trading for the year ended 31 December 2016:

Chelsea Mortgage Services Ltd
Norwich and Peterborough (LP) Ltd
Norwich and Peterborough Covered Bonds LLP
Norwich and Peterborough Financial Services Ltd*
Norwich and Peterborough General Insurance Services Ltd*
Norwich and Peterborough Insurance Services Ltd*
Norwich and Peterborough Ltd*
Norwich and Peterborough Sharedealing Services Ltd
YBS Covered Bonds Finance (Holdings) Limited
YBS Covered Bonds Finance Limited
YBS Group Ltd
YBS Investments (No. 1) Ltd
YBS Investments (No. 2) Ltd
Brass No. 1 PLC
YBS Properties (York) Ltd
YBS Ltd
Yorkshire Direct Ltd
Yorkshire Estate Agents Ltd
Yorkshire Group Ltd
Yorkshire Guernsey Ltd
Yorkshire Insurance Services Ltd
Yorkshire Key Services (No. 2) Ltd
Yorkshire Life Assurance Services Ltd
Yorkshire Mortgage Services Ltd
Yorkshire Personal Financial Services Ltd
Yorkshire Property Services Ltd
Yorkshire Services Ltd
Brass Mortgage Holdings Limited

*Companies dissolved as of 24 January 2017.

All the companies are registered in England and operate in the United Kingdom, except Yorkshire Guernsey Ltd which is registered in Guernsey and is non-trading.

All the entities are wholly owned except for Yorkshire Building Society Covered Bonds LLP, YBS Covered Bonds Finance (Holdings) Limited, YBS Covered Bonds Finance Limited, Brass No. 1 PLC, Brass Mortgage Holdings Limited, Brass No. 2 PLC, Brass No. 2 Mortgage Holdings Limited, Brass No. 3 PLC, Brass No. 3 Mortgage Holdings Limited, Brass No. 4 PLC, Brass No. 4 Mortgage Holdings Limited, Brass No. 5 PLC, Brass No. 5 Mortgage Holdings Limited, Tombac No. 1 PLC, Tombac No. 1 Mortgage Holdings Limited, Tombac No. 2 PLC and Tombac No. 2 Mortgage Holdings Limited. The Society's interests in these entities are, in substance, no different than if they were 100% held subsidiary undertakings and consequently they are consolidated in the Group accounts.

11. Tax Expense

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Current tax:				
UK corporation tax at 20.00% (2015 – 20.25%)	**39.4**	34.0	**17.0**	23.2
Corporation tax – adjustment in respect of prior periods	**(0.8)**	(1.4)	**(0.6)**	(1.4)
Total current tax	**38.6**	32.6	**16.4**	21.8
Deferred tax (Note 20):				
Current year	**(2.3)**	1.5	**1.7**	(2.0)
Adjustment in respect of prior periods	**1.0**	0.7	**0.9**	0.7
Total tax expense in Income Statement	**37.3**	34.8	**19.0**	20.5

The actual tax expense for the year differs from that calculated using the standard rate of corporation tax in the UK. The differences are explained below:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Profit before tax	**151.5**	173.3	**97.5**	203.5
Tax calculated at a tax rate of 20.00% (2015 – 20.25%)	**30.3**	35.1	**19.5**	41.2
Effects of:				
Income not subject to tax	**(1.7)**	–	**(9.0)**	(20.5)
Expenses not deductible for tax purposes	**3.7**	1.4	**4.1**	1.4
Banking surcharge	**3.9**	–	**3.9**	–
Adjustment to tax charge in respect of previous periods	**0.2**	(0.7)	**0.3**	(0.7)
Change in tax rate	**0.9**	(1.0)	**0.2**	(0.9)
Total tax expense in Income Statement	**37.3**	34.8	**19.0**	20.5
Tax (credit)/expense recognised directly in equity:				
Tax on available for sale securities	**2.3**	0.3	**2.3**	0.3
Effect of change in tax rate	**(0.3)**	–	**(0.3)**	–
Tax on re-measurement of net retirement benefit obligations	**(7.6)**	(1.9)	**(7.6)**	(1.9)
Effect of change in tax rate	**–**	3.3	**–**	3.3
Deferred tax on cash flow hedges	**5.7**	3.0	**5.7**	3.0
Effect of change in tax rate	**(0.3)**	(1.9)	**(0.3)**	(1.9)
Effect of change in tax rate on prior year movements in general reserves	**–**	(2.1)	**–**	(2.1)
	(0.2)	0.7	**(0.2)**	0.7

The main rate of UK corporation tax will reduce to 19% from 1 April 2017, and to 17% from 1 April 2020.

These rate changes are reflected in the financial statements resulting in a charge of £0.9m to the Income Statement and a credit of £0.6m to Other Comprehensive Income in the period, giving an overall charge of £0.3m in respect of the Group's net deferred tax asset.

A charge of £3.9m is included in the Income Statement tax expense in respect of a surcharge of 8% on the profits of banking companies (including building societies) which was introduced from 1 January 2016.

Included within expenses not deductible for tax is £3.0m tax charge in respect of disallowable customer redress costs.

Included within income not subject to tax is £1.2m credit in relation to the profit on sale of land and buildings.

Notes to the Accounts continued...

12. Segmental Reporting

This section analyses the Group's performance by business segment.

The chief operating decision maker has been identified as the Board, which reviews the Group's internal reporting and is responsible for all significant decisions. The Group's reportable segments under IFRS 8 'Operating Segments', based on the information reviewed by the Board, have been determined according to similar economic characteristics and the nature of the products and service. Details of the reportable segments are listed below:

Segment	Description	Basis of aggregation
Retail	Prime residential owner occupied lending, prime intermediary lending and non-owner occupied lending. Traditional member savings, non-traditional savings and the sale of general insurance, protection and investment products provided by third parties.	These are the core activities and focus of the Group.
Non-retail	Prime commercial lending portfolio (including social housing).	These ongoing parts of the business support the Group's financial stability and primary businesses but are not considered core and have a non-retail customer base.
Secondary	Non-prime residential owner occupied lending, consumer banking, personal lending, non-prime commercial lending and non-owner occupied lending acquired through mergers.	These elements, originated and acquired through merger, are closed to new business and are historic areas in which the Group no longer operates.
Central	Supporting business units, the treasury function and other head office group functions which have not been apportioned across the aforementioned segments.	These operations are not directly customer related.

No segmental information is presented on geographical lines, because substantially all of the Group's activities are in the United Kingdom.

The majority of the Group's revenues are in the form of interest and the Board monitors the Group's net interest income, to assess performance and direct the Group. Therefore interest receivable and similar income has been shown net of interest payable and similar expense.

Recharging of funding across the Group has been included using the Group's internal funds transfer pricing methodology, which includes the cost of raising external funds.

Income and directly attributable costs have been allocated to each segment as applicable, with support costs being apportioned based on levels of employees.

12. Segmental Reporting continued...

The accounting policies for the reported segments are consistent with the Group's accounting policies outlined in Note 1.

2016	Notes	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
Net interest income		**301.1**	**18.9**	**28.8**	**126.8**	**475.6**
Non-interest income (net)	**a**	**22.4**	**–**	**–**	**13.9**	**36.3**
Net realised profits and fair value		**–**	**–**	**–**	**2.7**	**2.7**
Management expenses	**b**	**(208.9)**	**(2.5)**	**(2.0)**	**(132.6)**	**(346.0)**
Operating profit before provisions		**114.6**	**16.4**	**26.8**	**10.8**	**168.6**
Impairment and other provisions		**(7.1)**	**–**	**1.2**	**(11.2)**	**(17.1)**
Profit/(loss) before tax		**107.5**	**16.4**	**28.0**	**(0.4)**	**151.5**
Total assets		**32,139.0**	**1,025.3**	**824.2**	**5,607.0**	**39,595.5**
Total liabilities		**29,354.5**	**–**	**–**	**8,020.1**	**37,374.6**
Equity		**–**	**–**	**–**	**2,220.9**	**2,220.9**

2015	Notes	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
Net interest income		319.5	20.5	33.2	161.4	534.6
Non-interest income (net)	a	23.7	2.4	–	(8.1)	18.0
Net realised profits and fair value		–	–	–	(4.4)	(4.4)
Management expenses	b	(206.5)	(2.6)	(1.9)	(135.1)	(346.1)
Operating profit before provisions		136.7	20.3	31.3	13.8	202.1
Impairment and other provisions		(22.3)	1.6	(3.6)	(4.5)	(28.8)
Profit before tax		114.4	21.9	27.7	9.3	173.3
Total assets		31,445.0	857.0	940.0	4,976.6	38,218.6
Total liabilities		28,142.8	–	–	7,970.9	36,113.7
Equity		–	–	–	2,104.9	2,104.9

Notes

a Non-interest income (net) includes fees and commissions receivable, fees and commissions payable, other operating income and income from investments.

b Management expenses include administrative expenses, depreciation and amortisation.

Notes to the Accounts continued...

12. Segmental Reporting continued...

Total income for the reportable segments can be analysed as follows:

2016	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
External income	**620.5**	**35.1**	**43.6**	**(187.3)**	**511.9**
Income from other segments	**(297.0)**	**(16.2)**	**(14.8)**	**328.0**	**–**
Total income	**323.5**	**18.9**	**28.8**	**140.7**	**511.9**

2015	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
External income	684.6	35.4	53.4	(220.8)	552.6
Income from other segments	(341.4)	(12.5)	(20.2)	374.1	–
Total income	343.2	22.9	33.2	153.3	552.6

13. Cash in Hand and Balances with the Bank of England

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Cash in hand	**11.8**	16.6	**11.8**	16.6
Cash ratio deposit with the Bank of England	**51.6**	49.4	**51.6**	49.4
Other deposits with the Bank of England	**3,461.6**	3,373.3	**3,461.6**	3,373.3
	3,525.0	3,439.3	**3,525.0**	3,439.3

Cash ratio deposits are mandatory requirements of the Bank of England. They are considered to be encumbered assets as they are not available for use in the Group's day to day operations. These balances are non-interest-bearing, whereas other deposits are at variable money market rates.

14. Loans and Advances to Credit Institutions

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Loans and advances to credit institutions	**542.8**	695.9	**257.2**	270.3

Included within loans and advances to credit institutions are balances held in collateral accounts relating to swap agreements, and bank account balances held in the Group's Covered Bond and Securitisation programmes. Such items are considered to be encumbered assets as they are not available for use in the Group's day to day operations.

Loans and advances to credit institutions are all due within one year.

15. Debt Securities

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Debt securities issued by:				
Public bodies	**560.5**	229.2	**560.5**	229.2
Other borrowers	**47.6**	40.3	**47.6**	40.3
Group companies	**–**	–	**4,617.9**	3,983.9
	608.1	269.5	**5,226.0**	4,253.4

All debt securities are listed in a recognised investment exchange. Debt securities of £0.6bn (2015 – £0.3bn) are due in over one year.

Debt securities issued by Group companies comprise retained investments in the Group's Brass and Tombac securitisation vehicles.

Group	Held at fair value £m	Embedded derivatives £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1 January 2016	**9.1**	**(9.8)**	**270.2**	**–**	**269.5**
Additions	**–**	**–**	**502.4**	**–**	**502.4**
Disposals and repayments	**(3.1)**	**–**	**(185.7)**	**–**	**(188.8)**
Exchange translation	**1.4**	**–**	**7.6**	**–**	**9.0**
Other changes in value	**0.2**	**0.9**	**14.9**	**–**	**16.0**
At 31 December 2016	**7.6**	**(8.9)**	**609.4**	**–**	**608.1**
Movements in debt securities during the year were:					
At 1 January 2015	9.2	(8.9)	524.5	–	524.8
Additions	–	–	202.1	–	202.1
Disposals and repayments	–	0.8	(463.4)	–	(462.6)
Exchange translation	(0.5)	–	1.4	–	0.9
Other changes in value	0.4	(1.7)	5.6	–	4.3
At 31 December 2015	9.1	(9.8)	270.2	–	269.5

Notes to the Accounts continued...

15. Debt Securities continued...

Society	Held at fair value £m	Embedded derivatives £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1 January 2016	**9.1**	**(9.8)**	**270.2**	**3,983.9**	**4,253.4**
Additions	**–**	**–**	**502.4**	**2,000.0**	**2,502.4**
Disposals and repayments	**(3.1)**	**–**	**(185.7)**	**(1,369.0)**	**(1,557.8)**
Exchange translation	**1.4**	**–**	**7.6**	**–**	**9.0**
Other changes in value	**0.2**	**0.9**	**14.9**	**3.0**	**19.0**
At 31 December 2016	**7.6**	**(8.9)**	**609.4**	**4,617.9**	**5,226.0**
Movements in debt securities during the year were:					
At 1 January 2015	9.2	(8.9)	524.5	3,990.0	4,514.8
Additions	–	–	202.1	1,250.0	1,452.1
Disposals and repayments	–	0.8	(463.4)	(1,255.7)	(1,718.3)
Exchange translation	(0.5)	–	1.4	–	0.9
Other changes in value	0.4	(1.7)	5.6	(0.4)	3.9
At 31 December 2015	9.1	(9.8)	270.2	3,983.9	4,253.4

Debt securities have a £6.0m impairment provision held against them which relates entirely to individually assessed collateralised debt obligations. There has been no movement in this provision since 31 December 2015 when it also totalled £6.0m.

The disposals and repayments for the held to maturity category relate entirely to repayments.

A number of debt securities are structured so that they can pay a return over and above their regular coupon. This feature is regarded as an embedded derivative. The Group is unable to value this element separately from the host instrument so, in accordance with IAS 39, has designated these securities as being held at fair value with movements in value being taken to the Income Statement.

The Group also holds synthetic collateralised debt obligations which contain embedded derivatives. These embedded derivatives are separated from the host instrument and are held at fair value with movements in fair value taken to the Income Statement.

16. Loans and Advances to Customers

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Loans and advances to customers comprise:				
Loans secured on residential property				
Loans fully secured on residential property	**33,537.3**	32,806.2	**17,011.1**	17,557.9
Other loans secured on residential property	**19.1**	50.5	**7.3**	11.4
Unsecured loans	**(1.2)**	0.9	**(1.2)**	0.9
Loans secured on commercial property	**478.4**	433.4	**478.4**	433.4
Fair value hedging adjustments	**114.7**	79.6	**114.7**	79.6
Impairment provisions	**(45.0)**	(48.9)	**(6.2)**	(6.5)
	34,103.3	33,321.7	**17,604.1**	18,076.7

Loans and advances to customers are held at amortised cost, with interest and associated costs being recognised in the interest receivable and similar income line of the Income Statement on an effective interest rate basis. Amounts totalling £32.7bn (2015 – £33.0bn) are due in over one year.

A number of fair value adjustments arose at the time of merging with Norwich & Peterborough Building Society and Chelsea Building Society; such adjustments are included within the relevant loans and advances to customer balances above. Some adjustments relate to provisions for lifetime losses which can be larger than current exposures.

Fair value hedging adjustments of £114.7m (2015 – £79.6m) have been made to certain fixed rate mortgages that are in fair value hedging relationships.

Note 35 details the extent to which these assets are encumbered.

Notes to the Accounts continued...

17. Intangible Assets

	Construction in progress £m	Purchased software £m	Internally generated assets £m	Other £m	Total £m
Group					
Cost					
At 1 January 2016	**6.3**	**30.3**	**20.9**	**18.5**	**76.0**
Additions	**3.6**	**2.6**	**–**	**–**	**6.2**
Disposals	**(0.5)**	**(1.7)**	**(0.4)**	**–**	**(2.6)**
Transfers	**(3.2)**	**0.3**	**2.9**	**–**	**–**
At 31 December 2016	**6.2**	**31.5**	**23.4**	**18.5**	**79.6**
Amortisation					
At 1 January 2016	**1.1**	**18.7**	**8.4**	**10.5**	**38.7**
Charged in year	**–**	**4.3**	**3.1**	**1.5**	**8.9**
Disposals	**–**	**(1.7)**	**(0.4)**	**–**	**(2.1)**
Transfers	**–**	**–**	**–**	**–**	**–**
At 31 December 2016	**1.1**	**21.3**	**11.1**	**12.0**	**45.5**
Net book value					
At 31 December 2016	**5.1**	**10.2**	**12.3**	**6.5**	**34.1**
Cost					
At 1 January 2015	14.0	26.8	12.8	18.5	72.1
Additions	4.9	2.3	2.0	–	9.2
Disposals	–	(1.4)	(3.6)	–	(5.0)
Transfers	(12.6)	2.6	9.7	–	(0.3)
At 31 December 2015	6.3	30.3	20.9	18.5	76.0
Amortisation					
At 1 January 2015	–	16.4	10.5	9.0	35.9
Charged in year	–	3.5	1.5	1.5	6.5
Impairment	1.1	0.1	–	–	1.2
Disposals	–	(1.3)	(3.6)	–	(4.9)
Transfers	–	–	–	–	–
At 31 December 2015	1.1	18.7	8.4	10.5	38.7
Net book value					
At 31 December 2015	5.2	11.6	12.5	8.0	37.3

17. Intangible Assets continued...

	Construction in progress £m	Purchased software £m	Internally generated assets £m	Other £m	Total £m
Society					
Cost					
At 1 January 2016	**6.3**	**29.3**	**20.9**	**18.5**	**75.0**
Additions	**3.6**	**2.6**	**–**	**–**	**6.2**
Disposals	**(0.5)**	**(1.7)**	**(0.4)**	**–**	**(2.6)**
Transfers	**(3.2)**	**0.3**	**2.9**	**–**	**–**
At 31 December 2016	**6.2**	**30.5**	**23.4**	**18.5**	**78.6**
Amortisation					
At 1 January 2016	**1.1**	**17.7**	**8.4**	**10.5**	**37.7**
Charged in year	**–**	**4.3**	**3.1**	**1.5**	**8.9**
Disposals	**–**	**(1.7)**	**(0.4)**	**–**	**(2.1)**
Transfers	**–**	**–**	**–**	**–**	**–**
At 31 December 2016	**1.1**	**20.3**	**11.1**	**12.0**	**44.5**
Net book value					
At 31 December 2016	**5.1**	**10.2**	**12.3**	**6.5**	**34.1**
Cost					
At 1 January 2015	14.0	25.8	12.8	18.5	71.1
Additions	4.9	2.3	2.0	–	9.2
Disposals	–	(1.4)	(3.6)	–	(5.0)
Transfers	(12.6)	2.6	9.7	–	(0.3)
At 31 December 2015	6.3	29.3	20.9	18.5	75.0
Amortisation					
At 1 January 2015	–	15.4	10.5	9.0	34.9
Charged in year	–	3.5	1.5	1.5	6.5
Impairment	1.1	0.1	–	–	1.2
Disposals	–	(1.3)	(3.6)	–	(4.9)
Transfers	–	–	–	–	–
At 31 December 2015	1.1	17.7	8.4	10.5	37.7
Net book value					
At 31 December 2015	5.2	11.6	12.5	8.0	37.3

Notes to the Accounts continued...

17. Intangible Assets continued...

Other intangible assets primarily comprise the intrinsic value of items acquired on mergers (current accounts, retail savings and brands) and an amount paid for the transfer of a number of employee sharesave schemes to the Society.

Amortisation is provided to write off the cost less the estimated residual value of intangible assets over their estimated useful economic lives of between one and ten years.

Transfers relate to the reclassification of assets from construction in progress to purchased software and internally generated assets. Any impairment in the value of intangible assets is dealt with through the Income Statement as it arises. During the period, £nil (2015 – £0.1m) of purchased software and £nil (2015 – £1.1m) of construction in progress was written off as the recoverable amount based on the value in use was deemed to be nil.

18. Investment Properties

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Cost				
At 1 January	**21.9**	21.5	**21.7**	21.3
Additions	**0.2**	0.5	**0.2**	0.5
Disposals	**(3.2)**	–	**(3.2)**	–
Transfers	**0.5**	(0.1)	**0.5**	(0.1)
At 31 December	**19.4**	21.9	**19.2**	21.7
Depreciation				
At 1 January	**5.3**	5.0	**5.3**	5.0
Charged in year	**0.3**	0.3	**0.3**	0.3
Impairment	**–**	–	**–**	–
Disposals	**(1.3)**	–	**(1.3)**	–
Transfers	**0.1**	–	**0.1**	–
At 31 December	**4.4**	5.3	**4.4**	5.3
Net book value				
At 31 December	**15.0**	16.6	**14.8**	16.4
Fair value				
At 31 December	**22.6**	21.9	**22.0**	21.6

18. Investment Properties continued...

Investment properties are generally flats and offices ancillary to branch premises and not used by the Group. Rental income of £1.8m on investment properties has been included within other operating income (2015 – £2.0m).

Transfers relate to the reclassification of assets between investment properties and property, plant and equipment, usually due to changes in occupancy.

Depreciation is provided by the Group to write off the cost less the estimated residual value of investment properties (excluding land) by equal instalments over their estimated useful economic life of 50 years.

The fair value of the Group's investment properties at 31 December 2016 has been arrived at predominantly on the basis of external valuations provided by Gerald Eve surveyors, the remaining properties being valued internally by the Group's Estates Manager, an appropriately qualified surveyor. Under IFRS 13 fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.

The fair value measurements for investment properties have been classified as Level 3 as they have been calculated based on observable market comparable transactions (as defined in Note 40). In the opinion of the directors the market valuation of such investment properties as at 31 December 2016 was not materially different from their valuation disclosed in the financial statements.

Notes to the Accounts continued...

19. Property, Plant and Equipment

	Construction in progress £m	Land and buildings £m	Equipment fixtures, fittings and vehicles £m	Total £m
Group				
Cost				
At 1 January 2016	**0.6**	**138.8**	**77.2**	**216.6**
Additions	**3.5**	**3.0**	**5.3**	**11.8**
Disposals	**–**	**(14.9)**	**(6.3)**	**(21.2)**
Transfers	**(4.0)**	**2.1**	**1.3**	**(0.6)**
At 31 December 2016	**0.1**	**129.0**	**77.5**	**206.6**
Depreciation				
At 1 January 2016	**–**	**35.4**	**43.3**	**78.7**
Charged in year	**–**	**4.1**	**9.4**	**13.5**
Impairment	**–**	**–**	**–**	**–**
Disposals	**–**	**(8.8)**	**(6.0)**	**(14.8)**
Transfers	**–**	**(0.1)**	**–**	**(0.1)**
At 31 December 2016	**–**	**30.6**	**46.7**	**77.3**
Net book value				
At 31 December 2016	**0.1**	**98.4**	**30.8**	**129.3**
Cost				
At 1 January 2015	4.3	135.3	72.2	211.8
Additions	2.7	2.4	12.6	17.7
Disposals	–	(4.1)	(9.2)	(13.3)
Transfers	(6.4)	5.2	1.6	0.4
At 31 December 2015	0.6	138.8	77.2	216.6
Depreciation				
At 1 January 2015	–	34.1	41.0	75.1
Charged in year	–	3.8	10.2	14.0
Impairment	–	–	1.0	1.0
Disposals	–	(2.5)	(8.9)	(11.4)
Transfers	–	–	–	–
At 31 December 2015	–	35.4	43.3	78.7
Net book value				
At 31 December 2015	0.6	103.4	33.9	137.9

19. Property, Plant and Equipment continued...

	Construction in progress £m	Land and buildings £m	Equipment fixtures, fittings and vehicles £m	Total £m
Society				
Cost				
At 1 January 2016	**0.6**	**132.7**	**77.1**	**210.4**
Additions	**3.5**	**3.0**	**5.3**	**11.8**
Disposals	**–**	**(14.9)**	**(6.3)**	**(21.2)**
Transfers	**(4.0)**	**2.1**	**1.3**	**(0.6)**
At 31 December 2016	**0.1**	**122.9**	**77.4**	**200.4**
Depreciation				
At 1 January 2016	**–**	**29.9**	**43.0**	**72.9**
Charged in year	**–**	**4.1**	**9.4**	**13.5**
Impairment	**–**	**–**	**–**	**–**
Disposals	**–**	**(8.8)**	**(6.0)**	**(14.8)**
Transfers	**–**	**(0.1)**	**–**	**(0.1)**
At 31 December 2016	**–**	**25.1**	**46.4**	**71.5**
Net book value				
At 31 December 2016	**0.1**	**97.8**	**31.0**	**128.9**
Cost				
At 1 January 2015	4.3	129.2	72.1	205.6
Additions	2.7	2.4	12.6	17.7
Disposals	–	(4.1)	(9.2)	(13.3)
Transfers	(6.4)	5.2	1.6	0.4
At 31 December 2015	0.6	132.7	77.1	210.4
Depreciation				
At 1 January 2015	–	28.6	40.7	69.3
Charged in year	–	3.8	10.2	14.0
Impairment	–	–	1.0	1.0
Disposals	–	(2.5)	(8.9)	(11.4)
Transfers	–	–	–	–
At 31 December 2015	–	29.9	43.0	72.9
Net book value				
At 31 December 2015	0.6	102.8	34.1	137.5

Notes to the Accounts continued...

20. Deferred Tax Assets and Liabilities

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
The movement on the net deferred tax asset is as follows:				
At 1 January	**9.6**	27.5	**9.9**	24.3
Income Statement credit /(charge) (Note 11)	**1.3**	(2.2)	**(2.6)**	1.3
Tax expense recognised directly in equity	**(10.8)**	(15.7)	**(10.8)**	(15.7)
At 31 December	**0.1**	9.6	**(3.5)**	9.9
Deferred tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Other temporary differences	**1.2**	0.7	**1.2**	0.6
Depreciation in excess of capital allowances	**2.2**	2.6	**2.2**	2.6
Transfer of engagements – tax value of losses carried forward	**2.3**	4.7	**2.3**	4.7
Pensions and other post retirement benefits	**0.8**	1.6	**0.8**	1.6
Implementation of IAS 39 – mortgages and hedging	**0.9**	1.4	**0.9**	1.4
Cash flow hedging	**2.7**	8.1	**2.7**	8.1
Transfer of engagements – fair value adjustments	**2.2**	8.1	**2.2**	8.1
Fair value volatility on financial instruments in securitisation entities	**4.0**	1.3	**–**	–
	16.3	28.5	**12.3**	27.1
Deferred tax liabilities				
Pensions and other post retirement benefits	**10.5**	16.0	**10.5**	16.0
Other temporary differences	**1.8**	0.4	**1.7**	0.3
Transfer of engagements – fair value adjustments	**0.4**	0.6	**0.4**	0.6
Fair value volatility on financial instruments in securitisation entities	**0.3**	1.6	**–**	–
Available for sale securities	**3.2**	0.3	**3.2**	0.3
	16.2	18.9	**15.8**	17.2

20. Deferred Tax Assets and Liabilities continued...

Within deferred tax assets are balances in respect of fair value adjustments and tax value of losses acquired on transfer of engagements. These are expected to be recoverable against future taxable profits (as projected in the latest Strategic Plan) within one to two years. The deferred tax assets have not been discounted.

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

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Accelerated tax depreciation	**0.4**	–	**0.4**	(0.1)
Pensions and other post-retirement benefits	**0.2**	(0.1)	**0.2**	(0.1)
Other temporary differences	**2.1**	(1.3)	**2.0**	(1.2)
Release of fair value adjustments on merger	**–**	0.1	**–**	0.1
Fair value volatility on financial instruments in securitisation entities	**(4.0)**	3.5	**–**	–
	(1.3)	2.2	**2.6**	(1.3)

21. Other Assets

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Prepayments and accrued income	**18.0**	19.4	**18.0**	17.7
Due from subsidiary undertakings	**–**	–	**13.0**	16.9
Other assets	**10.8**	9.3	**8.6**	7.5
	28.8	28.7	**39.6**	42.1

22. Shares

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Shares comprising balances held by individuals	**28,757.2**	27,479.8	**28,757.2**	27,479.8
Fair value adjustments	**(64.0)**	(83.4)	**(64.0)**	(83.4)
	28,693.2	27,396.4	**28,693.2**	27,396.4

Notes to the Accounts continued...

23. Amounts Owed to Credit Institutions

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Amounts owed to:				
Banks	**3,120.8**	3,302.4	**3,111.4**	3,293.0
	3,120.8	3,302.4	**3,111.4**	3,293.0

Included within amounts owed to credit institutions are amounts deposited by counterparties under swap collateralisation agreements.

24. Other Deposits

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Amounts owed to:				
Group companies	**–**	–	**6,733.8**	6,187.5
Other customers	**434.7**	544.3	**165.0**	255.4
	434.7	544.3	**6,898.8**	6,442.9

Amounts due to Group companies comprise balances due to subsidiary undertakings.

25. Debt Securities in Issue

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Covered bonds	**2,105.4**	2,433.2	**2,105.4**	2,433.2
Medium term notes	**1,601.4**	1,014.3	**1,601.4**	1,014.3
Residential mortgage backed securities	**654.6**	661.3	**–**	–
	4,361.4	4,108.8	**3,706.8**	3,447.5

Debt securities in issue include amounts secured on certain loans and advances to customers – Group £2.8bn (2015 – £3.1bn) and Society £2.1bn (2015 – £2.4bn).

26. Retirement Benefit Obligations

The Group operates one main employee benefit scheme (the Scheme), the costs of which are borne by the Society, with both defined benefit and defined contribution sections.

In addition, the Group operates unfunded defined benefit pension schemes for certain current and former members of staff. The present value at 31 December 2016 of the defined benefit obligation in relation to these schemes was £9.8m (2015 – £7.2m) and the relevant disclosures have been aggregated with those of the main employee benefits scheme.

Defined contribution post-employment benefits
In addition to the defined benefit section (see below), the Group operates a defined contribution section of the main scheme. This includes a section which covers auto-enrolled employees. The Group also contributes to the National Employment Savings Trust in respect of its auto-enrolment employees. The total expense recognised for these defined contribution benefits is £17.1m (2015 – £11.7m).

Defined benefit post-employment benefits
The Group operates a funded defined benefit scheme for certain employees, providing benefits based on final salary. Benefits earned by members of the defined benefit section of the main scheme from, with the exception of N&P Section members, 1 April 2010 are based on career average revalued earnings. N&P Section members' benefits are based on their Final Pensionable Salary. The assets of the scheme are held in a separate trustee-administered fund. Contributions are assessed in accordance with the advice of an independent qualified actuary using the projected unit method. The defined benefit section was closed to new employees in 2000 and to future accrual on 31 December 2015.

The Scheme is governed under the Scheme's current Trust Deed and Rules dated 1 April 2010 and subsequent Deeds of Amendment and Merger Deeds. The Trustees are responsible for the operation and governance of the Scheme, including making decisions regarding the Scheme's funding and investment strategy.

The defined benefit section of the Scheme has a weighted average maturity of around 21 years.

Summary of assumptions	**31 Dec 2016 %**	31 Dec 2015 %
Retail Prices index (RPI) Inflation	**3.5**	3.3
Consumer price index (CPI) inflation	**2.5**	2.3
Discount rate	**2.6**	3.8
Rate of increase in pay	**4.5**	4.3
Rate of increase of pensions in payment*		
in line with RPI, subject to a min of 3% and a max of 5% pa	**3.9**	3.8
in line with RPI, subject to a min of 0% and a max of 5% pa	**3.2**	3.1
in line with RPI, subject to a min of 0% and a max of 2.5% pa	**2.0**	2.0
in line with CPI, subject to a min of 0% and a max of 3% pa	**2.1**	2.0
Rate of increase for deferred pensions*		
in line with CPI, subject to a min of 0% and a max of 5% pa	**2.5**	2.3
in line with CPI, subject to a min of 0% and a max of 2.5% pa	**2.5**	2.3

*In excess of any Guaranteed Minimum Pension (GMP) element.

Notes to the Accounts continued...

26. Retirement Benefit Obligations continued...

The most significant non-financial assumption is the assumed rate of longevity. The assumptions made are equivalent to the following life expectancies for scheme members at age 60:

	2016 Years	2015 Years
For a current 60 year old male	**28.6**	28.5
For a current 60 year old female	**29.2**	29.1
For a current 45 year old male	**30.4**	30.3
For a current 45 year old female	**31.1**	31.0

Reconciliation of funded status	31 Dec 2016 £m	31 Dec 2015 £m
Present value of defined benefit obligation	**(949.3)**	(735.2)
Assets at fair value	**991.3**	796.9
Funded status/defined benefit asset	**42.0**	61.7

Statement of comprehensive income (SCI)	2016 £m	2015 £m
Cumulative actuarial gains recognised at 1 January	**18.7**	28.2
(Loss)/gain on change of financial assumptions	**(220.0)**	9.9
Loss on change of demographic assumptions	**–**	(3.5)
Experience adjustments	**6.3**	(2.1)
Return on plan assets greater/(less) than discount rate	**186.7**	(13.8)
Total actuarial loss recognised in SCI	**(27.0)**	(9.5)
Cumulative actuarial (losses)/gains recognised at 31 December	**(8.3)**	18.7

Components of pension expense as shown in the Income Statement	2016 £m	2015 £m
Service cost	**–**	6.9
Administrative expenses	**1.5**	0.6
Interest on net defined benefit surplus	**(2.4)**	(2.1)
Total pension expense	**(0.9)**	5.4

Service cost is the Group's cost, net of employee contributions and inclusive of interest to the reporting date.

26. Retirement Benefit Obligations continued...

Reconciliation of present value of defined benefit obligation	2016 £m	2015 £m
Present value of defined benefit obligation at 1 January	**735.2**	725.4
Defined benefit service cost	**–**	6.9
Administrative expenses	**1.5**	0.6
Interest cost	**27.2**	26.6
Actuarial gain/(loss)	**214.5**	(4.3)
Defined benefit actual benefits paid	**(29.1)**	(20.0)
Present value of defined benefit obligation at 31 December	**949.3**	735.2

Movement in defined benefit fair value of assets	2016 £m	2015 £m
Fair value of assets at 1 January	**796.9**	789.8
Interest income on scheme assets	**29.6**	28.7
Actuarial gain/(loss) on assets	**186.7**	(13.8)
Defined benefit actual Society contributions	**6.9**	12.1
Defined benefit actual benefits and costs paid	**(28.8)**	(19.9)
Fair value of plan assets at 31 December	**991.3**	796.9

Defined benefit actual contributions paid wholly relate to contributions made by the Society. Society contributions include deficit contributions of £6.4m (2015 – £7.5m). In addition, Society contributions include £nil (2015 – £1.5m) in relation to a salary sacrifice scheme whereby employees have accepted a reduction in salary in return for the Society agreeing to make the contributions that were previously paid by the employee.

Expected contributions for the period ending 31 December 2017 are £4.0m.

None of the assets were invested in the Group's own financial instruments (2015 – £nil) or the Group's own property (2015 – £nil).

Notes to the Accounts continued...

26. Retirement Benefit Obligations continued...

Scheme specific risks
The ultimate cost of the Scheme to the Society will depend upon actual future events rather than the assumptions made. Many of the assumptions made are unlikely to be borne out in practice and, as such, the cost of the schemes may be higher or lower than disclosed. In general, the risk to the Society is that the assumptions underlying the disclosures, or the calculation of contribution requirements, are not borne out in practice and the cost to the Society is higher than expected. This could result in higher contributions being required from the Society and a higher deficit being disclosed. This may also impact the Society's ability to grant discretionary benefits or other enhancements to members.

The assumptions not being borne out in practice could include:

i. The investment return on the Scheme's assets being lower than assumed, resulting in an unaffordable increase in the contributions required from the Society. The level of bond returns will be a key determinant of overall investment return; the investment portfolio is also subject to a range of other risks typical of the asset classes held, in particular equity returns, credit risk on bonds and exposure to the property market.

ii. Falls in asset values (particularly equities) not being matched by similar falls in the value of liabilities. This risk has been mitigated to some degree by the implementation of an asset liability matching investment strategy which is designed to match a proportion of the Scheme's interest rate exposure.

iii. Future levels of inflation being higher than assumed, resulting in higher than anticipated annual increases to benefits in payment, revaluations of benefits prior to retirement and salary increases. This risk has been mitigated to some degree by the implementation of an asset liability matching investment strategy which is designed to match a proportion of the Scheme's inflation exposure.

iv. Unanticipated improvements in the longevity of members leading to an increase in the Scheme's liabilities.

Assets
The Scheme's investment strategy, with a significant proportion of the assets invested in an asset liability matching strategy (consisting of index-linked government and corporate bonds and swaps), is expected to reduce the volatility of the difference between the market value of the assets and the IAS 19 liabilities (at the date of implementation in October 2012, the strategy hedged around 70% of the Scheme's interest rate and inflation rate risk).

Disaggregation of assets	31 Dec 2016 %	31 Dec 2015 %
Equities	**13**	19
Index-linked bonds	**61**	54
Corporate and other bonds	**8**	9
Cash and other	**7**	10
Swaps	**11**	8
	100	100

The majority of the Scheme's investments are in quoted assets, with the exception of the liability matching assets classified as 'Swaps' and reinsurance assets included in 'Cash and other', where a proportion of these will be invested in unquoted assets.

Sensitivities
The IAS19 liability measurement and the service cost are sensitive to the assumptions made about future inflation and salary growth levels, as well as the assumptions made about life expectation. They are also sensitive to the discount rate, which depends on market yields on Sterling-denominated high quality corporate bonds. A decrease in corporate bond yields will increase the liabilities although this will be partially offset by an increase in matching assets.

26. Retirement Benefit Obligations continued...

The table below shows the sensitivity of the defined benefit obligation and Scheme assets to changes in these assumptions. The final assumptions are chosen by the Society.

Principal Sensitivity Illustrations	Defined benefit obligation £m	Assets £m	Net effect £m
Total as at 31 December 2016	(949.3)	991.3	**42.0**
Change in defined benefit obligation / assets given the following change of assumption:			
Discount Rate[1]: 1.00% decrease	(236.4)	235.0	**(1.4)**
Salary Escalation: 0.75% increase	(14.1)	–	**(14.1)**
Inflation[2]: 0.50% increase	(38.9)	49.6	**10.7**
Life Expectancy: 1 year average increase	(33.2)	–	**(33.2)**

[1] The change in the discount rate is assumed to be equivalent to a 1% decrease in gilt, swap and credit based interest rates.

[2] The sensitivity illustrations above are calculated by changing each assumption in isolation, keeping all other assumptions constant. In practice this is unrealistic as the financial assumptions are correlated.

The asset liability matching strategy implemented for the Scheme means that a change in discount rate or inflation assumption has a broadly similar impact on the liabilities and the assets, reducing the volatility of the net impact.

27. Other Liabilities

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Accruals and deferred income	**43.5**	46.6	**42.0**	46.2
Income tax deducted at source	**–**	25.6	**–**	25.6
Other	**11.2**	5.4	**11.0**	5.3
	54.7	77.6	**53.0**	77.1

Notes to the Accounts continued...

28. Provisions

Movements in provisions during the year were as follows:

Group	FSCS levy £m	Customer redress £m	Other £m	Total £m
2016				
At 1 January 2016	**9.0**	**7.0**	**9.8**	**25.8**
Amounts utilised during the year	**(8.3)**	**(4.7)**	**(0.7)**	**(13.7)**
Provision charge/(release) during the year	**4.5**	**15.6**	**(3.1)**	**17.0**
At 31 December 2016	**5.2**	**17.9**	**6.0**	**29.1**
2015				
At 1 January 2015	16.3	14.1	5.8	36.2
Amounts utilised during the year	(18.8)	(7.1)	(0.5)	(26.4)
Provision charge during the year	11.5	–	4.5	16.0
At 31 December 2015	9.0	7.0	9.8	25.8

Society	FSCS levy £m	Customer redress £m	Other £m	Total £m
2016				
At 1 January 2016	**9.0**	**7.0**	**9.8**	**25.8**
Amounts utilised during the year	**(8.3)**	**(4.8)**	**(0.7)**	**(13.8)**
Provision charge / (release) during the year	**4.5**	**15.6**	**(3.1)**	**17.0**
At 31 December 2016	**5.2**	**17.8**	**6.0**	**29.0**
2015				
At 1 January 2015	16.3	13.8	5.8	35.9
Amounts utilised during the year	(18.8)	(6.9)	(0.5)	(26.2)
Provision charge during the year	11.5	0.1	4.5	16.1
At 31 December 2015	9.0	7.0	9.8	25.8

28. Provisions continued...

Financial Service Compensation Scheme (FSCS)
The FSCS provides compensation to consumers if a firm is unable to pay claims against it. As a consequence of the default of a number of deposit taking institutions, FSCS took out loans from HM Treasury to compensate their protected deposits. The FSCS levies member firms to recover the interest cost on the loans from HM Treasury and has communicated that the level of the future levies will be reviewed following developments from the failed legacy estates.

The Group has recognised a provision charge for estimated levies due of £4.5m, (2015 – £11.5m), for the scheme year 2016/2017, in this year's results. The amount relating to the 2016/17 scheme year is payable by 1 September 2017. The decrease in provision in 2016 compared with the prior year is due to a lower expected levy as a result of recoveries made by FSCS on Icelandic banks.

Customer remediation and conduct issues
Provisions have been made in respect of various potential customer claims and represent management's best estimate of the likely costs. The largest provision of £9.6m (2015 – £4.2m) relates to sales of Payment Protection Insurance (PPI) and is calculated using management's estimate of complaint volumes, referral levels to the Financial Ombudsman Service (FOS), claim rates upheld internally and by FOS, redress payments and complaint handling costs. The increase in the provision in 2016 is due to an expected increase in the volumes of claims resulting from the forthcoming Financial Conduct Authority's communication campaign to consumers and a longer time period in which claims can be submitted.

A provision of £4.9m has been established during 2016 in relation to other customer remediation relating to a small number of specific instances where we made mistakes we needed to rectify. It is expected these amounts will be payable in 2017. We remain committed to identifying and fairly rectifying areas where we have made mistakes.

Of the remaining provision, £1.1m (2015 – £1.1m) relates to the Group's approach to sales of investments linked to stock market performance and administration fee charging in relation to mortgage collection. These have been calculated using management's estimates of complaint volumes, redress payments and other costs. The costs are not expected to vary materially given that the remediation exercises are in their final stages.

Other
Other provisions include onerous property lease provisions £4.9m (2015 – £3.4m) and provisions for claims relating to negligent valuations undertaken prior to 2010 by a subsidiary of Norwich & Peterborough Building Society £1.0m (2015 – £2.4m).

29. Subordinated Liabilities

Group and Society	2016 £m	2015 £m
Floating Subordinated Bonds 2018	**5.0**	5.0
11⅜% Subordinated Bonds 2022	**5.0**	5.0
6⅜% Subordinated Bonds 2024	**4.1**	4.1
4⅛% Subordinated Bonds 2024	**249.4**	248.7
13½% Convertible Tier 2 Capital Notes 2025	**26.0**	25.9
Fair value hedging adjustments	**7.5**	(2.6)
	297.0	286.1

Notes to the Accounts continued...

29. Subordinated Liabilities continued...

All subordinated liabilities are denominated in Sterling. The following notes are repayable at the dates stated or earlier at the option of the Society and with the prior consent of the Prudential Regulation Authority under the following conditions:

- Redemption of all (but not some only) of the 11⅜% Notes at par on 27 November 2017 after giving not less than thirty nor more than sixty days' notice to the holders. In the event the Society does not redeem the notes on 27 November 2017 the fixed rate of interest will become the greater of 11⅜% and an aggregate of 3.10% and the then current five year benchmark Gilt rate.
- Redemption of all (but not some only) of the 4⅛% Notes at par on 20 November 2019 after giving not less than thirty nor more than sixty days' notice to the holders. In the event the Society does not redeem the notes on 20 November 2019 the fixed rate of interest will become the sum of the five year Gilt rate and 2.90%.
- Redemption of all (but not some only) of the 13½% Convertible Tier 2 Capital Notes will occur on 1 April 2025 unless the notes are converted to Profit Participating Deferred Shares (PPDS). The 'Conversion Trigger' shall occur if on any Calculation Date the Society's Common Equity Tier 1 Capital Ratio, as confirmed in a report of the auditor to the Society and addressed to the Board of Directors of the Society, is less than 5%. Should the Conversion Trigger occur on the 13½% Convertible Notes and these notes convert into PPDS, the PPDS will be perpetual in nature, ranking pari passu with the currently issued Subscribed Capital (detailed in Note 30).

The rights of repayment of the holders of subordinated liabilities are subordinated to the claims of all depositors, creditors and members holding shares in the Society, as regards the principal of their shares and interest due on them.

30. Subscribed Capital

Group and Society	2016 £m	2015 £m
5.649% Permanent Interest Bearing Shares	**6.2**	6.1
Fair value hedging adjustments	**0.5**	0.6
	6.7	6.7

All Permanent Interest Bearing Shares (PIBS) are unsecured and denominated in Sterling. Interest is payable half yearly on 27 March and 27 September. PIBS are repayable at the option of the Society, in whole, in March 2019 or any interest payment date thereafter.

Repayment requires the prior consent of the Prudential Regulation Authority. If the PIBS are not repaid on a call date the interest rate is reset at a margin to the then prevailing LIBOR rate. They are deferred shares of the Society and the rights of repayment of the holders of PIBS are subordinated to the claims of all depositors, creditors, members holding shares in the Society and holders of subordinated liabilities, as regards the principal of their shares and interest due on them. The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

31. Capital Management

The ratios, deductions and definitions below are in accordance with CRD IV regulations.

	2016 £m	2015 £m
Tier 1		
Common Equity Tier 1 (CET1)		
General reserve	**2,215.4**	2,123.1
AFS reserve	**8.2**	4.9
Deferred tax assets that rely on future profitability	**(2.3)**	(4.7)
Pension fund adjustments[1]	**(31.5)**	(45.7)
Intangible fixed assets[2]	**(32.9)**	(36.8)
Deductions from Tier 1 capital[3]	**(37.6)**	(27.8)
Total Common Equity Tier 1 capital	**2,119.3**	2,013.0
Additional Tier 1 Capital		
Subscribed Capital[4]	**4.0**	4.7
	2,123.3	2,017.7
Tier 2		
Subordinated liabilities[5]	**291.5**	282.9
Collective allowances for impairment	**34.4**	33.3
	325.9	316.2
Total capital	**2,449.2**	2,333.9
Risk weighted assets	**14,179.7**	13,883.0
Common Equity Tier 1 ratio	**14.9%**	14.5%
Tier 1 ratio	**15.0%**	14.5%
Total capital ratio	**17.3%**	16.8%
Leverage ratio[6]	**5.1%**	5.0%

[1] CRD IV requires a pension fund surplus, net of any associated deferred tax liabilities, to be deducted from Tier 1 capital (CET1). CRD IV does not permit a pension fund deficit to be added back to regulatory capital.

[2] CRD IV requires intangible fixed assets, net of any associated deferred tax liabilities, to be deducted from CET1.

[3] Securitisation positions that are unrated or have low external ratings have been deducted from CET1.

[4] Under CRD IV, subscribed capital is being phased out as qualifying for regulatory Tier 1 capital over a ten year period. Currently 60% of the subscribed capital balance sheet carrying value qualifies as additional Tier 1 capital.

[5] Subordinated liabilities with less than five years to maturity are adjusted for amortisation in the regulatory capital value of instruments. One of our subordinated liabilities becomes ineligible as capital in 2022 and is being phased out in the same way as subscribed capital.

[6] CRD IV regulatory capital rules have introduced a non-risk based leverage requirement that measures the relationship between capital resources and an adjusted measure of total on and off balance sheet assets. A minimum leverage ratio of 3% is in force for the UK's largest institutions until 2017. It will be become mandatory for all other institutions (including the Group) from 2018.

Notes to the Accounts continued...

31. Capital Management continued...

Throughout the year the Prudential Risk Committee has reviewed the Group's capital position and regulatory developments under CRD IV.

For a detailed analysis of the Group's capital position and disclosures please refer to the Pillar 3 Disclosure for 2016 which can be found on our website ybs.co.uk.

32. Financial Commitments

Group and Society	**2016 £m**	2015 £m
Committed undrawn standby facilities	**217.7**	156.3

The Society has an obligation under the Building Societies Act 1986 to discharge the liabilities incurred up to 11 June 1996 of all subsidiaries in so far as those subsidiaries are unable to discharge the liabilities out of their own assets. The Society has given undertakings whereby it has agreed to discharge the liabilities incurred after 11 June 1996 by certain subsidiaries, in the event that these subsidiaries may be unable to discharge them out of their own assets. In addition, the Society guarantees certain Accord's mortgage buyback obligations regarding the Group's securitisation entities (discussed in note 35) in the event that Accord may be unable to discharge these obligations.

The Society accounts for these guarantees in accordance with IFRS 4 'Insurance Contracts'.

Capital commitments contracted for at 31 December 2016, but for which no provision has been made in the accounts, amounted to Group £0.5m and Society £0.5m (2015 – Group £0.9m and Society £0.9m).

Amounts payable under non-cancellable operating leases are as follows:

	2016		2015	
Group	**Land and buildings £m**	**Other £m**	Land and buildings £m	Other £m
Within one year	**6.7**	**0.4**	7.1	0.5
Between one and five years	**19.7**	**0.9**	20.0	0.6
Over five years	**9.6**	**–**	11.3	–
	36.0	**1.3**	38.4	1.1

The Group is not in default on any of its financial liabilities or commitments.

33. Financial Instruments

The table below summarises the main financial instruments, their significant terms and conditions and the accounting treatment adopted.

Financial instrument	Significant terms and conditions	Accounting treatment
Cash in hand and balances with the Bank of England	Short-term cash balances and statutory deposits Fixed and variable interest rates and non-interest bearing	Amortised cost
Loans and advances to credit institutions	Short-term Fixed and variable interest rates	Amortised cost
Debt securities	Short-term, medium-term and long-term Fixed and variable interest rates	Generally held at fair value as available for sale assets. Certain investments are held at fair value through the Income Statement or held to maturity at amortised cost. Detail is given in Note 15
Loans and advances to customers	Loan period is typically up to 25 years Primarily mortgage products offering a variety of fixed and variable interest rates	Amortised cost*
Derivative financial instruments	Primarily medium-term Value derived from underlying price, rate or index	Fair value through profit and loss
Intercompany deposit from Covered Bond Limited Liability Partnerships	Long-term Fixed and variable interest rates	Fair value through profit and loss
Investments	Share and loan investments in subsidiary companies Investments in equities	Cost / Amortised cost Fair value as available for sale
Shares	Deposits made by individuals Varying withdrawal notice periods Fixed and variable interest rates	Amortised cost
Amounts owed to credit institutions	Primarily short-term Time Deposits Fixed and variable interest rates	Amortised cost
Debt securities in issue	Medium-term Fixed and variable interest rates	Amortised cost*
Subordinated liabilities	Long-term Fixed and variable interest rates	Amortised cost*
Subscribed capital	Long-term Fixed interest rates	Amortised cost*

* Except where hedge accounting allows a fair value adjustment to be made for interest rate risk.

Notes to the Accounts continued...

34. Derivative Financial Instruments

Instruments used for the management of market risk include derivative financial instruments (derivatives) which are contracts or agreements whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates, exchange rates or stock market indices.

Derivatives are only used by the Group in accordance with the Building Societies Act 1986. This means that such instruments are not used in trading activity or for speculative purposes and are only used to reduce the risk of loss on core assets or liabilities arising from changes in interest rates, currency rates or other factors of a prescribed description.

The principal derivatives used in balance sheet risk management are interest rate swaps, interest rate options, cross-currency interest rate swaps, forward rate agreements, futures contracts and foreign exchange contracts. These are used to hedge Group exposures arising from fixed rate mortgage lending and savings products, funding and investment activities.

The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the type of derivatives which are typically used in managing such risks. Such risks may alternatively be managed using 'on balance sheet' instruments as part of the Group's integrated approach to risk management.

Activity	Risk	Type of hedge
Management of the investment of reserves and other net non-interest bearing liabilities	Sensitivity to changes in interest rates	Interest rate swaps
Fixed rate savings products and options, forward fixed rate funding	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Fixed rate mortgage lending and options, forward fixed rate investments	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Management of the interest basis risk arising from differences in the underlying pricing basis of assets and liabilities	Sensitivity to changes in relationships between interest rate bases	Interest rate swaps where one leg is referenced to LIBOR or SONIA and the other to Bank Base Rate
Equity linked investment products	Sensitivity to changes in equity indices	Equity linked interest rate swaps
Investment and funding in rate swaps and foreign currencies	Sensitivity to changes in foreign exchange rates	Cross-currency interest rate swaps and foreign exchange contracts

The Group's objective is to manage risk within its risk tolerance, irrespective of the accounting treatment.

Those derivative products which are combinations of more basic derivatives are used only in circumstances where the underlying position being hedged contains the same risk features. In such cases the derivatives used will be designed to match the risks of the underlying asset or liability and therefore to hedge the associated market risk.

Certain financial instruments (including some retail products) contain features that are similar to derivatives. In the majority of such cases, the Group manages the associated risks by entering into derivative contracts that match these features.

Whilst all derivatives have been entered into for hedging purposes, only certain ones have been designated as such for accounting purposes. In some cases a natural offset can be achieved without applying the requirements of IAS 39. The Group only designates hedges where a high degree of effectiveness can be achieved.

Fair value hedges are designated where interest rate swaps are used to minimise the variability in the fair value of fixed interest financial instruments (mainly fixed rate mortgages).

Cash flow hedges are designated where interest rate swaps are used to convert the interest rate variability on short-term financial instruments into fixed rates.

34. Derivative Financial Instruments continued...

The following tables summarise the notional and fair value of all derivative financial instruments held at the year end and the hedging designations in place at that date.

	Contract/ notional amount £m	Fair values Assets £m	Liabilities £m
Group			
At 31 December 2016			
Interest rate swaps designated as fair value hedges	**22,529.3**	**142.6**	**281.8**
Equity linked interest rate swaps designated as fair value hedges	**179.1**	**32.0**	**–**
Interest rate swaps designated as cash flow hedges	**350.2**	**4.7**	**26.2**
Cross-currency interest rate swaps designated as fair value hedges	**2,434.6**	**343.9**	**–**
Derivatives not designated as hedges:			
Interest rate swaps	**5,398.0**	**17.3**	**39.0**
Foreign exchange	**48.6**	**–**	**1.0**
Total derivatives held for hedging	**30,939.8**	**540.5**	**348.0**
Society			
At 31 December 2016			
Interest rate swaps designated as fair value hedges	**26,763.4**	**92.5**	**285.6**
Equity linked interest rate swaps designated as fair value hedges	**179.1**	**32.0**	**–**
Interest rate swaps designated as cash flow hedges	**350.2**	**4.7**	**26.2**
Cross-currency interest rate swaps designated as fair value hedges	**1,153.2**	**156.9**	**–**
Derivatives not designated as hedges:			
Interest rate swaps	**5,398.0**	**17.3**	**39.0**
Foreign exchange	**48.6**	**–**	**1.0**
Total derivatives held for hedging	**33,892.5**	**303.4**	**351.8**

The Society table above includes transactions between Group subsidiaries which are eliminated in the Group accounts.

For collateralised positions, expected future cash flows for derivative financial instruments have been discounted using the Overnight Indexed Swap (OIS) curve, and for non-collateralised positions the LIBOR curve is used for discounting. Credit Valuation Adjustments (CVA) and Debit Valuation Adjustments (DVA) are incorporated into the fair value of derivative valuations to reflect the impact of counterparty credit risk and the Group's own credit quality respectively for uncollateralised derivatives.

Notes to the Accounts continued...

34. Derivative Financial Instruments continued...

Credit risk on derivative exposures is significantly mitigated within the Group by the existence of a Credit Support Annex (CSA) with the vast majority of our derivative counterparties. Under a CSA, cash is passed between parties to mitigate the counterparty risk inherent in the outstanding positions. Where cash collateral is received, to mitigate the risk inherent in amounts due to the Group, it is included as a liability within amounts owed to credit institutions. Where cash collateral is given to mitigate the risk inherent in amounts due from the Group, it is included as an asset in loans and advances to credit institutions. Credit risk is also mitigated by the use of central counterparties (CCPs) for eligible derivatives.

	Contract/ notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Group			
At 31 December 2015			
Interest rate swaps designated as fair value hedges	22,738.7	122.8	212.1
Equity linked interest rate swaps designated as fair value hedges	208.3	25.8	–
Interest rate swaps designated as cash flow hedges	1,075.1	3.9	33.6
Cross-currency interest swaps designated as fair value hedges	2,094.0	24.5	66.8
Derivatives not designated as hedges:			
Interest rate swaps	5,052.4	3.1	27.9
Foreign exchange	39.7	–	0.5
Total derivatives held for hedging	31,208.2	180.1	340.9
Society			
At 31 December 2015			
Interest rate swaps designated as fair value hedges	21,988.7	60.5	214.9
Equity linked interest rate swaps designated as fair value hedges	208.3	25.8	–
Interest rate swaps designated as cash flow hedges	1,075.1	3.9	33.6
Cross-currency interest swaps designated as fair value hedges	991.9	8.7	44.0
Derivatives not designated as hedges:			
Interest rate swaps	5,052.4	3.1	27.9
Foreign exchange	39.7	–	0.5
Total derivatives held for hedging	29,356.1	102.0	320.9

34. Derivative Financial Instruments continued...

Cash Flow Hedging

The Group applies cash flow hedge accounting to a portfolio of interest rate swaps which are economically hedging either floating rate assets, floating rate liabilities or highly probable forecast issuance of debt. During 2016 the following amounts were recorded in relation to cash flow hedge relationships:

- £25.7m loss recognised in the cash flow hedge reserve related to the effective portion of active cash flow hedge relationships that will be recycled to Income Statement over the life of the hedged item.
- £0.6m loss recorded directly in the Income Statement for the ineffective portion of the hedge relationships.
- £12.6m loss recycled from the cash flow hedge reserve into the Income Statement for hedge transactions that occurred during the year.
- £33.4m loss transferred from the cash flow hedge reserve into the Income Statement that would otherwise largely have recycled to the Income Statement during 2017 and 2018. This followed a reduction in the expected amount of wholesale issuance that the Group expects to have over the next few years and which had previously been hedged as a forecast transaction.

The following table shows the maturity profile of the cash flows designated as hedged items:

	Repayable up to three years £m	In more than three years but not more than five years £m	In more than five year but not more than ten years £m	Total £m
Group				
As at 31 December 2016				
Forecast receivable cash flows	**20.6**	**0.2**	**20.4**	**41.2**
Forecast payable cash flows	**3.7**	**206.8**	**106.2**	**316.7**
Total Cash flows	**24.3**	**207.0**	**126.6**	**357.9**

Notes to the Accounts continued...

35. Liquidity Risk

Liquidity risk is an intrinsic part of the Group's business as long-term mortgages are funded by short-term retail customer balances. Most mortgages have a contractual maturity date of around 25 years but in practice are frequently repaid early; currently the estimated average life of a mortgage is approximately five years. Conversely, experience shows that retail deposits, nominally repayable on demand or with short notice periods, actually remain with the Society for relatively long periods. It is this inherent mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity management policy is designed to ensure the maintenance of adequate investments in liquid assets to cover statutory, regulatory and operational requirements. The primary function of liquidity is the provision of sufficient 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.

The Group's liquidity management comprises the following key areas:

- At the highest level, the Group manages its liquidity levels to ensure compliance with the Overall Liquidity Adequacy Rule, as set out by the PRA in Chapter 2 of the ILAAP (Individual Liquidity Adequacy Assessment Process) rules.
- Limits are established by the Board that govern the quantity, quality and marketability of and returns from the Group's portfolio of liquidity investments. The portfolio is managed by the Treasury function, monitored by the first and second line risk functions and overseen by the Asset and Liability Committee (ALCO) under a series of delegated authorities.
- The Group conducts a series of daily stress tests that are designed to ensure that its liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include ones caused by both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding. They are constructed on various timescales as far out as three months.
- The Group also manages liquidity in line with prevailing regulatory requirements, which has been the Liquidity Coverage Ratio (LCR) as prescribed under the European Capital Requirements Directive IV (CRD IV) as part of the Capital Requirements Regulation (CRR) element, since 1 October 2015. The LCR measures the quantity of High Quality Liquid Assets (HQLA) against net liquidity outflows over a 30 day period. YBS currently reports to the PRA on a monthly basis at a Group and Society-only level, with the lower of the two being reported as 159.91% for December 2016 month end. For comparison, the lowest as at 31 December 2015 was 172.02%.
- The Group has also implemented internal backstop limits for liquidity, to mitigate the potential risk of liquidity levels under a risk-based approach being able to be reduced to below what is considered a minimum appropriate level for the Group. These are linked to balance sheet size, and also take account of sources of contingent liquidity, including the ability of the Group to access funding through the various Bank of England facilities.
- The liquidity position of the Group is forecast across the next two years and measured against forecasts of the requirements on both a regulatory and internal basis. This is to ensure that the short-term plans of the Group do not lead to liquidity limits being breached and the financial sustainability of the organisation being threatened. These forecasts are refreshed on a weekly basis and are discussed at the weekly ALCO meetings.

The above metrics are the key elements of the suite of measures by which the Group actively seeks to manage its liquidity position, along with other complimentary metrics which are included within the Group's risk appetite framework.

Liquidity risk in subsidiary companies, with the exception of other deposits, is mitigated by the use of appropriate intercompany loans and deposits.

35. Liquidity Risk continued...

Pledged assets

The Group's asset backed funding programmes, reported within debt securities in issue (see Note 25) are secured against certain loans and advances to customers.

In addition, as part of its liquidity management, the Group enters into sale and repurchase agreements whereby the Group sells but agrees to repurchase assets at a future date. Typically this is for up to three months and for UK Government securities and listed transferable debt securities. Proceeds of these sale and repurchase agreements are included within amounts owed to credit institutions (see Note 23).

Assets pledged are as follows:

2016	**Carrying amounts of encumbered assets £m**	**Carrying amounts of unencumbered assets £m**	**Total £m**
Liquid assets	**771.4**	**3,904.5**	**4,675.9**
Loans and advances to customers	**7,644.0**	**26,459.3**	**34,103.3**
Other assets	**–**	**816.3**	**816.3**
Total assets	**8,415.4**	**31,180.1**	**39,595.5**

2015	Carrying amounts of encumbered assets £m	Carrying amounts of unencumbered assets £m	Total £m
Liquid assets	1,102.9	3,301.8	4,404.7
Loans and advances to customers	8,541.7	24,779.9	33,321.6
Other assets	–	492.3	492.3
Total assets	9,644.6	28,574.0	38,218.6

All of the assets pledged as security are shown in the Statement of Financial Position as the Group has retained substantially all the risk and rewards of ownership.

The Society established Yorkshire Building Society Covered Bonds LLP in November 2006. The LLP provides security for issues of covered bonds made by the Society to external counterparties. As at 31 December 2016 the Society had in issue £750m and €1,500m of covered bonds.

The Group established its first securitisation programme in 2011. This year the latest securitisation structure, Brass No.5 PLC was established and in November 2016 issued £2,300m of listed debt securities secured against certain loans of Accord Mortgages Ltd. Of these debt securities, £2,000m were retained by the Group to be used as collateral for use in sale and repurchase agreements or central bank operations. As at 31 December 2016, the Group had in issue £5,268m of securitisation notes, of which £4,612m were retained.

Whole mortgage loan pools are pre-positioned at the Bank of England under the Funding for Lending Scheme (FLS). The whole loan pool is pledged and drawings are made directly against the eligible collateral. However, values shown are the whole mortgage loan pool balances.

Notes to the Accounts continued...

35. Liquidity Risk continued...

The tables below show contractual future cash flows for all financial liabilities including interest payments. Further details of liquidity management are contained within the Risk Management Report on pages 75 to 78.

	Repayable on demand and up to three months £m	In more than three months but not more than one year £m	In more than one year but not more than five years £m	Over five years £m	Total £m
Group					
As at 31 December 2016					
Shares	**21,790.8**	**3,983.4**	**3,096.2**	**2.9**	**28,873.3**
Amounts owed to credit institutions	**802.5**	**2,131.4**	**149.1**	**–**	**3,083.0**
Other deposits					
Society	**159.6**	**3.4**	**2.0**	**–**	**165.0**
Subsidiaries	**270.0**	**–**	**–**	**–**	**270.0**
Debt securities in issue	**20.4**	**64.7**	**2,974.3**	**1,549.0**	**4,608.4**
Subordinated liabilities	**–**	**14.6**	**63.4**	**328.8**	**406.8**
Subscribed capital*	**0.2**	**0.2**	**1.4**	**1.7**	**3.5**
Operating lease payments	**1.8**	**5.4**	**20.6**	**9.6**	**37.4**
Derivative financial liabilities	**40.1**	**99.3**	**257.7**	**71.2**	**468.3**
Total	**23,085.4**	**6,302.4**	**6,564.7**	**1,963.2**	**37,915.7**
Group					
As at 31 December 2015					
Shares	19,354.1	3,771.9	4,538.5	5.1	27,669.6
Amounts owed to credit institutions	867.2	2,152.6	234.5	–	3,254.3
Other deposits					
Society	251.8	–	3.0	–	254.8
Subsidiaries	289.4	–	–	–	289.4
Debt securities in issue	521.3	112.5	2,338.3	1,309.6	4,281.7
Subordinated liabilities	–	14.6	63.4	343.4	421.4
Subscribed capital*	0.2	0.2	1.4	1.7	3.5
Operating lease payments	1.9	5.8	20.7	11.3	39.7
Derivative financial liabilities	41.0	128.7	379.8	67.4	616.9
Total	21,326.9	6,186.3	7,579.6	1,738.5	36,831.3

* The table includes interest payments on subscribed capital for 10 years.

36. Market Risk

Market risk is the risk to earnings and capital arising from changes in interest rates, foreign currency exchange rates, structural mismatches within the Statements of Financial Position and the price of financial instruments.

Value at Risk (VaR)

VaR is a risk management tool which evaluates the potential losses that may be incurred as a result of movements in market conditions over a specified holding period and to a given level of confidence. The model used is based on a 10 day holding period and a 99% confidence level.

The VaR model calculates potential movements in market prices by reference to market data from the last 252 days and incorporates underlying risk factors based on historic interest rate volatilities and correlations.

VaR for the Treasury portfolios is calculated and reported on a daily basis and for the Group on a monthly basis. A back test of the VaR model is performed to test the validity of the assumptions and parameters within the model.

A number of limitations should be considered in relation to the VaR model:

1. Historic data is not necessarily a good guide to future events.
2. The model, by definition, does not capture potential losses outside the 99% confidence level, i.e. those events that are extreme in nature.
3. VaR is calculated on the basis of exposures outstanding at the close of business and, therefore, does not necessarily reflect intra-day exposures.

VaR measures below are based upon Treasury positions.

Structural risk analysis (basis risk)

An analysis of interest bearing items by rate type is performed to illustrate key areas of structural mismatch. It identifies mismatches between administered rates, fixed rates and other rates including those linked to Bank Base Rate, SONIA and LIBOR. The effect of LIBOR and SONIA mismatches within the Balance Sheet is measured as the impact on net interest income (for a 12 month rolling period) of an isolated increase in LIBOR/SONIA of one basis point (0.01%). A one basis sensitivity measure is an industry standard approach to quantify the quantum and direction of the interest rate exposure within the Group.

Basis Point value (BP) sensitivity

This measure calculates the change in value of the assets and liabilities resulting from a one basis point parallel upward shift in interest rates. Within the Treasury portfolio this is calculated and reported on a daily basis separately for each currency and at the full Statement of Financial Position level on a monthly basis.

Repricing gap analysis

Repricing dates are analysed primarily to avoid repricing risk concentrations, i.e. the situation where too great a proportion of the Group's assets and liabilities see the interest rates earned or charged on them resetting within a given time period. The aim is to prevent excessive volatility in the net interest margin that could arise if rates shifted adversely within a given time period, and since the Group cannot dictate interest rate movements themselves, the best approach is to limit the amount of assets or liabilities that are exposed in this way. The analysis identifies the net asset/liability repricing position across a series of time intervals. Positions are calculated using nominal amounts and exclude interest flows. General reserves, fixed assets and other liabilities are classified as having 'non-specific' repricing characteristics with a zero rate of interest. The measure is calculated as a reverse cumulative gap.

Notes to the Accounts continued...

36. Market Risk continued...

All market risk is managed in the Society on behalf of the Group, hence the tables below apply to the Group.

2016	Year end £000	Average £000	Maximum £000	Minimum £000
LIBOR basis	**28**	**76**	**326**	**10**
SONIA basis	**1,296**	**1,067**	**1,296**	**746**
PV01 sensitivity	**(279)**	**(160)**	**16**	**(279)**
PV200 sensitivity	**(53,108)**	**(30,870)**	**2,725**	**(53,108)**
Treasury VaR	**9,488**	**3,729**	**12,476**	**210**

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	**916**	**116**	**2**

2015	Year end £000	Average £000	Maximum £000	Minimum £000
LIBOR basis	99	88	119	50
SONIA basis	779	635	779	483
PV01 sensitivity	(88)	(108)	(27)	(199)
PV200 sensitivity	(17,506)	(21,640)	(6,029)	(38,667)
Treasury VaR	2,969	3,384	5,373	394

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	1,249	(67)	(1)

Detail of how the Group manages its interest rate risk is included in the Strategic Report on pages 38 – 41.

37. Currency Risk

Currency exchange risk is monitored daily and the Group seeks to minimise its net exposure to assets and liabilities denominated in currencies other than Sterling. Maximum positions throughout the year represented less than 0.01% of total assets. Actual exposures were:

	2016 £m	2015 £m
Year end	**0.4**	0.3
Maximum	**2.4**	0.3

38. Wholesale Credit Risk

The Group's wholesale credit risk arises principally from assets held for liquidity purposes. The risk is that counterparties with whom the Group invests liquid assets fail to repay those investments when they fall due. The Group, through the Treasury function, undertakes its own internal rating of all its counterparties and sets individual limits accordingly. These limits are regularly reviewed internally and against the external rating agencies, with revocation or suspension taking place where considered appropriate.

Limits are in place governing the types of instrument in which the Group will invest, as well as geographic limits designed to prevent over-exposure to a given country.

The Group uses an internal credit ratings process to identify potential risks and wholesale related credit risks are reported and discussed monthly at the Prudential Risk Committee.

Whilst recognising that exposures will be maintained across a spectrum of counterparties the Board has maintained a low risk appetite for wholesale credit risk resulting in our inter-bank exposures being limited to operational requirements. A diversified range of counterparties is in place to meet business and regulatory requirements with no credit risk exposures being undertaken by Treasury to counterparties that have not been through an internal approvals process including a formal second line of defence function.

The following tables break down Wholesale Group exposures[1] by type using the composite external ratings[2].

2016	**Aaa-Aa3 £m**	**A1-A3 £m**	**Baa1-Baa3 £m**	**Ba1-B3 £m**	**Caa1-C3 £m**	**Unrated £m**	**Total £m**
Central Bank and Sovereigns	**5,706.2**	**–**	**–**	**–**	**–**	**–**	**5,706.2**
Financial Institutions	**333.6**	**445.5**	**19.8**	**–**	**–**	**–**	**798.9**
Structured	**–**	**–**	**7.6**	**–**	**36.5**	**–**	**44.1**
Other	**–**	**–**	**–**	**–**	**–**	**3.6**	**3.6**
Total	**6,039.8**	**445.5**	**27.4**	**–**	**36.5**	**3.6**	**6,552.8**

[1] Exposures are measured and reported equivalent to those under CRR 575/2013: Part Four.

[2] The composite rating is derived from an average external rating.

2015	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Ba1-B3 £m	Caa1-C3 £m	Unrated £m	Total £m
Central Bank and Sovereigns	5,574.3	–	–	–	–	–	5,574.3
Financial Institutions	226.7	455.9	24.3	–	–	–	706.9
Structured	–	–	9.0	–	27.9	–	36.9
Other	–	–	–	3.4	–	–	3.4
Total	5,801.0	455.9	33.3	3.4	27.9	–	6,321.5

[1] Exposures are measured and reported equivalent to those under CRR 575/2013: Part Four.

[2] The composite rating is derived from an average external rating.

Notes to the Accounts continued...

38. Wholesale Credit Risk continued...

The Group's low risk appetite outside the UK is reflected in the country exposures[1] by type shown in the tables below.

2016	Central Banks and Sovereigns £m	Financial Institutions £m	Structured £m	Other £m	Total £m
United Kingdom	**5,706.2**	**566.5**	–	**3.6**	**6,276.3**
United States	–	**118.9**	–	–	**118.9**
France	–	**93.2**	–	–	**93.2**
Cayman Islands	–	–	**24.3**	–	**24.3**
Switzerland	–	**18.3**	–	–	**18.3**
Ireland	–	–	**12.2**	–	**12.2**
Netherlands	–	–	**7.6**	–	**7.6**
Germany	–	**0.6**	–	–	**0.6**
Australia	–	**0.6**	–	–	**0.6**
Spain	–	**0.4**	–	–	**0.4**
Denmark	–	**0.3**	–	–	**0.3**
Belgium	–	**0.1**	–	–	**0.1**
Canada	–	–	–	–	–
Total	**5,706.2**	**798.9**	**44.1**	**3.6**	**6,552.8**

[1] Country risk exposures for structured and RMBS are based on the country of origination for the asset.

2015	Central Banks and Sovereigns £m	Financial Institutions £m	Structured £m	Other £m	Total £m
United Kingdom	5,574.3	504.2	–	3.4	6,081.9
United States	–	141.1	–	–	141.1
Netherlands	–	–	9.0	–	9.0
Switzerland	–	22.0	–	–	22.0
Ireland	–	–	8.8	–	8.8
Cayman Islands	–	–	19.1	–	19.1
France	–	32.2	–	–	32.2
Canada	–	4.2	–	–	4.2
Denmark	–	0.4	–	–	0.4
Australia	–	0.7	–	–	0.7
Germany	–	1.5	–	–	1.5
Belgium	–	0.1	–	–	0.1
Spain	–	0.5	–	–	0.5
Total	5,574.3	706.9	36.9	3.4	6,321.5

[1] Country risk exposures for structured and RMBS are based on the country of origination for the asset.

38. Wholesale Credit Risk continued...

The Group's only Sovereign exposure is to the UK which has an average external rating of 'AA+'. At the year end, UK Sovereign exposure was £5,146m (2015 – £5,345m) to the Bank of England and £560m (2015 – £229m) in UK Government bonds. The largest exposure to a single institution (other than the UK Government) was £319m (2015 – £223m) in both instances to a UK clearing bank.

None of the wholesale exposures is either past due or impaired and there are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

The key trigger events used to evaluate impairments are set out in Note 1 on page 110.

In addition to the above direct exposures the Group regularly monitors indirect exposures (the primary exposures of our counterparties) to establish whether any second order concentration risks exist. This is performed on a best efforts basis given the inconsistency and timings of information that exists in the public domain with regards to this information.

Wholesale credit risk is recorded in the following Statement of Financial Position captions:

	2016 £m	2015 £m
Cash in hand and balances with the Bank of England	**3,525.0**	3,439.3
Loans and advances to credit institutions	**542.8**	695.9
Debt securities	**608.1**	269.5
Derivative financial instruments	**540.5**	180.1
Investments[1]	**10.3**	1.4
Total wholesale credit risk	**5,226.7**	4,586.2

Debt securities, which are shown after fair value and impairment adjustments, can be further analysed as:

	2016 £m	2015 £m
UK Government securities	**560.5**	229.2
Medium-term notes issued by financial institutions	**3.5**	3.3
Combination note[2]	**7.6**	9.1
Synthetic collateralised debt obligations[3]	**36.5**	27.9
	608.1	269.5

[1] Principally an equity investment in VocaLink Holdings Limited, which is associated with the Group's operation of cash machines, and Preference shares in Visa Inc, in part consideration for a previous shareholding in Visa Europe following their acquisition by Visa Inc in June 2016.

[2] The combination note continues to pay contractual coupons with no evidence of impairment. Changes in fair value are taken directly to the Income Statement.

[3] There are two holdings in synthetic credit investments. These contain embedded derivatives that have been separated with changes in fair value being taken directly to the Income Statement.

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers

Credit risk management

The Group articulates its tolerance for credit risk through a series of risk appetite statements. These statements are supported by a number of qualitative and quantitative measures that are monitored closely by the Group Risk function and reported monthly to the Group's credit risk committees. Further challenge and oversight is provided by the Group Risk Committee which reviews credit risk reporting as part of their quarterly meetings.

The Group's exposure to credit risk on loans and advances to customers can be broken down as follows:

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Retail mortgages	**33,134.0**	32,592.6	**16,629.8**	17,325.7
Commercial lending	**1,057.6**	896.6	**1,054.9**	893.4
Unsecured lending	**3.0**	4.1	**3.0**	4.1
Total gross exposure (contractual amounts)	**34,194.6**	33,493.3	**17,687.7**	18,223.2
Impairment, fair value, EIR and hedging adjustments	**(91.3)**	(171.6)	**(83.6)**	(146.5)
Total net exposure	**34,103.3**	33,321.7	**17,604.1**	18,076.7

Retail mortgages

The Group's exposure to mortgage related credit risk is monitored closely by the Credit Risk area. Reporting on risk exposures is provided monthly to the Retail and Commercial Credit Committee. Reports include analysis of the movement of loans into arrears and between arrears bands by differing loan portfolios, as well as monitoring of the overall characteristics of the loan portfolios (e.g. geographic location, indexed loan-to-value concentrations and affordability metrics). In addition, the Group undertakes a number of stress tests periodically that subject the mortgage portfolios to different levels of default, house price deflation and other factors to identify the potential loan losses under the different economic conditions represented by those stress tests.

At an operational level, adherence to the Group's retail credit risk appetite is supported through the use of a suite of tools used in activities such as credit decisioning, portfolio management and arrears management.

Geographic distribution of retail mortgage balances	**2016 %**	2015 %
Scotland	**6.5**	6.6
North East	**3.6**	3.5
Yorkshire & Humberside	**9.1**	9.4
North West	**9.1**	8.9
Midlands	**10.7**	10.0
East of England	**4.4**	4.3
South West	**7.0**	7.0
Greater London	**20.8**	21.4
South East	**24.9**	25.0
Wales & Northern Ireland	**3.8**	3.8
Non-UK	**0.1**	0.1
	100.0	100.0

39. Credit Risk on Loans and Advances to Customers continued...

Substantially all retail mortgage balances are secured on property. As part of the portfolio monitoring process, these properties are subject to regular updates in respect of their loan–to-value by way of an indexation process. This is applied to provide some measure of relative house price movements across the UK and their impact on the relative property values. Although the indexation approach is very broad, typically at the regional level, it is an industry standard for providing senior management with a view as to the value and risk of the properties on which retail mortgages are secured.

Loan-to-value distribution of retail mortgage balances

	Book		**New Lending**	
	2016 %	2015 %	**2016 %**	2015 %
Greater than 100%	**0.3**	0.6	**–**	–
90 to 100%	**1.5**	1.9	**4.2**	2.7
75% to 90%	**14.9**	17.2	**39.3**	37.8
50% to 75%	**49.4**	51.4	**46.5**	49.1
Less than 50%	**33.9**	28.9	**10.0**	10.4
	100.0	100.0	**100.0**	100.0

The average indexed loan-to-value, based on a simple average of each loan's indexed loan–to-value, is 48.0% (2015 – 49.5%).

Loan-to-value distribution of retail mortgage balances

	2016		2015	
	Not individually impaired %	**Individually impaired %**	Not individually impaired %	Individually impaired %
Greater than 100%	**0.3**	**0.1**	0.5	0.1
90% to 100%	**1.5**	**0.1**	1.7	0.2
75% to 90%	**14.7**	**0.2**	16.9	0.3
50% to 75%	**49.1**	**0.2**	50.9	0.5
Less than 50%	**33.7**	**0.1**	28.7	0.2
	99.3	**0.7**	98.7	1.3

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

Retail mortgage customer type

	Book		New Lending	
	2016 %	2015 %	**2016 %**	2015 %
First time buyer	**19.2**	19.6	**19.5**	20.7
Other buyers e.g. movers	**40.1**	41.7	**33.9**	37.9
Remortgage	**30.4**	29.4	**34.6**	28.8
Buy-to-let	**10.3**	9.3	**12.0**	12.6
	100.0	100.0	**100.0**	100.0

Retail mortgage arrears

	Group		Society	
	2016 %	2015 %	**2016 %**	2015 %
Arrears outstanding as a percentage of debt				
No arrears	**96.9**	96.4	**96.8**	96.1
Less than three months	**2.4**	2.7	**2.5**	3.0
Three months or more	**0.7**	0.8	**0.7**	0.8
Property in possession	**–**	0.1	**–**	0.1
	100.0	100.0	**100.0**	100.0
Number of properties in possession at the year end	**92**	126	**53**	72

The percentage of retail mortgages with arrears of three months or more (as a % of outstanding balances, including possessions) has fallen during 2016 from 0.89% to 0.68%. The Council of Mortgage Lending (CML) industry average ratio for mortgage arrears is measured using the number of accounts (including possessions). On this basis, the Group's retail mortgage arrears ratio 0.76% (2015 – 0.96%) is below the comparable CML ratio (1.03%, 2015 – 1.20%). Arrears on more recent lending are minimal, reflecting the Group's credit risk appetite.

39. Credit Risk on Loans and Advances to Customers continued...

Commercial lending

Commercial lending credit risk exposures are monitored by Group Risk and reported to the Retail and Commercial Credit Committee. Reporting includes analysis of book growth, sector distribution of book, geographic distribution, loan-to-value analysis and the movement of loans into arrears and between arrears bands. Loans against specialist properties are strictly limited and we do not lend against land only. The Group assesses whether current valuations are appropriate by re-valuing properties periodically using third party valuation data which takes into account the property type and geographical location. Third party valuation data is also used to assess the risk of loss on individual loans and to monitor whether loan-to-value covenants are met. Where borrowers are more than two months in arrears, consideration is given to obtaining a professional valuation of the property.

At 31 December 2016 the Group had a commercial lending book (including lending to housing associations on residential properties) of £1,058m. The Group originates commercial lending via its N&P brand, providing loans to commercial owner occupiers, commercial and residential property landlords (where the borrower is a corporate entity) and a small number of housing associations. The N&P commercial loan portfolio, which comprises 67.2% (2015 – 64.9%) of the total commercial lending book, is managed by a specialist team using a combination of lending policy rules, underwriting and close relationship management to assess new applicants and manage existing loans. The majority of loans are advanced against commercial properties using a vacant possession valuation to mitigate against future losses.

This proactive approach to account management has resulted in only 0.29% of N&P commercial accounts being more than three months in arrears (as a % of outstanding balances, including repossessions) as at the year end (2015 – 0.34%). While arrears and losses to date have been low, as part of the merger all acquired N&P commercial loans were subject to a fair value adjustment to reflect likely future losses on the portfolio.

We have a small closed commercial loan book which arose from the merger with Chelsea Building Society. The book is in run off and we do not write any new commercial business under the Chelsea brand. At 31 December 2016 there were four loans remaining with outstanding balances totalling £18.7m (2015 – £18.9m). All loans are performing and are covenant compliant.

In addition to the N&P commercial lending book, we have an active business lending to housing associations, in England and Wales, via the Yorkshire Building Society brand, properly known as 'Registered Providers'. This sector has particularly robust credit characteristics and the lending is low risk albeit at low margins. We have an opportunistic approach to attracting new business, within the constraints of a Board approved risk appetite, and do so when returns and capital efficiency contribute to financial sustainability. At 31 December 2016 the loan book was £327.9m (2015 – £296.2m). We have written further term loan facilities in the region of £120.0m (2015 – £156.0m) and these will draw down over the next two to three years.

The Group commercial loan portfolio (including lending to housing associations) is spread throughout the UK as follows:

Geographic distribution of commercial mortgage balances

	2016 %	2015 %
Scotland	**0.0**	0.0
North East	**1.4**	1.4
Yorkshire & Humberside	**2.7**	2.6
North West	**11.0**	10.5
Midlands	**6.5**	6.6
East of England	**3.3**	4.1
South West	**4.0**	4.7
Greater London	**28.1**	24.4
South East	**34.8**	36.7
Wales	**8.2**	9.0
	100.0	100.0

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

N&P commercial mortgages by customer type

	2016 %	2015 %
Housing associations	**2.0**	2.9
Buy-to-let	**33.4**	25.3
Commercial mortgages	**64.6**	71.8
	100.0	100.0

N&P commercial mortgages by property type

	2016 %	2015 %
Office	**53.2**	46.8
Industrial	**5.4**	6.6
Retail and leisure	**25.1**	24.6
Housing Associations	**1.6**	2.9
Other, including mixed use	**14.7**	19.1
	100.0	100.0

The average loan-to-value of the N&P commercial loan portfolio is 54.3% (2015 – 51.7%). The loan-to-value calculation has been undertaken using a combination of external professional valuations and indexation of the original valuation using data from the Investment Property Databank (IPD). IPD provides performance measurement services in the UK and Ireland. N&P commercial BTL and social housing mortgages are indexed using Halifax adjusted HPIs.

The total value of the security held against N&P commercial loans is estimated to be £1,467m (2015 – £1,297m). £14.6m of the N&P exposures have an estimated LTV of greater than 100% (2015 – £13.8m). Of these, loans totalling £1.0m are in arrears. The largest N&P exposure to a single counterparty at 31 December 2016 is £12.3m (2015 – £8.0m).

Loans monitored on the "watch list" include those where there are circumstances which could impact on the quality and safety of the loan. Examples include borrowers requesting forbearance (such as changing loan repayments to interest only for a period), or reporting trading losses. Loans on the watch list total £9.3m (2015 – £8.5m). Our appetite and approach to the provision of commercial lending is to provide amortising term loans, typically over 10 – 25 years. We do not provide short-term, interest only facilities which require repayment on expiry through refinance. Where a period of interest only is agreed, it will be for a short period following which the loan will be structured to amortise over the remaining term. Buy-to-let loans are mainly interest only (N&P BTL £237.8m, 2015 – £146.5m). These loans are continuously monitored to ensure that full repayment is made on the expiry of the loan term.

39. Credit Risk on Loans and Advances to Customers continued...

N&P commercial mortgage arrears

	2016 %	2015 %
Arrears outstanding as a percentage of debt		
No arrears	**99.3**	98.9
Less than three months	**0.4**	0.7
Three months or more	**0.2**	0.3
Property in possession	**0.1**	0.1
	100.0	100.0

Unsecured lending

The group has unsecured lending portfolios consisting of current accounts and personal loan portfolio, via its N&P brand. The Group has recently announced its intention to close its N&P current accounts to existing customers, and withdraw the N&P brand from the high street over the next year. As at 31 December 2016 unsecured lending balances stood at £3.0m (current account overdrafts of £1.5m, personal loans of £1.5m). Within the Group, unsecured lending is managed by the Credit Risk area within Group Risk, with monthly reporting provided to the Retail and Commercial Credit Committee. Reporting includes analysis of accounts in arrears and overdraft limits.

Current account overdrafts are assessed and managed using a combination of statistical credit models, lending policy rules and underwriting, with all overdraft limits reviewed on at least a monthly basis. Accounts are monitored closely for early signs of distress and advice offered to customers where deemed appropriate. Customers who are unable to repay overdrafts when due are passed to the Collections department who review individual customer circumstances before deciding what appropriate action to take. As at 31 December 2016, accounts that have been in excess of their agreed overdraft for three or more consecutive months stood at 0.8% of the portfolio by volume (2015 – 1.1%).

The personal loan portfolio is currently in run-off. Customers who are unable to repay personal loans are passed to the Collections department who review individual customer circumstances before deciding what appropriate action to take. As at 31 December 2016, accounts which were within term and three or more months in arrears stood at 81.0% of the portfolio by volume (2015 – 52.9%). The 2015 comparatives have been revised to reflect the change in criteria of personal loan accounts classed as default and therefore included in 3+ months in arrears.

At the point of merger, as with all N&P loan books, a fair value adjustment was applied against all unsecured lending.

Impairment

All loans (retail mortgage, commercial and unsecured) are reviewed at each reporting date for indications of impairment.

The following table shows as at the year end, impairment on the overall loan balances as well as a prudent assessment of collateral held against total loans and advances. The collateral is calculated as the lower of the value of the property and the outstanding loan amount. It is not the overall value of properties secured against the loans.

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

	Loans and advances		Collateral	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Group				
Not individually impaired:				
Neither past due nor individually impaired	**33,140.1**	32,291.4	**33,127.0**	32,282.8
Past due but not individually impaired	**819.8**	757.7	**818.5**	759.8
Individually impaired	**234.7**	444.2	**220.9**	421.3
Total loans and advances	**34,194.6**	33,493.3	**34,166.4**	33,463.9
Society				
Not individually impaired:				
Neither past due nor individually impaired	**17,144.8**	17,530.6	**17,139.1**	17,533.2
Past due but not individually impaired	**430.2**	458.2	**430.0**	461.2
Individually impaired	**112.7**	234.4	**102.7**	216.0
Total loans and advances	**17,687.7**	18,223.2	**17,671.8**	18,210.4

The loans and advances shown above exclude effective interest rate adjustments and credit loss fair values and therefore do not tie through directly to Note 16.

Impairment is assessed based on the arrears of each loan. Where retail or commercial mortgages are in arrears by three months or more, they are individually assessed for impairment. In previous years, loans were regarded as individually impaired if they were in arrears by two months or more. The Group has changed its impairment approach during 2016 in order to align with others in the industry. This change did not have a material impact on the group's overall impairment provision.

Commercial loans less than three months in arrears (2015 – two months in arrears) are also individually impaired where other qualitative factors suggest a measureable decrease in the present value of their future cash flows, i.e. where they are included on the watch list as noted previously. Where retail or commercial mortgages are less than three months in arrears they are assessed for collective impairment.

Loans acquired on the merger with Chelsea in 2010 and Norwich & Peterborough in 2011 were measured at fair value on acquisition, which makes allowances for expected losses over the remaining life of the loans. Any further losses from the past due loans totalling £379.1m at 31 December 2016 (2015 – £472.0m), are unlikely to be significant to the Group.

Note 1 on page 110 describes the Group's approach to impairment provisioning and the key factors used in the calculation. The key model assumptions underpinning the current mortgage impairment provisions (shown in Note 9) are forecast house price inflation/(deflation), probability of possession, emergence period, loss given possession and forced sale discount.

Personal loans are individually assessed for impairment where they are more than one month in arrears and assessed for collective impairment if they are one month or less in arrears. Current accounts with overdraft facilities are assessed for impairment on a collective basis and the estimation of future losses takes into account historic experience.

39. Credit Risk on Loans and Advances to Customers continued...

Forbearance

The Group uses forbearance tools where they are deemed appropriate for an individual customer's circumstances, in line with industry guidance. Forbearance tools, which the Group may offer, include capitalisation, interest only concessions, arrears arrangements, direct debit suspension and term extensions. The use of account management tools are either fully recognised within provisioning or are low in materiality.

The disclosure of balances subject to forbearance measures has been revised to align with the guidance provided by the European Banking Authority for FINREP reporting whereby mortgage balances are included until a probation period of two years has elapsed from the date the account was again considered to be performing. This is a change from the prior year where the disclosure included mortgage balances subject to some form of forbearance during the prior 12 months totalling £417.5m. During 2016 the position with regards to arrears and the consequent need for extending forbearance measures to customers has shown a noticeable improvement such that the increase in balances disclosed as being subject to forbearance relates only to the change in the basis of preparation.

The analysis below sets out a total of £1,558.3m (2015 – £417.5m) mortgage balances which have been subject to some form of forbearance during the past two years. Had the analysis been prepared in a comparable manner in 2015, £1,631.6m of mortgage balances would have been disclosed as subject to some form of forbearance. Balances totalling £181.2m (2015 – £232.3m) are more than three months in arrears (2015 – two months in arrears) and therefore fall within the Group's individual provision calculation. The remaining £1,377.1m (2015 – £185.2m) are covered by the Group's collective provision through the assumptions surrounding the emergence period. There is nothing in the forbearance data to suggest that the impairment provisioning methodology or assumptions do not provide adequate cover in respect of lending which is subject to forbearance.

Forbearance is included in mortgage provisions in the same way as any other debt, with that which is more than three months in arrears being recorded as impaired, and that which is less than or equal to three months (2015 – two months) being collectively assessed. If it were all to be incorporated as impaired the increase to the mortgage provision of £45.0m would be less than £1.0m (2015 – increase from £48.9m would be less than £0.1m).

	Arrears arrangements £m	Other concessions £m	Term extension £m	Interest only £m	Capitalisation £m	Total £m
Gross carrying amount						
Neither past due nor individually impaired	359.7	180.5	493.9	9.5	2.6	**1,046.2**
Past due but not individually impaired:						
Less than one month	105.7	2.3	4.2	0.3	0.5	**113.0**
One to three months	212.0	3.4	2.4	0.1	–	**217.9**
	677.4	**186.2**	**500.5**	**9.9**	**3.1**	**1,377.1**
Impaired:						
Three to six months	106.8	0.7	0.2	–	–	**107.7**
Six to 12 months	51.1	0.4	0.3	0.1	–	**51.9**
12 months or over	15.3	–	–	–	–	**15.3**
Property in possession	6.2	0.1	–	–	–	**6.3**
	856.8	**187.4**	**501.0**	**10.0**	**3.1**	**1,558.3**

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

Arrears arrangements include positive and negative arrears arrangements. A positive arrears arrangement is one where the customer's regular monthly repayment is in excess of their contractual repayment amount in order to reduce their arrears. A negative arrears arrangement is one where an agreement is in place, due to the borrower's circumstances, that allows the customer to repay less than their contractual repayment amount for a short period. In this circumstance interest will continue to accrue on the unpaid amounts. Other concessions include the suspension of direct debits.

All requests for forbearance on commercial loans are subject to full credit risk appraisal and are predominately for a period of interest only which allows the borrower to improve income from trading or rent receipts, or pending the sale of the property. The appraisal process considers the likelihood of a loss being sustained from any borrower granted a concession and ensures that the concession is in the interests of both the borrower and the Group. In 2016 there are 16 accounts in the N&P commercial loans portfolio totalling £2.5m with an interest only concession (2015 – 17 accounts totalling £2.6m).

40. Fair Values

Fair value is the price that would be received to sell an asset or the price paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Where external market prices are available they have been used to determine fair value. Otherwise, internal pricing models using external market data have been used. The Group measures fair value using the following fair value hierarchy:

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

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The table below summarises the carrying value and fair value of financial assets and liabilities measured at amortised cost as at the Statement of Financial Position date.

	Carrying Value £m	Fair Values Level 1 £m	Level 2 £m	Level 3 £m	Total Fair Value £m
Group					
At 31 December 2016					
Assets					
Cash in hand and balances with the Bank of England	**3,525.0**	–	**3,525.0**	–	**3,525.0**
Loans and advances to credit institutions	**542.8**	–	**542.8**	–	**542.8**
Loans and advances to customers	**34,103.3**	–	**34,698.9**	–	**34,698.9**
Liabilities					
Shares	**28,693.2**	–	**28,641.2**	–	**28,641.2**
Amounts due to credit institutions	**3,120.8**	–	**3,120.8**	–	**3,120.8**
Other deposits	**434.7**	–	**434.7**	–	**434.7**
Debt securities in issue	**4,361.4**	–	**4,421.8**	–	**4,421.8**
Subordinated liabilities	**297.0**	–	**305.1**	–	**305.1**
Subscribed capital	**6.7**	–	**6.0**	–	**6.0**

Notes to the Accounts continued...

40. Fair Values continued...

	Carrying Value £m	Level 1 £m	Fair Values Level 2 £m	Level 3 £m	Total Fair Value £m
Society					
At 31 December 2016					
Assets					
Cash in hand and balances with the Bank of England	3,525.0	–	3,525.0	–	3,525.0
Loans and advances to credit institutions	257.2	–	257.2	–	257.2
Loans and advances to customers	17,604.1	–	17,894.0	–	17,894.0
Liabilities					
Shares	28,693.2	–	28,641.2	–	28,641.2
Amounts due to credit institutions	3,111.4	–	3,111.4	–	3,111.4
Other deposits	6,898.8	–	6,898.8	–	6,898.8
Debt securities in issue	3,706.8	–	3,764.1	–	3,764.1
Subordinated liabilities	297.0	–	305.1	–	305.1
Subscribed capital	6.7	–	6.0	–	6.0

40. Fair Values continued...

	Carrying Value £m	Level 1 £m	Fair Values Level 2 £m	Level 3 £m	Total Fair Value £m
Group At 31 December 2015					
Assets					
Cash in hand and balances with the Bank of England	3,439.3	–	3,439.3	–	3,439.3
Loans and advances to credit institutions	695.9	–	695.9	–	695.9
Loans and advances to customers	33,321.7	–	33,868.4	–	33,868.4
Liabilities					
Shares	27,396.4	–	27,374.3	–	27,374.3
Amounts due to credit institutions	3,302.4	–	3,302.4	–	3,302.4
Other deposits	544.3	–	544.3	–	544.3
Debt securities in issue	4,108.8	–	4,125.6	–	4,125.6
Subordinated liabilities	286.1	–	301.5	–	301.5
Subscribed capital	6.7	–	5.8	–	5.8
Society At 31 December 2015					
Assets					
Cash in hand and balances with the Bank of England	3,439.3	–	3,439.3	–	3,439.3
Loans and advances to credit institutions	270.3	–	270.3	–	270.3
Loans and advances to customers	18,076.7	–	18,377.2	–	18,377.2
Liabilities					
Shares	27,396.4	–	27,374.3	–	27,374.3
Amounts due to credit institutions	3,293.0	–	3,293.0	–	3,293.0
Other deposits	6,442.9	–	6,442.9	–	6,442.9
Debt securities in issue	3,447.5	–	3,464.7	–	3,464.7
Subordinated liabilities	286.1	–	301.5	–	301.5
Subscribed capital	6.7	–	5.8	–	5.8

Notes to the Accounts continued...

40. Fair Values continued...

The fair values of all cash in hand, balances with the Bank of England and loans and advances to credit institutions have been recorded at par as they are all due in under one year and there is no impairment.

The fair value of loans and advances to customers uses a Level 2 method and is assessed as the value of the expected future cash flows. Future cash flows are projected using contractual interest payments, contractual repayments and the expected prepayment behaviour of borrowers. Prudent assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The resulting expected future cash flows are discounted at current market rates to determine fair value. Overall the fair value is higher than the carrying value by £595.6m (2015 – £546.7m), which arises primarily due to the product rates being above prevailing market rates.

All of the Group's financial liabilities are initially recorded at fair value less directly attributable costs and are subsequently measured at amortised cost other than derivative financial instruments or where an adjustment is made to certain fixed rate shares balances that are in hedging relationships. The fair value of shares and deposits that are available on demand approximates to the carrying value. The fair value of fixed term shares and deposits is determined from the projected future cash flows from those deposits, discounted at the current market rates. In 2016, the estimated fair value of share balances, using a Level 2 method is now lower than the carrying value by £52.0m (2015 – £22.1m), which arises primarily due to the product rates being above prevailing market rates.

The fair value of debt securities, subordinated liabilities and subscribed capital are calculated using a Level 2 method based on observable market prices. The fair value of subordinated liabilities is higher than carrying value by £8.1m which arises primarily due to the interest rates on the notes being significantly below prevailing market rates.

The table on page 175 classifies all financial instruments held at fair value on the face of the Group's Statement of Financial Position according to the method used to establish the fair value.

40. Fair Values continued...

	Level 1 £m	Fair Values Level 2 £m	Level 3 £m	Total Fair Value £m
Group At 31 December 2016				
Assets				
Debt securities – fair value	**–**	**–**	**7.6**	**7.6**
Embedded derivatives	**–**	**–**	**(8.9)**	**(8.9)**
Debt securities – available for sale	**560.5**	**3.5**	**45.4**	**609.4**
Debt securities – held to maturity	**–**	**–**	**–**	**–**
Derivative financial instruments	**–**	**486.6**	**53.9**	**540.5**
Investments	**–**	**–**	**10.3**	**10.3**
Liabilities				
Derivative financial instruments	**–**	**329.8**	**18.2**	**348.0**
Group At 31 December 2015				
Assets				
Debt securities – fair value	–	9.1	–	9.1
Embedded derivatives	–	(9.8)	–	(9.8)
Debt securities – available for sale	229.2	41.0	–	270.2
Debt securities – held to maturity	–	–	–	–
Derivative financial instruments	–	180.1	–	180.1
Investments	–	–	1.4	1.4
Liabilities				
Derivative financial instruments	–	340.9	–	340.9

Notes to the Accounts continued...

40. Fair Values continued...

The Group's Level 1 portfolio of available for sale debt securities comprises liquid securities for which traded prices are readily available.

Level 3 assets and liabilities are comprised of structured investments, interest rate swaps, equity index swaps and embedded derivatives within issued equity linked deposits. The derivatives and embedded derivatives have been transferred from Level 2 to Level 3 during 2016 following reassessment of the significance of the prepayment rate on the underlying mortgages and savings. The changes in the fair value of these instruments from movements in level 3 parameters related to prepayment risk will largely offset across the interest rate swaps, equity index swaps and embedded derivatives as the Group is hedged across these positions. Sensitivity analysis to the individual level 3 parameters has not been disclosed on the basis that the Group does not have a significant exposure to these.

The Group's £44m of level 3 debt securities at 31 December 2016 comprise investments in collateralised debt obligations (CDOs), of which £36m is due to mature in 2017. During 2016, there has been a £7m gain recorded in the Income Statement on these investments as a result of exchange rate movements and an increase in the amount expected to be recovered by investors at maturity. Valuations are obtained from third party brokers in order to determine the fair value as there is no active market for these investments. If the Group were to look to sell the investments, it is uncertain whether the proceeds received would be £44m. A 10% increase/(decrease) in the valuation would lead to a £4.4m gain/(loss) in the Income Statement.

Fair values of derivative financial instruments are disaggregated further in Note 34.

41. Related Parties

Identity of related parties

The Group and Society have related party relationships with their subsidiaries, joint venture, the pension schemes and key management personnel. The Group considers its key management personnel to be its directors.

Contributions to the pension scheme

The Society paid contributions of £24.0m to the pension scheme (2015 – £23.8m).

Key management compensation

The key management personnel compensations are as follows:

	No. of key management personnel	**2016 £000**	No. of key management personnel	2015 £000
Short-term employee benefits		**2,738**		2,600
Post employment benefits		**6**		120
Total key management personnel compensation	**15**	**2,744**	15	2,720

Key management compensation in 2016 includes amounts paid to key management personnel who both retired and joined the Society during 2016. The number of key management personnel at 31 December 2016 totalled 11.

As explained in the Directors' Remuneration Report on pages 79 to 93, the disclosure of bonuses has been changed, in line with best practice, to show the total earned in the reporting year irrespective of deferral arrangements. Therefore the total directors' remuneration for 2015 has been recalculated to reflect this. In addition, the 2015 total for "Post-employment benefits" includes a revalued figure in relation to the increase in the accrued pension of one director, who left the Direct Benefits scheme, on its closure, at the end of 2015. This figure has been restated to reflect a value of £80,000, in line with best practice, instead of the absolute increase in accrued pension (£4,000) which was originally included in the 2015 disclosures.

Transactions with key management personnel

Key management personnel and their close family members have undertaken the following transactions with the Society under normal business terms.

	No. of key management personnel 2016	**Amounts in respect of key management personnel and their close family members* 2016 £000**	No. of key management personnel 2015	Amounts in respect of key management personnel and their close family members* 2015 £000
Mortgage loans				
At 1 January		**460**		355
Net movements in the year		**218**		105
At 31 December	**3**	**678**	2	460
Deposit accounts and investments				
At 1 January		**611**		667
Net movements in the year		**137**		(56)
At 31 December	**11**	**748**	11	611

* Net movements in the year include amounts relating to directors who joined or left the Society during 2016.

Notes to the Accounts continued...

41. Related Parties continued...

Mortgage loans made to key management personnel and their close family members were granted in the ordinary course of business and are subject to repayment under normal lending terms. The maximum outstanding balances during the year were £716,310 (2015 – £605,810).

Amounts deposited by key management personnel and their close family members earn interest at the same rates offered to the public.

Key management personnel and their close family members paid interest totalling £2,935 (2015 – £2,246), received interest totalling £3,562 (2015 – £4,262), and paid no fees and commissions during the year. Interest paid includes amounts relating to 'offset' mortgages where savings balances are used to reduce the interest bearing balance of mortgage loans.

Transactions with subsidiaries

The Society enters into a number of transactions with its subsidiaries in the normal course of business. These include loans and shares. The value of related party transactions, outstanding balances at the year end and related income and expense for the financial year are as follows:

	2016 £m	2015 £m
Shares in subsidiaries		
At 1 January	**105.8**	105.8
Net movements	**(0.8)**	–
At 31 December	**105.0**	105.8
Loans to subsidiaries		
At 1 January	**16,655.0**	14,299.3
Net movements	**1,193.9**	2,355.7
At 31 December	**17,848.9**	16,655.0
Deposits from subsidiaries		
At 1 January	**6,187.5**	5,562.9
Net movements	**546.3**	624.6
At 31 December	**6,733.8**	6,187.5
Interest receivable on loans	**411.7**	455.4
Interest payable on deposits	**(69.3)**	(77.2)
Fees and expenses receivable	**44.2**	42.0
Fees and expenses payable	**–**	(0.2)

41. Related Parties continued...

Transactions with joint venture

The outstanding investment in MutualPlus Ltd at 31 December 2016 and 31 December 2015 was £0.3m. MutualPlus Ltd was placed into Members' Voluntary Liquidation on 15 December 2016.

Other

The Society has an investment in Arkose Funding Limited. In 2014, a loan of £4.0m to Arkose Funding Limited was fully impaired.

Subsequent to Alison Hutchinson's appointment to the Society's Board as a Non-executive director in February 2015, the acquisition of the Friends Life business by Aviva created a related party relationship with Sesame Bankhall Group Limited (SBG) as Mrs Hutchinson is a non-executive director of an indirect parent company of SBG, Aviva Life Holdings UK Limited. SBG is a lending partner of Accord Mortgages Limited, a subsidiary of the Society and from November 2016 SBG became a Lead Panel Valuer for the Group. In 2016 Accord Mortgages Limited paid commission of £2.9m to SBG, in relation to lending completed via their network of independent financial advisers. As at 31 December 2016 an amount of £0.8m is outstanding between the two companies relating to fees for property valuation reports in respect of mortgage applications. Transactions are made on an arm's length basis.

The Group also has a related party relationship with Aviva Insurance Limited, as Mark Pain, Vice Chairman, is a non-executive director of this company. The Group historically sold insurance products provided by Aviva Insurance Limited. The income from these sales in 2016 was £0.2m.

In January 2016, Willis Group merged with Towers Watson creating a related party relationship as David Paige, Non-executive director, was a non-executive director of Willis Limited, part of the Willis Tower Watson Group until his retirement from that company on 30 December 2016. Willis Towers Watson (WTW) are the corporate advisors to the Society on pension matters, providing independent advice on pension risk, pension accounting and ICAAP. A separate team in WTW are the Society Pension Scheme advisors. £1.1m was paid by the Society and Trustees relating to pension services provided by WTW.

Notes to the Accounts continued...

42. Cash Flows from Other Operating Activities

	Group		Society	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Working capital adjustments:				
Depreciation and amortisation	**22.7**	22.9	**22.7**	22.9
(Profit)/loss on sale of assets	**(11.8)**	0.4	**(11.8)**	0.4
Interest on subordinated liabilities and subscribed capital	**16.0**	16.2	**16.0**	16.2
Provisions	**17.1**	28.8	**15.9**	14.2
Fair value of subordinated liabilities and subscribed capital	**10.9**	(3.6)	**10.9**	(3.6)
Loss on realisation of debt securities	**(1.8)**	(2.1)	**(1.8)**	(2.1)
Increase in other assets	**(9.5)**	(3.7)	**(7.1)**	(5.4)
Decrease in other liabilities	**(36.6)**	(32.3)	**(38.0)**	(32.1)
Working capital adjustments	**7.0**	26.6	**6.8**	10.5
(Increase)/decrease in operating assets:				
Loans and advances to customers	**(781.7)**	(1,100.4)	**474.0**	393.1
Investments	**(8.9)**	–	**(1,202.3)**	(2,354.3)
Derivative financial instruments	**23.8**	(119.8)	**209.1**	(138.4)
Net increase in operating assets	**(766.8)**	(1,220.2)	**(519.2)**	(2,099.6)
Increase/(decrease) in operating liabilities:				
Shares	**1,296.8**	155.0	**1,296.8**	155.0
Amounts owed to credit institutions	**(181.6)**	(168.9)	**(181.6)**	(178.3)
Other deposits	**(109.6)**	36.3	**455.9**	654.0
Net increase in operating liabilities	**1,005.6**	22.4	**1,571.1**	630.7

Annual Business Statement

1. Statutory Percentages

	2016 %	Statutory Limit %
Lending limit	**3.1**	25.0
Funding limit	**21.6**	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986.

The Lending limit measures the proportion of business assets not in the form of loans fully secured on residential property.

The Funding limit measures the proportion of shares and borrowings not in the form of shares.

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 and borrowings:		
Gross capital	**6.90**	6.78
Free capital	**6.50**	6.33
Liquid assets	**12.77**	12.46
Profit after taxation for the financial year as a percentage of mean total assets	**0.29**	0.37
Management expenses as a percentage of mean total assets	**0.89**	0.91

The above percentages have been prepared from the Group accounts and in particular:

- 'Shares and borrowings' represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.
- 'Gross capital' represents the aggregate of general reserve, hedging reserve, available for sale reserve, subordinated liabilities and subscribed capital.
- 'Free capital' represents the aggregate of gross capital and collective impairment provision less property, plant and equipment, intangible assets and investment properties.
- 'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

Annual Business Statement continued...

3. Information Relating to the Directors at 31 December 2016

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
J. R. Heaps, LLB 8 July 1953	Chairman	20 November 2014	The Garden Bridge Trust
K. M. Barker, DBE, CBE 29 November 1957	Economist	5 November 2010	Coal Pension Trustee Services Ltd Coal Staff Superannuation Scheme Trustees Ltd Essex Community Foundation Society of Business Economists Taylor Wimpey Plc
R. J. Churchouse, MA, ACA 16 January 1966	Finance Director	1 June 2010	Arkose Funding Ltd BCS Loans and Mortgages Ltd Chelsea Mortgage Services Ltd Mutual Plus Ltd Norwich and Peterborough General Insurance Services Ltd Norwich and Peterborough Insurance Brokers Ltd Norwich and Peterborough Insurance Services Ltd Norwich and Peterborough Sharedealing Services Ltd YBS Investments (No. 1) Ltd YBS Investments (No. 2) Ltd Yorkshire Key Services Ltd Yorkshire Key Services (No. 2) Ltd
A. E. Hutchinson, CBE, BSc 5 February 1967	Charity Chief Executive	4 February 2015	Aviva Life Holdings UK Ltd Aviva Annuity UK Ltd Aviva Life & Pensions UK Ltd Aviva Life Services UK Ltd Friends Life and Pensions Ltd Friends Life Ltd Friends Life Services Ltd Your Penny Ltd
G. R. Ireland, BSc, FCA 17 May 1953	Non-executive Director	1 September 2015	Aspen Insurance Holdings Ltd Aspen Insurance UK Ltd Iccaria Insurance ICC Ltd
D. V. Paige, BSc, FCA 3 July 1951	Non-executive Director	31 December 2006	IFG Group Plc

3. Information Relating to the Directors at 31 December 2016 continued...

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
M. A. Pain, BSc, FCA 15 June 1961	Non-executive Director	1 August 2013	Aviva Insurance Ltd London Square Developments (Holdings) Ltd Ladbrokes Coral Group Plc LSQ Management Ltd Somerset House Enterprises Ltd Somerset House Trust
G. P. C. Parsons, BA 31 July 1963	Company Director	1 May 2013	EasyHotel Plc EasyHotel UK Ltd
C. J. Pilling, MA 30 March 1965	Chief Executive Officer	31 December 2011	The Department of Health
M. C. Regnier, MEng, MBA 30 September 1971	Chief Customer Officer and Executive Director	3 June 2014	Accord Mortgages Ltd BCS Loans and Mortgages Ltd
S. C. White, BComm 4 April 1971	Chief Operating Officer and Executive Director	24 February 2016	Norwich and Peterborough (LP) Ltd YBS Properties (Edinburgh) Ltd YBS Properties Ltd YBS Properties (York) Ltd Yorkshire Key Services Ltd Yorkshire Key Services (No. 2) Ltd

The standard contractual notice period for all executive directors is one year. Mr R. J. Churchouse entered into a renegotiated contract in 2009, Mr C. J. Pilling entered into a contract on 31 December 2011 (but resigned on 31 December 2016), Mr M. C. Regnier entered into a contract on 3 June 2014 and Mr S. C. White entered a contract on 24 February 2016 on this basis.

Documents may be served on the above-named directors: Ref. 'Yorkshire Building Society' c/o Deloitte LLP at the following address: 1 City Square, Leeds LS1 2AL.

4. Registered Office

Yorkshire Building Society is a building society incorporated and domiciled in the United Kingdom. The address of the principal office is Yorkshire House, Yorkshire Drive, Bradford, BD5 8LJ.

Glossary

The following glossary defines terminology used within the Annual Report and Accounts:

Additional Tier 1 (AT1) capital	Any remaining eligible Permanent Interest Bearing shares.
Arrears	A customer is defined as in arrears when they fall behind in meeting their obligations to pay their mortgage and as a result there is an outstanding loan commitment that is overdue.
Basel	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Enacted in the European Union via capital requirements directives.
Buy-to-let (BTL)	Lending on property that is to be let to individuals.
Capital Requirements Directive (CRD)	European legislation giving force to the Basel regulatory capital framework in the UK. The latest legislation – the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) (together commonly referred to as CRD IV) came in to effect from 1 January 2014.
Collateralised debt obligations	Structured financial products issued by a third party which reference asset backed securities and/or certain other related assets purchased by the issuer.
Collateral (for loans and advances to customers)	Security (property) pledged for the repayment of a loan. Collateral is valued as the lower of the value of the property or the outstanding loan amount.
Commercial lending	Secured loans to a commercial borrower.
Common Equity Tier 1 (CET1) capital	The highest quality regulatory capital resources, comprising retained earnings less regulatory adjustments, as defined under CRD IV. Equivalent to Core Tier 1 defined under previous CRD legislation.
Common Equity Tier 1 capital ratio	The ratio of Common Equity Tier 1 Capital to Risk Weighted Assets.
Contractual maturity	The final payment date of a loan or financial instrument, at which all the outstanding loan and interest is repayable.
Cost:income ratio	A ratio that represents management expenses as a percentage of total income.
Council of Mortgage Lending (CML)	A not-for-profit organisation and trade association for the mortgage lending industry.
Covered bonds	A type of wholesale funding backed by cash flows from mortgages.
Credit risk	The risk of financial loss arising from a failure of a customer or counterparty to settle their financial and contractual obligations as they fall due.
Credit Valuation Adjustment	These are adjustments applied to the fair values of derivatives to reflect the creditworthiness of the counterparty.
Currency risk	The exposure to risk from assets and liabilities denominated in currencies other than Sterling.
Debt securities In issue	Transferable certificates of indebtness including certificates of deposits, and fixed and floating rate notes.
Debit Valuation Adjustment	These are adjustments applied to the fair values of derivatives to reflect the entity's own credit risk.

Derivative financial instruments	Contracts or agreements whose value is derived from one or more underlying prices, rates or indices inherent in the contract or agreement, such as interest rates, exchange rates or stock market indices. Examples of derivatives include interest rate swaps, forward rate agreements and futures.
Effective interest rate (EIR)	The method used to calculate the amortised cost of financial instruments and to recognise interest receivable or payable over the relevant period. The effective interest rate is the rate that exactly discounts estimated cash flows (excluding credit losses) to zero, through the expected life of the instrument.
Expected loss	An estimate of the potential losses on current exposures due to potential defaults on a mid-cycle assumption.
Exposure	The maximum loss that a financial institution might suffer if a borrower or counterparty fails to meet its obligations to the Group.
Fair value	The value of the assets based on either the external market price or internal pricing models (using external data).
Financial Conduct Authority (FCA)	The UK conduct regulator which is responsible for regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets. The FCA's objective is to protect consumers, promote competition and enhance market integrity.
Financial Ombudsman Service (FOS)	An independent service which provides a service for settling disputes between financial services providers and their customers.
Financial Services Compensation Scheme (FSCS)	A protection fund for depositors of failed institutions. This is funded by the financial services industry and each firm, including the Society, is obliged to pay an annual levy.
Forbearance	The Group grants concessions to assist borrowers who experience difficulties in meeting their obligations to pay their mortgage. Examples of forbearance tools are described in Note 39.
Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England and HM Treasury designed to boost lending to households and businesses. Banks and building societies participating in the scheme can access funding at rates below the natural market rate.
Impaired loans	Loans which have been assessed and there is evidence to suggest a measurable decrease in the present value of cash flows expected from the loans that have occurred after initial recognition of the asset, but before the statement of financial position date.
Individual Liquidity Adequacy Assessment Process (ILAAP)	The Group's internal assessment of the levels of liquidity that need to be held by the Society to meet its regulatory liquidity requirements.
Individually impaired loans	Where retail or commercial mortgages are in arrears by three months or more, they are individually assessed for impairment. Commercial loans less than three months in arrears are also individually impaired where other factors suggest a measurable decrease in the present value of their future cash flows.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's internal assessment of the levels of capital that need to be held by the Society to meet its regulatory capital requirements.
Internal ratings methodology	An assessment of wholesale counterparties and the risks they pose to the Group with limits set accordingly.
International Financial Reporting Standards (IFRS)	International Financial Reporting Standards issued by the International Accounting Standards Board (IASB).

Glossary continued...

Liquidity Coverage Ratio (LCR)	A liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its needs for a 30 calendar day time horizon under a severe stress scenario.
LIBOR (London Interbank Offered Rate)	A benchmark interest rate which banks can borrow funds from other banks in the London interbank market.
Liquidity risk	The risk that the Group does not hold sufficient liquidity, in terms of quantity and quality, to meet its liabilities as they fall due.
Loan loss provisions	A provision which is held against loans and advances to customers, representing management's best estimate of losses incurred in the loan portfolio at the reporting date.
Loan-to-value (LTV)	A ratio showing outstanding loan balance as a percentage of the value of the security.
Loss given possession	The loss that is expected to crystallise when a repossessed property is sold.
Medium-term notes (MTN)	Corporate notes continuously offered by a company to investors through a dealer. Investors can choose from differing maturities.
Member	A person who has a share account or a mortgage loan with the Society.
Mortgage Backed Security/Residential Mortgage Backed Securities (RMBS)	An asset-backed security that represents a claim on the cash flows from residential mortgage loans through a process known as securitisation.
Net interest income	The difference between the interest received on assets and the interest paid on liabilities.
Net interest margin	This ratio calculates the net interest income as a percentage of mean total assets.
Non-prime lending	Mortgage lending to borrowers with adverse credit histories or self-certification lending where borrowers are not required to provide their income levels.
Operational risk	The risk of direct and indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.
Other income	The income received from selling non-mortgage and savings products (e.g. home and contents insurance, investment products and other insurances).
Permanent Interest Bearing Shares (PIBS)	Unsecured, Sterling denominated Tier 1 capital instruments repayable at the option of the Society.
PRA Remuneration Code	Guidance provided by the PRA on directors' remuneration.
Prime lending	The Group's core business of providing residential mortgages to customers with no known default history.
Probability of possession	The likelihood of an account moving into possession. This is used when calculating loan loss provisions.
Prudential Regulation Authority (PRA)	The UK prudential regulator, which is a part of the Bank of England and alongside the FCA has responsibility for the oversight of building societies, banks and insurers. The PRA's objective is to promote the safety and soundness of regulated firms.

Repossessions	Property taken into ownership by the Society as a result of the borrower's failure to make contractual loan repayments.
Risk appetite	The level of risk that the Group is willing to take (or not take) in order to safeguard the interests of members whilst achieving business objectives.
Risk weighted assets	A regulatory measure that adjusts the value of assets to reflect their level of risk when calculating capital requirements.
Shares	Money deposited by members in a retail savings account with the Society and held as a liability in the Statement of Financial Position.
SONIA (Sterling Overnight Interbank Average)	An index that tracks actual market overnight funding rates calculated as a weighted average overnight deposit rate for each business day.
Structured credit investments	A small percentage of Group liquidity invested in high risk and higher yielding treasury investments.
Subordinated liabilities	Tier 2 capital that is subordinated to the claims of all depositors, creditors and members holding shares in the Society (other than holders of PIBS).
Term Funding Scheme (TFS)	A scheme launched by the Bank of England designed to boost lending to households and businesses by providing term funding to banks and building societies participating in the scheme at rates close to Bank Rate.
Tier 1 (T1) capital	The sum total of Common Equity Tier 1 and Additional Tier 1 capital.
Tier 1 capital ratio	The ratio of Tier 1 capital to risk weighted assets.
Tier 2 (T2) capital	A measure of regulatory capital that includes subordinated liabilities and provisions for collective impairment, less regulatory adjustments.
Total capital	The total capital resources, including retained earnings, PIBS, provisions for collective impairment and subordinated liabilities, less regulatory adjustments.
Total capital ratio	The ratio of total capital to risk weighted assets.
UK Corporate Governance Code	The UK code on corporate governance, published by the Financial Reporting Council in October 2012, which sets out standards of good practice in relation to Board leadership and effectiveness, accountability and remuneration.
Value at Risk (VaR)	A risk management tool which evaluates the potential losses that may be incurred as a result of movements in market conditions over a specified holding period and to a given level of confidence.
Watch list	The watch list is used by the N&P commercial lending team to flag those loans where there are circumstances which could impact on the quality and safety of the loan.
Weighted average maturity	Provides a measure of the weighted average remaining term of outstanding wholesale funding.
Wholesale funding	The funding that is available between banks and other financial or commercial institutions. Examples of wholesale funding include covered bonds, deposits and government guarantees.

Principal Office:
Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.
ybs.co.uk

Auditors:
Deloitte LLP, 1 City Square, Leeds LS1 2AL.

YBS GROUP

MIX
From responsible sources
FSC® C003009

References to 'YBS Group' or 'Yorkshire Group' refer to Yorkshire Building Society, the trading names under which it operates Chelsea Building Society, the Chelsea, Norwich & Peterborough Building Society, N&P and Egg) and its subsidiary companies. Yorkshire Building Society is a member of the Building Societies Association and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Yorkshire Building Society is entered in the Financial Services Register and its registration number is 106085. Head Office: Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.

Marie Cure Cancer Care, Registered Charity No. 207994 in England and Wales, Sco38731 in Scotland.

Yorkshire Building Society Charitable Foundation Registered Charity No: 1069082.

Small Change Big Difference ® is a registered trademark of Yorkshire Building Society.

Small Change Big Difference provides the majority of the Yorkshire Building Society Charitable Foundation's funding. Contributions never exceed 99p per account, per year. Annual interest accounts, the donation is taken in March. Monthly interest accounts the donation is taken in June. Mortgage donations are taken in December.

End Youth Homelessness (EYH) is a national movement of local charities working together to end youth homelessness in the UK. EYH trades through its designated Administrator, Centrepoint (charity number 292411).

The Silver Line Helpline is registered in England & Wales as a Charity with number 1147330 & as a Company limited by guarantee with number 08000807. Also registered in Scotland as Charity number SCO44467. Registered office address: 40 Queen Anne Street, London W1G 9EL.

Royal National Institute of Blind People (RNIB) is a charity aiming to make daily life better for people affected by sight loss. Registered Charity Number 226227 (England and Wales) and SC039316 (Scotland).

YBM 0019 09 03 17