Cover photo: South Shields, one of many great locations in the region.

Newcastle Building Society

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Connecting our communities with a better financial future

Newcastle Building Society Annual Report & Accounts 2019

Connecting our communities with a better financial future.

Newcastle Building Society
Annual Report & Accounts 2019

Newcastle Building Society

Customer testimonial

"They are customer-centric and always focus on ensuring their products are tailored to our individual needs".

Melvin and Sandra

Gosforth customers

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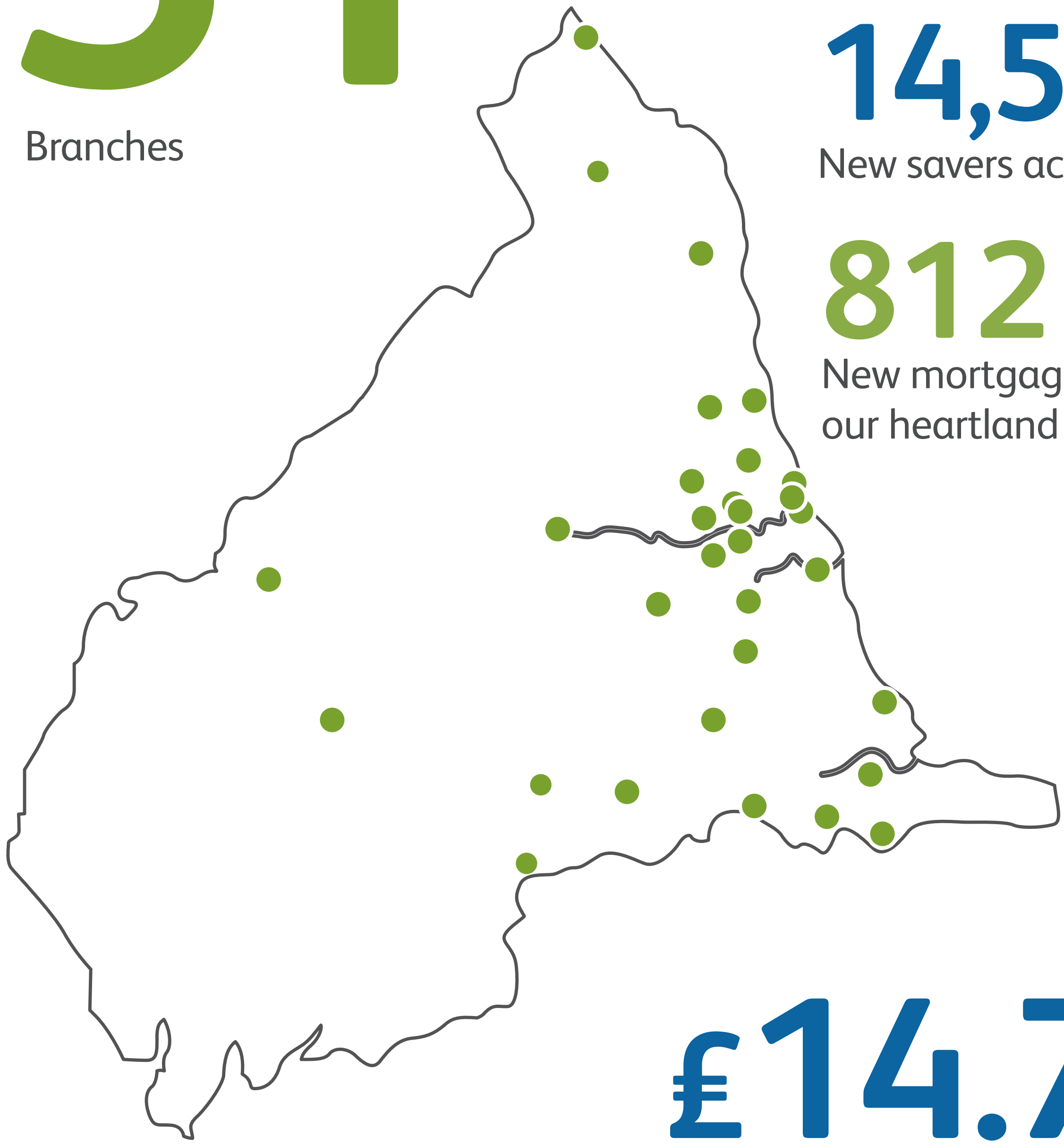


1,169
First-time buyers

14,516
New savers across the UK

812
New mortgages in our heartland area

£14.7m
Profit before tax

4,650
Volunteering hours donated by colleagues

1,250
Colleagues

£183m
Invested by new savers

86 Community projects supported with grants totalling
£403,000

96%
Overall customer satisfaction

Gross residential lending
£931m

37
Industry awards

13.9%
Common Equity Tier 1 Capital

Chairman's Statement

Newcastle Building Society made positive progress in 2019, despite continuing uncertainty and the challenges of the UK's sluggish economic growth. The Society continued to deliver its purpose led strategy to 'connect communities with a better financial future' and saw growth across the Group, an increase in Society membership and an increase in profit.

Phil Moorhouse, Chairman

Cow Hill, Town Moor, Newcastle

Chairman's Statement

Continued

Economic summary

The impact of Brexit uncertainty on investment and consumer confidence continued to be felt throughout the year. The outcome of the UK's future trading relationships will likely continue to impact consumer and business confidence until we have more clarity in this area.

Towards the end of 2019 GDP growth slowed due to the UK General Election and Brexit. Not surprisingly, the housing market has remained flat, while we have seen significant competition in the market with some of the lowest fixed rates seen for some time and continued downward pressure on margins. As re-mortgaging has reduced, we've seen first time buyers take a larger share of the market. Post-election, we saw an almost immediate uplift in mortgage approvals, increasing 10% on the previous month.

The level of UK personal debt has increased in recent years, driven by student loans and hire purchase. Despite recent growth, earnings in real terms are still lower than before the economic downturn in 2008/2009.

Savings rates continued to fall in 2019 with the outlook for 2020 not looking much better. As a result we are seeing customers choosing to save in easy access products, compared to fixed term/fixed rate products.

Looking forward, inflation is predicted to remain low but slightly higher than 2019 and forecasts for UK economic growth are similarly subdued.

We anticipate increased competition in both savings and mortgage markets, however the lower interest rate, lower margin environment has seen some lenders withdraw from the market altogether in 2019.

Although the Society has faced these significant headwinds, I am pleased to report it has delivered a strong financial performance alongside continuing to invest in the Society for the benefit of Members and colleagues.

Strategy and purpose

Our aim is for the Society to continue to build a long term sustainable business, through focus on and delivery of our purpose led strategy.

As a Member owned business there is a desire and a need to continue to invest for the benefit of Members. In addition to significant investment in IT resilience across the Group, a multi-million pound investment in creating a network of modern branches has continued.

New branch formats combine a modern design with a person first approach. It is our continuing belief that it's not just important for the Society to maintain or even grow a physical presence on our high streets, but to continue to combine that with a friendly face, empathy towards customers' individual circumstances and a high level of customer service and satisfaction. In our view, the future success of a branch network isn't just about bricks and mortar, but it's also about commitment and finding our place in the communities we serve.

Branches were opened in two new locations and building on the success of the Society's Community Branch in Yarm Library, partnerships were developed to enable the opening of two new, highly innovative community branches in remote, rural towns in region in early 2020.

Branches continue to offer accessible financial advice on the high street, which is provided through the Society's subsidiary, Newcastle Financial Advisers Ltd. The business has seen growing customer demand for its financial advice throughout the year. We were pleased to see this subsidiary strengthened with the acquisition of another advice business – extending its reach and adding to our customer base.

A commitment to being a great place to work and to realising regional potential saw continued investment in colleagues throughout 2019. Over 1,250 colleagues are now employed by the Group and I have been pleased to see the continued efforts across the business to ensure that all colleagues, wherever they work feel connected to our Purpose.

In addition to creating regional employment opportunities through 150 new roles, the Society has implemented additional positive changes for our colleagues throughout 2019 which include a focus on colleague wellbeing, a new approach to performance management, colleague engagement and an ongoing journey to ensure we offer fair and appropriate reward, connected to the overall performance of the business.

National recognition of the Society's achievements continued via a number of awards, ranging from mortgage lending to customer service and experience, being a great place to work, and its growing apprenticeship programme.

It is heartening to see how colleagues share the commitment to making our region a great one. From highest ever colleague fundraising in support of our Community Fund, to volunteering days spent in the service of local charities and community projects, I am proud of their dedication and passion to play their part in delivering positive change in areas that need it most.

Performance

Alongside a strong balance sheet, profit is one important measure of performance, and in 2019 the Group operating profit before impairments and provisions was £16.3m, a £1.6m increase on year-end figures for 2018. The Society has also continued to maintain robust capital ratios with Common Equity Tier 1 ratio at 13.9%, well within regulatory guidelines alongside more than adequate levels of liquidity at 15.8%. Further details of the financial performance are provided on the following pages, within the Chief Executive's Review.

The Society's mortgage lending has gone from strength to strength and it has proved itself capable of succeeding in a challenging and competitive market place, with record levels of new lending in 2019.

Innovation

In 2019 the Group's two subsidiaries, Newcastle Strategic Solutions Limited and Newcastle Systems Management Limited were merged into a single organisation under the Solutions brand. Award winning Newcastle Strategic Solutions is the UK's market leading provider of third party online savings management, technology and service.

These changes have brought under one area both the technology and service elements of the proposition. The subsidiary continues to make a valuable contribution to the Group's scale and efficiency, further strengthening its ability to invest for the long term benefit of current and future Members.

Governance and regulation

The Society has regard for the Revised UK Corporate Governance Code which emphasises the culture and purpose of an organisation and putting stakeholder organisational relationships at the core of a set of principles to promote long term sustainable growth.

We are comfortable this aligns well with our purpose led strategy.

Countercyclical Capital Buffers (CCyB) are one of the tools that the Bank of England uses to adjust the resilience of the banking system against the potential of increasing risk by determining an additional amount of capital that institutions are required to hold. In December 2019, the Bank announced that CCyB is due to increase in December 2020 from 1% to 2%. The Group's capital plans incorporate this increase in requirement.

Our board

As part of changes to our Board we welcomed Adam Bennett, who joined as a non-executive director in April 2019. He is a member of the Society's Group Risk Committee and a director of Newcastle Portland House Limited.

One of the UK's leading lawyers with more than 30 years' experience, his specialist expertise was in advising building societies and other financial mutuals on corporate, constitutional, governance and regulatory issues.

Patrick Ferguson, the Society's Strategy Planning and Risk Director left the Society after nine years' service, including five as a director. I would like to record our appreciation for Patrick's contribution over that time.

Summary

It has been pleasing to see how the Society's purpose and strategy has galvanised colleagues and continued to drive innovation in all areas of the organisation. I hope that our Members can detect this energy and ambition and can feel the benefits of the changes underway. There is a real desire to make Newcastle Building Society the best regional building society for its Members and for its region.

Phil Moorhouse

Chairman

25 February 2020

Chief Executive's Review

2019 was a year of hard work and challenge, along with many 'firsts' and real progress, as we have continued in our endeavour to make a genuine, positive difference in our region and beyond.

Andrew Haigh, Chief Executive

Whitley Bay Branch

Chief Executive's Review

Continued

I am very pleased to have welcomed over 40,000 additional customers to our Society. This is an important indicator that our purpose - 'to connect our communities with a better financial future' - which in turn drives our strategy, is delivering impact for the people we aim to serve. Alongside a 12% net growth in customers. I am also pleased to report an increase in profit, strong capital ratios, good liquidity and low credit risk across our mortgage book - all key measures of how we are building a long term, sustainable business.

Some of our key highlights include:

- Completion of 10 more branch launches as part of our multi-million pound branch refurbishment and relocation programme;
- First organisation in the UK to roll out a Slow Shopping environment across a branch network;
- Introduction of two new community branches in Hawes and Wooler to serve rural populations that the banks have left behind;
- Record mortgage lending supported by strong retail funding through our branches;
- A robust financial performance with Group profit before tax and Group operating profit before impairments and provisions increased by 11% to £14.7m and £16.3m respectively;
- Maintaining colleague engagement scores considerably higher than the financial services sector average;
- Welcoming 7 graduates and 15 new apprentices to develop their careers in our business and become our future leaders, including two young people from the Prince's Trust programme;
- 27 savings awards won by Newcastle Strategic Solutions' clients;
- The acquisition by our subsidiary, Newcastle Financial Advisers Limited, of a financial advice business;
- Launch of our new LISA Mortgage Booster in response to our customers' feedback to help with a deposit on a new home; and
- Surpassing £2m in the value of our Newcastle Community Fund at the Community Foundation.

Our regional view

As the North East's largest building society with assets now in excess of £4.4bn, we are committed to supporting and developing the potential of our heartland, which includes the North East, Cumbria, and North Yorkshire.

Our towns are facing many challenges, and like many regions in the UK we've witnessed the withdrawal of banks and financial institutions from our high streets. This creates concern as we witness closed premises, visible decline, and the reduction in the availability of local financial services. But at the same time it creates opportunity for a Building Society committed to the region and whose strategy is to be part of the solution. In our view, something has got to change and it is time for some new and innovative thinking.

Our strategy is expressed through our commitment: to a presence on our region's high streets; to work in partnership to support our communities; to making financial information and advice accessible to all. Work undertaken in 2019 in these areas will we believe, make a tangible difference in 2020 to our ability to support the communities in our region, including those which have been previously abandoned by financial services.

Strategy and purpose

We continue to place our purpose front and centre of our strategy.

Our strategy is powered by four key themes that include being purpose led; building our reputation and brand through the communities we serve; recognising that appropriately growing the scale of the business, while maintaining a sharp focus on efficiency are essential features of our long term sustainability; and that if we do all of these things well, our customers will value and support us, making mutual advocacy a key part of our ongoing success. Put more simply, as a purpose led, Member owned organisation, we recognise that our success will be determined by the reputation we build in, and what we deliver for, the communities we serve across our region.

We occupy a unique and privileged position as a Member owned organisation, based in the North East, with a powerful connection for our colleagues both to their roles, and to the customers they serve. Our colleagues know that they are personally making a real and positive difference to the people and places that are important to them.

Our performance

Our strategy is delivering results. We grew our customer numbers by 40,000 in 2019. We increased our branch savings balances by 23%, a net movement of £400m. Our overall net savings growth grew by 25% to £687m and since launching our Lifetime ISA in 2018, we now have more than 40,000 Lifetime ISA customers.

Strong retail savings balances provide a solid foundation for our record net residential mortgage lending of £575m, an increase of £415m on 2018. This lending has been achieved within margin forecasts and in the context of a flat mortgage market.

In addition to this positive progress, we continued our ongoing programme of investment into the resources and capabilities of the business, enabled by a continued improvement in our operating profits.

Building authentic, lasting relationships

With our customers

Nowhere is our success better measured than through our customer satisfaction scores. In 2019 we achieved a score of 96 per cent.

Our net promoter score measures the loyalty of our customer relationships and is driven by the quality and value our colleagues deliver to our customers. In 2019 our NPS score was 84 - a high score that puts us near the top of the spectrum, as NPS scores range from -100 to +100.

We have also introduced a new tool, Customer Voice, which measures real time customer satisfaction across all our channels including telephone, digital and face to face.

On our high streets

Our friendly and helpful colleagues are at the centre of excellent scores such as these, but they deliver more than an impressive level of service and satisfaction. Almost all colleagues across our business and all those in our branches are Dementia Friends. Our active commitment to promoting awareness of dementia has created more than 2,000 Dementia Friends in our region and beyond. This has driven other innovations, including an initial pilot and full roll out of 'Slow Shopping' across our branch network.

The Slow Shopping movement was pioneered by Katherine Vero in Gosforth and enlists shops and businesses on the high street to provide both a sympathetic environment and a deeper level of customer understanding to create a welcoming environment for people living with conditions like dementia and autism. The inclusive nature of Slow Shopping means that more people can feel at home on our high streets, reducing isolation and improving quality of life. We are the first institution in the UK to deliver this across a full network of branches.

We believe in the role of the high street at the heart of our communities. Our multi-million pound branch refurbishment and relocation programme this year delivered ten new-look, modern branches. Combining the best in personal face to face service with a spacious and open environment, our customers have been highly supportive of our changes. Where space allows, we have also introduced community rooms in which are provided free of charge for use by local community groups. Eleven of our branches have community rooms which groups meet up in for educational and reading groups, craft groups or to socialise and share cultures. We expect to add more community rooms to our branch network in 2020.

Our commitment to maintaining our presence on the high street has seen the Society increase its network to 31 branches in 2019, with the addition of four new branches. In Teesdale, we have transformed our Barnard Castle presence from an agency to a full branch. In Bishop Auckland our new branch was welcomed in such numbers by locals that we made the decision to begin trading there ahead of refurbishing the old bank premises it took over.

We're no less thrilled to be adding to our branch network through community partnerships and have introduced two new community branches - to Wooler in Northumberland and to Hawes in the Yorkshire Dales. Both towns were abandoned by the banks. It has been inspiring to witness the work of the Glendale Gateway Trust in Wooler and the Upper Dales Community Partnership in Hawes, both highly proactive local community trusts seeking to improve the lives of local people. We're proud to play our part by bringing local financial services back to these towns.

Providing accessible financial advice is another of our commitments and 2019 saw our subsidiary, Newcastle Financial Advisers, deliver approximately 6,500 advice sessions to customers. The team enjoy customer satisfaction levels of 98 per cent, and achieve a 93 per cent net promoter score. With a strategy for growth, in 2019 Newcastle Financial Advisers purchased the advice firm, Fidelis Financial Solutions, based in the bustling market town of Pickering in North Yorkshire.

Newcastle Financial Advisers also runs an Academy training programme in association with Openwork to recruit and skill the next generation of professional advisers. Six new trainees joined in 2019. The subsidiary experienced its best ever year for the volume of new investments.

With our communities

Creating a long term, sustainable, charitable funding legacy to support our region is another key priority and 2019 saw us celebrate surpassing £2m value in our Newcastle Building Society Community Fund at the Community Foundation, Tyne & Wear and Northumberland.

Our Society was the first to sign up to the Alternative Scheme operated by Reclaim Fund Limited, which enables smaller building societies and banks to utilise qualifying dormant accounts to support their local charities. This saw a substantial donation to the Community Fund of £943,000.

The Newcastle Building Society Community Fund made £403,000 in community grants across the North East and Cumbria during the year. The Fund doubled the value of Building Improvement Grants to provide up to £100,000 for maintaining or improving community buildings. Organisations that benefited included Barnabas Safe and Sound, which provides support and services for young and vulnerable people; Earsdon & Wellfield Community Association which welcomes around 500 people across all age ranges every week to its building; and East End Youth and Community Centre.

We supported 86 community projects and causes in 2019 including the Sir Bobby Robson Foundation and the Prince's Trust. Six grants were made to foodbanks in our region.

Our colleague fundraising is key to continuing to add momentum to the Fund's value and support and colleague fundraising surpassed a record £28,500 in the year. Meanwhile, 42 per cent of colleagues used their volunteering days to support community ventures.

We have a tradition of partnering with our region's libraries which began with our Yarm Library branch opened in 2016. Understanding that these valued public spaces are under financial pressure, the Society has committed to work with Whickham Library in Gateshead and Stokesley Library as part of a three year programme of financial support which will be used towards any funding gaps, and further enhance the library facility and community activities.

In partnership with the North East England Chamber of Commerce, and following the Chamber's High Street Report in 2018, we are piloting delivery of a programme of free information events for high street retailers in North Shields. Hosted largely by the Society, sessions are delivered by established businesses and share valuable know-how, experience, and tips to help smaller independents make the most of their businesses. The programme may be extended across the North East if it proves successful.

Chief Executive's Review

Continued

With our broker partners

The majority of our mortgage lending is done through UK wide networks of brokers and this channel of distribution has been significant in driving our record levels of mortgage lending. We actively listen to our brokers to better understand their needs and during the course of 2019 we increased our broker intermediaries team and introduced a product transfer facility and an online selection tool. We were pleased to maintain our FT Adviser four star rating for service, as voted for by brokers.

With our colleagues

We created and filled over 150 new jobs in the region in 2019 and were thrilled to achieve second place in the North East's 'Best 100 Places to Work' awards.

While we have maintained colleague engagement scores that are considerably higher than the sector average, we recognise we have more to do. Colleague feedback includes a requirement to improve our working environment; creating break out spaces for collaborative working and making our workspaces better and more creative places to be.

We continue to invest in our Early Talent programme and in 2019 we were placed in the top 100 employers with 'Rate My Apprenticeship'. We also saw one of our apprentices winning the 'Rising Star Award' for the North East region at the national apprenticeship awards.

Our Prince's Trust partnership was recognised at the end of its first year in 2019 with 'Highly Commended for the Best New Partnership' for our contribution in helping young people to live, learn and earn. In delivery of our partnership we welcomed five Prince's Trust students to our Society for a two week work experience programme which resulted in two young people being offered permanent roles with us through our apprentice programme.

As part of our investment in being a great place to work, in 2019 all managers attended our 'Manager as Coach' programme to help build a coaching culture and empower colleagues to take ownership of their performance and development.

All colleagues attended a Forum Theatre immersive learning experience to inform and empower their adoption of a new approach to performance management, incorporating a conversation rich, future focussed, colleague led approach. We also continued our investment in business leaders and launched a talent management framework.

Performance related pay was rolled out across the Group to enable recognition of colleagues for their development within their individual role and their contribution to our Society's success.

We launched a new 'Colleague Voice' platform, which provides-insight driven feedback via a continuous conversation. Our focus on colleague wellbeing included the introduction of wellbeing advocates, mental health first aiders and a number of successful awareness campaigns across the year. This resulted in a Bronze 'Better Health at Work' award.

We kicked off 2020 with all colleague Vision & Strategy events to outline our strategic ambition, progress to date and gain colleague feedback. Our colleague belief and energy is key to driving the organisation on to achieve greater success and our commitment to these two days across our Group was an important investment.

Innovating

Scale and efficiency

We are delighted that the UK's leading provider of third party online savings management services is based in the heart of the North East. A shining example of building society innovation, our subsidiary, Newcastle Strategic Solutions continues to strengthen its reputation as a fintech leader and influencer, and to provide valuable career opportunities in the region for those who want to develop a career in technology, service or related business support areas.

Employing more than 620 talented colleagues, Solutions has added to its growing roster of clients having welcomed B-North and Recognise on board, both developing new challenger banks to the market, focusing on the needs of small to medium sized businesses.

We made changes last year to our business structure to merge two subsidiaries, Newcastle Strategic Solutions Ltd and Newcastle Systems Management Ltd under a single Solutions brand. This has created a more streamlined and efficient approach to planning, operating and reporting for the benefit of both our clients and our Group.

Solutions has an important role to play in delivering our purpose and strategy. It drives technological innovation across our Group, provides great career opportunity for local talent, contributes to Group profitability and enables us to build scale and resulting efficiencies. I'm pleased to see that it is continuing to grow its contribution to the Group and its reputation and opportunities.

Products, services, recognition

Against a backdrop of record mortgage lending and attracting similarly high levels of retail savings through our branches, we have continued to develop and innovate our product range.

We launched Custom Build and Advance Payment Self-build propositions alongside launching Buy to Let in Scotland. When we talked to our Lifetime ISA customers they told us that while they could afford monthly mortgage payments the time it was taking to save a deposit was the big challenge. As a result, we launched an innovative LISA deposit booster mortgage providing a £2,000 boost to a mortgage deposit.

We became the first building society in the UK to introduce a digital debt help service using integrated Open Banking technology for mortgage customers facing financial difficulty or those needing extra support to understand their financial position. This led to the Society winning 'Best Debt and Arrears Management Strategy' at the Mortgage Finance Gazette Awards.

Other accolades during the year included: third time winner in a row of What Mortgage 'Best Regional Building Society'; second time winner of L&G's 'Best Smaller Lender'; and 'Best Self Build Lender' in the Personal Finance Awards.

Financial Performance

Group profit before tax improved, increasing by 11% to £14.7m for the year ended 31 December 2019, compared to £13.3m for 2018. Operating profit before impairments and provisions improved by 11% to £16.3m (£14.7m in 2018).

Total operating income increased by 16% to £74.9m in 2019 (£64.5m in 2018). This was offset by overall management expenses including business administration costs and depreciation expenses, both of which increased to a cumulative £58.6m from £49.8m in 2018, reflecting significant levels of investment in colleagues, the branch network, and information technology resilience and data security.

The Society's net interest margin improved to 0.95% from 0.92% in 2018. Net interest income increased by £4.4m to £38.6m, reflecting an increase in our mortgage lending and the impact of rises in LIBOR alongside reduced funding costs.

The Group's capital ratios remain robust with Common Equity Tier 1 ratio reducing slightly to 13.9% from 15.71% and Tier 1 ratio reducing to 14.3% from 16.3%. Both reductions were primarily as a result of increased lending. The Group complied with Individual Capital Guidance plus capital buffers, as notified by the Prudential Regulation Authority, throughout 2019.

The Society continued its focus on core residential lending while winding down legacy portfolios. The net increase in customer loans and advances was £523m overall in 2019 and included a £575m net increase in core residential, of which £94m was in buy to let.

The percentage of mortgages in arrears by three months or more remain at low levels for 2019. Overall number of loans arrears have seen a slight increase (0.04%) to 0.34%. This remains lower than the industry average.

The Group's liquidity, excluding encumbered assets, ended the year at 15.8% compared to 14.6% in 2018. This is comfortably in excess of the Society's minimum operating level.

Summary and look ahead

The combination of visible progress against our purpose led strategy; significant growth; substantial investment; and improved financial performance against a challenging and uncertain economic and political backdrop was very encouraging in 2019 and sets a positive tone for 2020 and beyond.

However, we need to be mindful that the outlook for business in a post Brexit world is far from settled, interest rates are likely to remain low and given so many uncertainties, we can expect continued and appropriate caution from regulators with regard to capital requirements for all financial institutions. We also plan to continue our investment programme into infrastructure, technology and resources across the business – with a view to growth, continued strengthening of our business model and improved efficiency and financial performance for the long term.

We have been pleased by the positive response to our activities – in supporting our communities, encouraging people to save, helping them own their own home and plan their finances. We are genuinely committed to supporting our high streets and finding new ways to ensure an authentic, face-to-face service, delivered locally can be part of our core offer to communities for the years ahead, while also investing in what the best of modern technology can offer. We are also proud of the achievements of Newcastle Strategic Solutions and the difference that subsidiary makes: bringing further diversification to the financial services market place; creating jobs in our region and delivering income back to the Group for the benefit of our Members.

I have no doubt that the year ahead will be full of both familiar and entirely new challenges. However, I believe we have a clarity of purpose and strategy that will enable us to continue to be relevant to the needs of our region, to make a genuine positive difference and to flourish. As ever, this only possible with the support of our wonderful colleagues across the Group, whom I thank for their tireless efforts and the many other partner organisations and advocates who have given us so much positive feedback over the last year. I must also recognise the support of our Board and most of all, our Members, as we look forward to a further year of progress in 2020 in 'Connecting our communities with a better financial future'.

Andrew Haigh
Chief Executive
25 February 2020

Customer testimonial

"I always see the same person. She is polite, treats me well and welcomes me as a valued customer. She offers advice and is a real people person."

Christopher

Ashington branch

Strategic Report

The Directors present their Strategic Report on the Group for the year ended 31 December 2019.

Newcastle Building Society is the largest building society based in the North East of England with assets of c£4.4 billion. 2019 has proven to be another year in which the Society has made very good progress. We are reporting increased profits, strong capital ratios, robust liquidity ratios and low credit risk across our mortgage book.

Purpose

Our purpose "Connecting our Communities with a Better Financial Future" is underpinned by five pillars which define what we do.

OUR PURPOSE

Connecting our communities with a better financial future.

WHAT WE DO

- Helping people own their home, save and plan their finances
- Building lasting, authentic relationships with customers
- Being a great place to work, where people can realise their potential
- Helping our communities make positive changes
- Helping clients and partners succeed

Our business model and strategy

Our business model is derived from how we believe a modern, regional building society should operate. We attract savings balances by offering our customers fair and consistent rates over the long term and we offer fairly priced mortgages on residential property to customers whom we believe will be well placed to repay their loan. As such, we meet our customers' needs to save and to own their own home. In addition, we offer financial planning in all our branches, which helps our customers to plan their finances for the long term, while strengthening the trust and bond between us.

We bring scale and a diversified income stream to the Group by taking one of our core skills, savings management, and offering that as a service to other banks and building societies.

As a regional society, we are particularly concerned to support the communities of our region, which we define as the North East of England, North Yorkshire and Cumbria. As a customer-owned business, we are clear how being truly led by our purpose of 'connecting our communities with a better financial future' means that we can deliver a unique and sustainable business to benefit both our region and our customers for the long-term.

We care about building lasting, authentic relationships with our customers, which means that while digital and intermediary channels play a key role in our distribution and service delivery, face-to-face contact and a thriving branch network are particularly important. We are therefore keen to innovate in this area, ensuring we can continue to play a role in maintaining vibrant high streets across our region.

Our strategy is built around four themes:

- Being truly purpose led in our approach to strategy and developing the business.
- Building our brand through our communities, recognising that our success relies on the reputation we build with our customers and the difference we make for the communities we serve across our region.
- Growing the scale and efficiency of the business, increasing our impact and the long-term sustainability of our operations.
- Fostering mutual advocacy, whereby our customers genuinely value the services we provide and the contribution we make to their community and region; they actively participate in the Society and become our biggest advocates, encouraging others to become part of our Society.

We believe that our approach to strategy delivers a truly purpose led business, which is driven to act in the interests of our customers, who are also our key stakeholders, but also has the attributes required to deliver a successful commercial outcome. Commercial success is vitally important as the profits we generate are re-invested into the business to support areas such as growth, innovation and infrastructure, for the long-term benefit of members and provide the capital to underpin our operations, providing resilience and security for our Members.

Our 'strategy wheel' summarises our approach and demonstrates how each aspect of our business contributes and complements each other to work in synergy and deliver stable, cost effective funding and lending, achieving a sustainable business model for the long-term, which is uniquely placed within the region and the communities we serve.

Group Structure

At our core, we remain a straightforward saving, lending and advice business putting Members at the heart of what we do. As well as providing mortgage and savings accounts to our Members, we also provide a number of other related services, including regulated financial advice for investments through our subsidiary Newcastle Financial Advisers Limited; an Appointed Representative of Openwork LLP. We also provide insurance products including home and contents insurance through our partner Legal & General Group PLC.

In 2019 we merged two of the Group's subsidiaries, Newcastle Strategic Solutions Limited (our savings management outsourcing subsidiary) and Newcastle Systems Management Limited (our IT subsidiary).

The combined subsidiary (Newcastle Strategic Solutions Limited) simplified our Group structure and will enable us to provide a more efficient approach for our clients and how we operate internally. It will also help facilitate our ongoing commitment to long-term strategic investment into our technology platform and the operational resilience of Newcastle Strategic Solutions, Newcastle Building Society and the wider Group, in the years ahead.

Newcastle Strategic Solutions

Newcastle Strategic Solutions, our savings management and IT subsidiary, has been managing savings accounts on behalf of some of the UK's leading savings providers since 2004. Newcastle Strategic Solutions purpose links directly to the overall Group's purpose and the pillar "we help our clients and partners succeed through our excellent products and services" and this plays a key role in the Society's financial model.

We support UK banks and building societies looking to launch and grow their savings operations, or transform the management of their existing portfolio. Our powerful systems are built to provide a secure online savings platform.

Supporting the full range of personal savings products, we continually invest in our technology to future-proof our solution so it will grow with the changing demands of UK savers. Our internet banking platform provides a fully automated account opening process, allowing accounts to be opened in minutes.

Our Solutions ambition will see us continuing to leverage the significant investment in core technology and the underlying quality of service through expansion of the number of clients and proposition offered to existing clients.

Solutions is entering a hugely exciting phase of growth with a major recruitment drive which will see a significant number of jobs created.

Newcastle Financial Advisers

Newcastle Financial Advisers our financial advice subsidiary was established over 16 years ago. It provides Members with access to trusted financial advice something we believe everyone deserves. As we see more and more banks withdraw from the high street or no longer offer this service it's getting harder for people to plan their finances with the help of a trained professional. We are committed to having a financial adviser in each of the Society's branches.

Newcastle Financial Advisers is continuing to affirm its position on the high street along with its reach in the community providing experienced advice in these challenging economic times.

Financial Performance

The Chief Executive's review details the Society's performance and success throughout 2019 and should be read in conjunction with this report. The Strategic Report outlines the financial performance of the Society over 2019.

Strategic Report

Continued

Key Performance Indicators

The Board regard key performance indicators (KPIs) as an important way of monitoring achievement of short-term objectives and progress against the strategic plan. The KPIs that are reported to the Board on a monthly basis are detailed below.

Key Performance Indicators

Non Financial Measures	2019	2018
Customer Satisfaction	96%	98%
Customer NPS	84	64
Colleague turnover	10.1%	11.3%
Colleague eNPS	26	-
Financial - Profitability		
Operating Profit before impairments and provisions	£16.3m	£14.7m
Net interest margin	0.95%	0.92%
Cost to income ratio	78%	77%
Financial - Balance Sheet		
Common Equity Tier 1 ratio	13.9%	15.7%
Leverage ratio	4.7%	5.4%
Liquidity coverage ratio	179%	179%
Gross lending	£931m	£520m

Senior management consider a wide range of financial and non-financial metrics to assess the performance and future direction of both the Group and Society. Financial metrics include both measures defined or specified by the Group's applicable financial reporting frameworks (primarily International Financial Reporting Standards and the Building Societies (Accounts and Related Provisions) regulations), such as profit before tax, and non-specified measures, such as net interest margin, cost to income ratio, and operating profit before impairments, provisions and exceptional items.

Those financial measures not specified by the Group's financial reporting frameworks are alternative performance measures (APMs) with further detail provided in the financial KPIs and analysis section.

Customers

The real proof of whether we are delivering on our commitments is through customer feedback. The score from our customer satisfaction survey reflects the proportion of our customers who say that they are satisfied or very satisfied with the service they receive. The Society achieved an overall satisfaction score of 96% in 2019 (2018: 98%). The results highlighted the fantastic job that our colleagues do every day in delivering a great service to our customers. In particular customers highlighted how much they valued their friendliness and helpfulness.

In addition, the Net Promoter Score (which measures the loyalty of our customer relationships) achieved a score of 84, which is testament to the quality and value our teams are delivering to our customers.

In 2019 we introduced a new voice of the customer programme which provides daily, real-time feedback from our customers, helping us to continue to develop and improve the experience we deliver. To date we have received in excess of 15,000 responses from our customers across all our channels including the branch network, mortgage operations, intermediaries and our financial advice subsidiary, Newcastle Financial Advisers Limited . In November we won the coveted accolade "Best use of Voice of the Customer" at the International Engage Awards in London.

We are always looking for new and exciting ways to engage with our Members and involve them in the development of our products and services. In December 2019 we conducted customer listening groups, inviting customers to share their experiences and ideas. This has had a direct impact on our product development and communications style and we look forward to continuing this dialogue into 2020.

Colleagues

Being a great place to work where people can realise their potential is key to living our purpose.

Our people strategy focuses on providing an immediate, on-going and long-term framework for engaging, developing and managing our people, creating an inspiring place for people to work and be able to achieve their full potential whilst delivering the Society's ambitions with key objectives as follows:-

- Developing high quality leadership and management;
- Developing individual and collective performance;
- Attracting, recruiting and retaining talent; and
- Developing colleagues communications and engagement.

The Society places a great deal of emphasis on engaging colleagues in the ongoing development of its business and delivering its Purpose and strategy.

Colleague Voice, our colleague feedback tool, is representative of views from colleagues across our Society and can make a significant contribution to our ongoing development, both from a business performance and a working life perspective. We regularly share the feedback with colleagues, one method being through our Colleague Voice booklet and another our colleague net promoter score or eNPS. Our eNPS enables us to benchmark ourselves against the financial services sector and the very best employers across the industry. Our colleague eNPS score for 2019 was +26, well ahead of the financial services average of +16. The feedback we receive through Colleague Voice is invaluable and is used to shape aspects of how we improve as an employer. Colleague focus groups help us understand the feedback received in more detail.

In January 2020, we hosted our "Vision and Strategy" all colleague event, which brought together our journey to date and reaffirmation of our "Vision and Strategy". The event was a huge success, giving us an opportunity to engage, inspire and involve all colleagues in our success to date and our future ambitions.

Many of our colleagues volunteer to help local charities and groups through participating in a huge variety of activities and events. Colleagues fundraised throughout the year and raised money for the Newcastle Building Society Fund at the Community Foundation, McMillan Cancer Support and Children in Need. Further details are given in the Community Support Report.

An annual pay review for all colleagues takes place on 1 April and the Group operates a discretionary Corporate Bonus Scheme for all colleagues based on performance as measured by the delivery of KPIs linked to the Group's strategic objectives. The 2019 Corporate Bonus Scheme will pay all eligible colleagues an amount based on their annual assessment rating, for 2019.

The majority of staff received a 5% bonus with a small portion (15%) receiving an enhanced bonus payment, 5% of staff did not qualify for a bonus payment. Unite has negotiating rights on behalf of all colleagues up to and including senior management level. The 2019 pay rise for all colleagues ranged from 0% to 12%, with an average 3.4% received by all colleagues.

The Society operates an Equal Opportunities Policy. It is the intention of the Society that no applicant or employee receives less favourable treatment on the grounds of disability, sex, transgender status, sexual orientation, marital status, civil partnership status, race, ethnic origin, colour, age, nationality, national origins, political beliefs or trade union membership, or is disadvantaged by conditions or requirements that cannot be shown to be justifiable.

The Board also has an approved diversity policy. The gender diversity statistics for the Group at 31 December 2019 are as follows:

	Female		Male	
	2019	**2018**	**2019**	**2018**
Directors	17%	19%	83%	81%
Senior Managers	49%	40%	51%	60%
Managers	41%	40%	59%	60%
Employees	67%	68%	33%	32%
Overall	61%	61%	39%	39%

Colleague turnover is as an important reflection of the success of our colleague agenda. The Group colleague turnover rate improved slightly to 10.1% in 2019 from 11.3% in 2018.

Colleague Turnover

The Society has a Health and Safety Committee that supports and assists the Society in developing safe systems of work. The purpose of the Committee is to provide a forum for representative colleagues to discuss specific issues to help ensure that the Society has taken all reasonable and practicable steps to maintain a safe and healthy working environment.

The Committee reviews the overall operation of the Society's Health and Safety Policy, including the content of employee health and safety training and discusses health and safety performance, problems and future priorities.

The Society recognises the importance of integrating health and wellbeing into day to day activities to enable us to create a positive and healthy working environment for our colleagues.

Our mental health first aiders and health and wellbeing advocates raise awareness across the Society of the importance of integrating health and wellbeing into our day to day activities.

Financial Profitability

Profitability is one of the key performance measures the Board monitors closely. The Society seeks to make sufficient profit in order to invest in and grow the business for the benefit of its current and future Members. A Building Society must be profitable to demonstrate it has a long term sustainable business model and show financial strength to savers, borrowers, regulators and business partners.

Summary Group Income Statement	2019 £m	2018 £m
Net interest income	38.6	34.2
Other income and charges	36.3	30.3
Total operating income	74.9	64.5
Administrative Expenses	(54.4)	(46.9)
Depreciation	(4.2)	(2.9)
Operating profit before impairments and provisions	**16.3**	**14.7**
Impairment charges	(1.5)	(1.5)
Provision for liabilities and charges	(0.1)	0.1
Profit for the year before taxation	**14.7**	**13.3**

Profit for the year before taxation was £14.7m in 2019 (2018: £13.3m), an increase of £1.4m or 11% in comparison to 2018. Operating profit before impairments and provisions improved by 11% to £16.3m in 2019 (2018: £14.7m). Total operating income was up by 16%, whilst due to the ongoing investment into the business, costs also increased by 18%. The depreciation charge for the year has increased by £0.9m due to the introduction of IFRS16. Operating profit before impairments and provisions is considered an important reflection of the operating strength of the Group's business.

Segmental information is available in note 9 and details the Member business and Solutions business segments. Solutions business profit figure for 2019 was £6.1m (2018: £5.3m).

Net Interest Margin

Net interest income increased by £4.4m to £38.6m reflecting increased mortgage lending and the impact of rises in LIBOR coupled with the ongoing benefit of reduced funding. Our net interest margin improved to 0.95% (2018: 0.92%).

It is expected that margin compression may impact this metric with considerable downward pressure in 2020 and beyond.

Net Interest Margin

Net interest margin is a relative measure of the Group's net interest income (as disclosed in the Income Statements) – the difference between interest received on assets and interest paid on liabilities – divided by the Group's average total assets during the year.

Other Income and Charges

Net other income and charges increased by £6.0m (20%) to £36.3m in 2019 from £30.3m in 2018. Income from Newcastle Strategic Solutions Limited, continues to grow as balances under management rise. Income from Newcastle Financial Advisers Limited (NFAL) was up £0.2m compared to the period ended 2018. The divisional performance of the Member and Solutions businesses are shown in Note 9.

Administrative Expenses and Depreciation

Administrative expenses increased by 16% or £7.5m from £46.9m to £54.4m in 2019, with depreciation expense increasing from £2.9m to £4.2m. Overall management expenses (the sum of administrative expenditure and depreciation) increased to £58.6m from £49.8m reflecting significant levels of investment in colleagues, our technology infrastructure and the branch network during the year.

Our branch refurbishment programme has continued throughout 2019. Information technology is a cornerstone of any business and investment ensures our core platforms are at a leading level to provide security of data and enhanced resilience.

The Board considers the cost to income ratio to be a simple measure of financial progress against internal targets and the return achieved on investment in the business. The cost to income ratio was broadly stable as compared to the prior year at 78% in 2019 (2018: 77%). The cost to income ratio reflects costs deemed to be under the control of management (administrative expenses plus depreciation as disclosed in the Income Statements) divided by total operating income, as similarly presented. Management assess the ratio as a measure of operating efficiency and continue to look for ways to improve this metric.

Cost to Income Ratio

Impairment charges

The impairment charge for loans and advances to customers was £1.5m in 2019 (2018: £1.5m). The majority of which reflects an increase in credit risk provisions reflecting a view of potential macro-economic stressed scenarios together with associated likelihood factors within the IFRS9 credit risk models. The Society has been successful in its strategy of winding down the commercial portfolio and reducing the associated risk. The outstanding balances net of impairment provisions have reduced to £28m representing only 0.9% of the total mortgage book.

Provisions for Liabilities and Charges

Provision for liabilities and charges includes the annual charge for the Financial Services Compensation Scheme (FSCS) levy and charges for customer redress. Further details are given in note 25.

Taxation

The Group shows an effective corporation tax rate of 22% in 2019. The tax charge reflects both tax payable against 2019's profitable operations and a reduction in the deferred tax asset carried on the balance sheet. Taxable losses from previous years (prior to 2013) have been used to extinguish the eligible part of the current year corporation tax charge in line with the provisions of the Finance Act that came into force during 2018. In addition, there was a net £0.2m adjustment in respect of prior year items.

Balance Sheet

A consolidated balance sheet is set out below with key balance sheet items discussed in detail in this report.

Summary Consolidated Balance Sheet	2019	2018
	£m	£m
Assets		
Liquid assets	862.5	692.4
Derivative financial instruments	0.1	3.5
Loans and advances to customers	3,295.1	2,772.2
Fair value adjustments for hedged risk	186.6	175.9
Property, plant and equipment	48.7	38.8
Other assets	19.1	15.0
Total Assets	**4,412.1**	**3,697.8**
Liabilities		
Shares	3,400.9	2,713.7
Fair value adjustments for hedged risk	–	0.4
Deposits and debt securities	579.4	552.4
Derivative financial instruments	185.9	178.3
Other liabilities	20.1	12.7
Subordinated liabilities	–	25.0
Subscribed capital	20.0	20.0
Reserves	205.8	195.3
Total Liabilities	**4,412.1**	**3,697.8**

Liquid Assets

The Society has continued to maintain a level of high quality liquid assets throughout 2019. The Society's liquid assets comprise of assets held in cash or that can be easily convertible to cash through treasury markets (repo) or via the various Bank of England liquidity schemes. All of the liquid assets are placed with AAA rated UK Institutions with the exception of Gilts and deposits with the Bank of England which carry the UK Sovereign rating of AA+.

Asset Class	2019	2018
	%	%
Cash in hand and balances with the Bank of England	33.6	31.1
Covered bonds	26.4	23.9
Residential mortgage backed securities	22.9	28.4
Other	9.2	2.1
Gilts	7.9	14.5
	100.0	**100.0**

As mentioned the Society has access to the Bank of England liquidity schemes and has pre-positioned mortgage collateral and asset backed securities that provide funding as part of business as usual and contingency funding plans. The statutory liquidity percentage (liquid assets as a percentage of Shares, Deposits and Liabilities) reported at 31 December 2019 was 21.7% compared to 21.2% in 2018.

Excluding encumbered collateral balances liquidity was 15.8% compared to 14.6% at the previous year end. This is in excess of the Society's minimum operating level. The Liquidity Coverage Ratio (LCR) measures unencumbered high quality liquid assets as a percentage of net cash outflows over a 30 day stress period. The LCR as at 31 December 2019 was 179%, comfortably in excess of the minimum regulatory limit of 100%.

Loans and Advances to Customers

The Society's strategy to grow prime residential mortgage business whilst winding down legacy portfolios continued during 2019.

Loan Portfolios	2019	2018	Increase in year
	£m	£m	%
Core Lending			
Prime Residential	2,326	1,845	26
Retail BTL <£1m	295	201	47
Legacy Lending			
Equity Release	187	200	(7)
Specialist Residential	38	48	(21)
Housing Associations	397	425	(7)
Commercial	30	39	(23)
Other	27	26	4
	3,300	**2,784**	**19**
Provisions	(5)	(12)	
	3,295	**2,772**	
Average LTV %	65.2	62.0	

The net increase in loans and advances to customers after provisions was £523m overall in 2019, this includes a net £575m increase in our core lending of which £94m of this was on buy to let properties to individuals. Average LTV increased during the year to 65.2%, as an expected consequence of purposefully offering more products aimed at first time buyers and younger homeowners. The Society does not offer new lending to professional landlords or undertake buy-to-let lending to corporates.

The Group's lending is all secured with a first charge registered against the collateral property. Residential loans are shown at indexed loan to value using the quarterly regional Halifax House Price Indices, all other loans are shown without indexing. Further information on security loan to value is provided in Note 31.

Mortgage Credit Quality

Arrears

The Society measures mortgage arrears of 3 months or more (excluding possessions) for both number and value of loans. Although primarily a measure of the quality of the existing mortgage books, the Society also uses its mortgage support functions to influence future lending with "lessons learned" fed back into lending policy.

Arrears Performance
3 months or more arrears

	By number of loans		By balance	
	2019	2018	2019	2018
	%	%	%	%
Residential	0.33	0.29	0.43	0.44
Other	1.09	1.36	0.55	0.69
Total	0.34	0.30	0.37	0.36

The percentage of mortgages in arrears by 3 months or more remain at low levels for 2019. Overall by number of loans arrears we have seen an increase of 4bp to 0.34%, and by balance we have seen an increase of 1bp to 0.37%. There were no commercial loans in arrears at the year end.

Forbearance

The Society will work closely with any homeowner experiencing difficulties, offering help and advice on all aspects of the situation. Forbearance cases and options granted are monitored by the Society's Credit Risk Committee with the levels of concessions granted not considered to be material for the size of the overall book.

Law of Property Act Receiverships and Possessions

The Society continued to experience a low level of possessions on residential loans and Law of Property Act receiver appointments. At the end of 2019 the Society had 7 possession properties in relation to owner occupied loans and there were 2 exposures being managed by a Law of Property Act receiver.

Strategic Report

Continued

Funding

The Society manages its funding levels, mix and duration carefully to ensure it has the required resources in place to meet its liquidity and lending targets. The Society is predominantly funded through retail savings with wholesale funding used to provide a diversified funding source.

Retail savings balances increased by £687m during 2019 to £3.4.bn. Wholesale funding, including drawdown on Bank of England Funding Schemes, also increased during the year by £27m. This increase in retail balances has resulted in the ratio of shares and deposits to wholesale balances moving from 83%/17% in 2018 to 85%/15% in 2019.

Capital

The table below shows the composition of the Group's capital ratios at the end of the year.

Capital

	2019 £m	2018 £m
Tier 1 Capital		
Common Equity Tier 1 Capital	201.6	191.8
Additional Tier 1	6.0	8.0
	207.6	199.8
Tier 2 Capital		
Tier 2 Capital	14.0	16.6
Collective Impairment Allowance	0.4	0.6
	14.4	17.2
	222.0	217.0
Risk Weighted Assets		
Liquid Assets	47.4	46.1
Loans and Advances to Customers	1,213.6	1,019.9
Other Assets	65.8	53.2
Off Balance Sheet	21.1	16.2
Operational Risk	98.9	88.9
	1,446.8	1,224.3
Capital Ratios	**%**	**%**
Common Equity Tier 1 Ratio	13.9	15.7
Tier 1 Ratio	14.3	16.3
Total Capital Ratio	15.3	17.7
Leverage Ratio	4.7	5.4

The Group complied with Individual Capital Guidance plus capital buffers, as notified by the Prudential Regulation Authority, throughout 2019. The total capital ratio was 15.3% (2018: 17.7%); Tier 1, and more importantly Common Equity Tier 1, which offers the greatest protection to Member's funds in the unlikely event of unforeseen financial stress; were 14.3% and 13.9%, respectively in 2019.

The fall in ratios reflects successful growth on our prime residential lending portfolio however remains in line with our internal plan and well above regulatory limits.

The Group repaid £25.0m fixed rate subordinated notes during 2019.

The leverage ratio is a simplified capital strength ratio measuring qualifying tier 1 capital against on and off balance sheet assets. The Board monitors the leverage ratio on a monthly basis and as at 31 December 2019 the figure was 4.7% (2018: 5.4%). This is, and has remained throughout 2019, well in excess of the regulatory target.

The Group holds capital, primarily though accumulated reserves, to protect itself against the risk inherent in the running of a building society: primarily credit risk inherent in mortgage lending, liquidity investment, operational risk and the ability to realise other balance sheet assets ultimately into cash.

The Group's total capital requirement/individual capital guidance is communicated annually by the Prudential Regulation Authority and consists of minimum regulatory capital requirements (Pillar 1) plus additional, Society specific capital requirements for credit, market, operational, counterparty, credit concentration, interest rate and pension obligation risk (Pillar 2A). The Group's total capital requirement at 31 December 2019 was £138.4m. Further details on the Group's capital position including the transitional impact of Basel III is given in the Pillar III disclosures available on the Society's website.

Principal Risks and Uncertainties

The principal risks and uncertainties faced by the Group are set out in the Risk Management Report.

Outlook

Following the UK ceasing to be a member of the European Union on 31st January 2020, the 11 month transition period and connected negotiations are unlikely to be straightforward. Whilst the Society does not have any significant direct dependency on Europe, we expect the consequential economic and political year ahead to be fundamentally uncertain resulting in continued and significant negative pressure on the Group. Whilst this challenging market evolves the Society will focus on what we do best by reinforcing our purpose led strategy aimed at achieving a sustainable business model for the long-term, which is uniquely placed within our region and the communities we serve.

On behalf of the Board

David Samper

Chief Financial Officer

25 February 2020

Customer testimonial

"All of the staff go above and beyond. They always have a smile on their faces and if they're unsure about something, they'll ask - which doesn't happen very often."

Joanne

Gateshead customer

Community Support

Newcastle Building Society Community Fund
at the Community Foundation

Here at Newcastle Building Society, we are committed to helping our communities make positive changes.

Our colleague volunteering supported 153 causes this year and we provided 86 grants to the many small (and not so small) community groups across our region.

We provide our grant support through the Newcastle Building Society Community Fund. We celebrated a major milestone when the fund passed a £2m milestone this year.

One of our priorities, through the fund, is to create a long term, sustainable funding legacy to support the hard working and committed communities of our region for many years to come.

More than £403,000 was distributed in community donations across the North East and Cumbria during the year. We doubled the value of Building Improvement Grants to provide up to £100,000 for groups in need of assistance in maintaining or improving their community buildings.

To the right are a few of the local causes that have been supported over the year.

We've made a small change to our grant nomination process recently. From 2020 Members can nominate local community groups, causes and charities across the North East for grants of up to £3,000, at any point in the year.

If you would like to nominate a cause local to you and to our branch network, please see our website: **newcastle.co.uk/community** or visit your local branch for more information.

BAY Foodbank

The BAY Foodbank aims to provide emergency food provision to individuals or families experiencing a financial crisis. A grant of £3,000 is helping to fund the Foodbank's food for two breakfast clubs and a lunch club for schools on the Meadowell Estate in North Tyneside.

RDA Unicorn Centre

The centre based in Cleveland has used their grant of £3,000 to pay for a new horse, named Caesar. Caesar helps the centre to deliver their riding therapy sessions to children and young adults with disabilities.

The Children's Foundation

The Children's Foundation is a charity which works to improve the health and well-being of children and young people in the North East. They used their grant of £3,000 to create a wooden story chair and provide reading resources for children visiting the Great North Children's Hospital to help reduce their anxiety whilst in hospital.

Barnabas Safe and Sound

Barnabas Safe and Sound works with young people aged 11 – 25 experiencing a personal or housing crisis. A BIG grant of £49,956 was used to refurbish Wellwood House and remove interior walls. This has created a 1-1 room and an open plan area for delivery of services for young people in their care.

Boardroom Charity Challenge

This year, we changed up the Boardroom Charity Challenge and hosted the event externally with Gateshead Council and Proto, supporting 8 Gateshead schools. St Mary's RC Primary School in Whickham were the winners on the day and won the £1,000 cash prize to host their big school pyjama party, raising funds for a local charity.

East End Youth and Community Centre

The Community Centre in North Shields used a grant of £3,560 to make much-needed repairs to its dance studio, which is used for theatre and dance groups and Zumba classes. The grant enabled them to redecorate the interior and replace the performance mirrors.

Community Support

Continued

Earsdon & Wellfield Community Association

The volunteer run community centre in Whitley Bay, who host around 500 people per week for a variety of activities from art classes to dance classes used their grant of £49,288 to complete essential roof repairs on the South side of the centre.

Liberdade

Liberdade was set up to create the opportunity for a group of people with learning disabilities to establish and run their own physical theatre community. A grant of £2,820 was used to pay for volunteer support worker for people with learning disabilities at Gosforth Civic Theatre.

Great North Air Ambulance

The charity relies on three aircraft to cover 8,000 square miles to provide vital care to severely injured or ill patients. We were able to provide a grant of £1,058 to pay for three new flight suits for Air Ambulance doctors.

St. Oswald's Hospice

In 2019 we supported St. Oswald's Hospice through volunteering and were also a part of the Hospice's 'Elmer's Great North Parade' which lasted for 11 weeks. As part of the parade, we welcomed 'Tynie' the sculpture to our Portland House Office on New Bridge Street.

Colleague Community Champions

In 2019 we introduced our colleague Community Champions programme which encourages colleagues from around our Society to visit local projects who have received a grant to understand more about their cause and the challenges they face. Colleagues, our Executive team and members of our Board visited 50 groups this year.

Bede Foodbank (Newcastle West End Foodbank)

The Bede Foodbank received a grant of £2,885 enabling them to purchase a greenhouse for the garden at the Lillia Centre. They plan to transform an area of unused land to the rear of the Centre into a productive kitchen garden to support healthy eating amongst those who use the Foodbank's services.

Library Support

The Society supported both Stokesley and Whickham libraries by providing financial support for at least three years to use towards any funding gaps and to further enhance the library facility and community activities.

Fundraising

Colleagues raised over £28,500 for the Community Fund, Children in Need and Macmillan Cancer Support in a variety of ways, from bake sales to coastal walks.

Our Directors

Phil Moorhouse
Chairman

Phil has been the Society's Chairman since the 2013 AGM. He is a Fellow of the Chartered Association of Certified Accountants. He is the Chair of Newcastle Strategic Solutions Limited. Phil also chairs the Society's Nominations Committee.

Phil brings important skills to our board as a qualified and highly experienced accountant and business operator, providing a knowledgeable overview in balancing risk, capital, liquidity and profitability.

As Managing Director of a highly successful and fast growing plc he understands how to ensure an entity grows safely and sustainably. His NHS experience brings additional insight from a highly regulated, non financial services sector organisation.

He has held a number of senior Board positions, including that of Managing Director (UK) of Northgate PLC, which he held for more than seven years; this followed six years as Finance Director. In addition to being Vice Chairman of Cumbria Partnership NHS foundation trust for four years, Phil was a Non-Executive Director at MPAC plc for seven years, and a Non-Executive Director at North P&I Group. He brings many years of business experience to the Society's Board. In recognition of his skills and expertise he was awarded 'North East Non-Executive of the Year 2015' at the North East Business Executive of the Year Awards.

Karen Ingham
Non-Executive Director

Karen has an extensive customer services background gained in highly competitive consumer sectors and is extremely people and customer focused.

In her current role as Vice President of Expedia for EMEA and as part of a digital business, Karen brings a valuable level of experience to the Board across culture, diversity and the development of customer benefits using digital technologies.

As an ex-HR Director she also understands employment law and is able to bring this perspective to Board discussions.

Her contribution to delivering great customer experiences linked to profitable growth aligns to the Society's strategy in building impact and long term success.

Karen's external roles have included Head of Service and Customer Experience Director. She also spent 18 months as HR Director in the construction industry and started her career with 18 years in Financial Services at the Co-operative Bank. Karen is a member of the Chief Customer Officer Forum. She is also a Director of Newcastle Strategic Solutions Limited and a member of the Remuneration Committee.

Adam Bennett
Non-Executive Director

Adam joined the Board in April 2019 and is a member of the Society's Group Risk Committee and a Director of Newcastle Portland House Limited.

Adam spent 36 years at law firm, Addleshaw Goddard, where he specialised in advising building societies. He has a deep knowledge of the building society sector and its associated corporate governance and regulatory requirements.

Adam's fantastic professional network is a great benefit to the Society. He has advised building societies across a diverse range of issues. He brings formidable legal insight and experience of different business models and structures, important given the Group structure, which includes two key subsidiaries, Newcastle Strategic Solutions Ltd and Newcastle Financial Advisers Ltd.

During his professional career, Adam has advised on Rules of Building Societies, on corporate governance, including compliance with the UK Corporate Governance Code, and on the powers and statutory and fiduciary duties of directors.

Andrew Haigh
Chief Executive

Andrew became the Society's Chief Executive in May 2015 having joined the Board as Chief Operating Officer in January 2014.

He has a track record in transforming and developing businesses, and has more than 30 years' business experience, including over 20 years in the mutual sector. He has held financial services leadership roles as both an Executive and a Non-Executive Director, bringing a depth of consumer understanding developed from a variety of sectors including the financial, motor, information technology and airline industries.

A proven Chief Executive, Andrew has particular strength in building effective leadership teams and organisations with healthy cultures. His sound experience and customer focus has seen him guide the long term growth and innovation of brands through clearly defined, purpose led strategies.

Andrew is a strong advocate for the role of mutuals in the financial services sector and appreciates the balance between delivering profitability and meaningful member value. As the former Chief Executive of Engage Mutual Assurance, he led the organisation for over 10 years, through a period of sustained growth and innovation.

Andrew is a Board member of the Community Foundation serving Tyne & Wear and Northumberland, a Director of the North East England Chamber of Commerce and a Vice President of the Chamber Council, and Chairman of the Northern Association of Building Societies.

David Samper
Chief Financial Officer

David joined the Society in 2018 as Chief Financial Officer.

An accomplished strategic leader with over 20 years' experience as a Chartered Accountant, David has a fundamental knowledge of the issues impacting the long term commercial sustainability of our business model, balance sheet and profitability.

He understands the financial services sector exceptionally well and has valuable experience in managing financial performance across both large and medium sized financial organisations in the UK and abroad. He brings a different perspective to his team and the Board, gained from his international business experience. David's career has also encompassed multiple platform builds and system migrations, complementing the knowledge and expertise of our growing Solutions business.

He has held senior roles across a number of organisations, including RBS, Ulster Bank, and at Sainsbury's Bank as its interim Chief Financial Officer. He has led complex acquisitions and driven transformational change, whilst consistently delivering core commercial outperformance.

David's previous experience with broader capital markets and shaping organisational strategy in an ever changing economic and competitive environment will be key to ensuring the success of our ambitious Group.

Stuart Miller
Customer Director

Stuart became Customer Director for the Society in 2018.

He is an Associate of the Chartered Institute of Bankers and holds the Customer Experience Professionals Association qualification for senior business leaders. Stuart is a Director of Newcastle Financial Advisers Limited.

Stuart brings extensive experience of regulated sales across mortgages, savings and financial advice. This ensures the Society delivers a great experience and outcomes for customers and the right conduct and culture amongst colleagues.

Amongst his areas of expertise are developing customer experience strategies and voice of customer programmes, which are critical to acquiring, retaining and growing the Society's customer base.

His broad experience in managing and inspiring large teams of colleagues is critical to the Society's work to connect its people to its strategy and purpose and contribute to making the Society a great place to work.

Stuart has more than three decades' customer service experience in the financial services sector, including with Virgin Money, RBS International, and NatWest. He is responsible for ensuring Newcastle Building Society Members receive a stand out experience, whether across its branch network, via telephone or online.

Our Directors

Continued

Mick Thompson

Non-Executive Director

Mick joined the Board in January 2019, is Chairman of the Audit Committee and is also a member of the Nominations Committee.

He brings significant accountancy experience to the Board and with a deep knowledge of audit can support the Society's governance and audit function.

Mick spent 21 years as a Partner and nine years as Office Senior Partner at KPMG Newcastle, where he was responsible for driving growth and expansion.

He has worked with companies and organisations across a broad range of industry sectors, including housebuilding, social housing, education, retail, charities and financial services.

He is a Trustee of Greggs Foundation Charity; Trustee of NUFC Foundation Charity; Trustee of Tyne and Wear Building Preservation Trust; Regional Treasurer of The Lord's Taverners Charity and a Member of the International Advisory Board of the Newcastle University Business School.

His extensive network in the region helps bring excellent connections to support the development of the Society's brand and strategy. His wide ranging board portfolio, particularly in the charity sector, is well aligned to our community focus and helps us better understand the issues affecting this sector.

Anne Shiels

Non-Executive Director

Anne is an HR professional with extensive Executive and Board level experience, across a broad range of sectors including retail, financial services, telecommunications, manufacturing and consumer.

Her widespread sector experience and deep understanding of employment law, diversity and changing workforce demographics both helps us develop a broader view on matters affecting the Society, and assists in developing our current and future people strategies.

She has held Executive roles at Hallmark Cards and Lloyds Banking Group/HBOS. She is also a trusted executive coach and adviser to boards and directors in diverse businesses in the UK and the US.

Anne is a member of the Society's Audit Committee, Nominations Committee, and Remuneration Committee.

John Morris

Deputy Chairman and Senior Independent Director

As a Fellow of the Institute of Chartered Accountants, John brings significant experience of both the banking and building society sectors.

Highly experienced in accounting standards and governance, John's strong sector experience and deep knowledge of issues affecting balance sheets and long term profitability provide robust oversight and future focused guidance for the Society. This is consolidated with his financial services risk management experience, from both a prudential risk and conduct risk perspective.

As a Non-Executive Director with the Society for over eight years, John has built considerable understanding of the Society's business model, including its highly successful Solutions business. The Society has achieved a sustained improvement in profitability during the period in which John has served on the Board.

John worked for several years as Director of Finance for the Retail Banking Division at HBOS. Prior to that, he held senior posts at Halifax (Halifax Building Society and then Halifax PLC) as General Manager and Leeds Permanent Building Society where he held the post of General Manager Finance. He also worked at KPMG where he started his accountancy career. He is Chairman of the Remuneration Committee and a member of both the Nominations Committee and the Audit Committee.

Bryce Glover

Non-Executive Director

Bryce is a highly experienced Director who has operated at Executive Committee and Board level in a number of leading UK financial services businesses.

Bryce adds a genuine breadth of commercial and retail banking expertise, along with a strong credit and risk management background, which is particularly valuable in his role as Chair of the Society's Risk Committee.

He has a deep understanding of the mutual sector, having spent nine years working for the UK's largest building society, the last three as Corporate Affairs Director.

His extensive industry knowledge and business acumen assist the development of the business.

The majority of Bryce's career has focused on corporate and commercial banking. He was Managing Director of Commercial Banking at A&L / Santander, before joining Nationwide Building Society in 2009 as a Director heading its Commercial Division, where he managed a £22bn commercial lending portfolio and the Society's business savings accounts before heading Corporate Affairs.

Bryce is Chairman of the Society's Group Risk Committee and a member of the Remuneration Committee.

Ian Ward

Non-Executive Director

Ian has extensive experience in financial services and was Chief Executive of Leeds Building Society for 16 years until his retirement in 2011.

As CEO of Leeds Building Society, Ian acquired significant experience of managing and guiding a building society through a period of significant growth, such as that currently being experienced by the Society.

As a Board Director he provides ongoing and valuable strategic input and knowledge to the business, while his previous experience within the NHS has proved helpful in bringing non financial services thinking to the Board.

Ian is a Non-Executive Director of OneSavings Bank PLC as well as Charter Court Financial Services Group PLC and its subsidiaries.

He was Senior Independent Director of Harrogate & District NHS Foundation Trust and a member of its Audit & Finance Committees for six years until September 2018.

He has been a Non-Executive Director of Newcastle Building Society since 2013 and Chairs Newcastle Financial Advisers Limited. He is also a member of the Society's Group Risk Committee.

Customer testimonial

“I’ve been a member of the Building Society now for 20 years, I like coming here as its very friendly and the staff are very efficient and will tell you about any new products.”

Patricia

Chester-le-Street branch

Directors' Report

The Directors present their Annual Report and Accounts and Annual Business Statement for the year ended 31 December 2019, which they consider to be fair, balanced and understandable, providing Members with the information necessary to assess the Group's position and performance, business model and strategy.

Objectives and Activities

It is the intention of the Directors that the Society will continue to remain an independent regional building society. The Society's purpose and strategy are set out in the Strategic Report.

Business Review and Future Developments

The Chief Executive's Review and Strategic Report set out the business activities and business performance in the year against our strategic objectives, as well as likely future developments. The Strategic Report also outlines the Group's key performance indicators (KPI's), which include customer, colleague and financial KPI's, details of the Group's customer focus and colleague agenda, financial analysis, mortgage credit quality and capital position.

The Annual Business Statement and the Credit Risk section of Note 31 contain respectively the ratios and arrears disclosures required by the Building Societies Act 1986.

The Board has assessed the viability of the Group by reviewing medium and long term plans over a detailed 3 year horizon with particular emphasis on examining forecast liquidity, capital and profitability of the Group and the risks to those forecasts through a variety of stress testing scenarios. This horizon is considered appropriate through alignment to the Group's usual forecasting and management reporting allowing robust and continuous assessment of the Group's expected position and principal risks over the time-frame. Active risk management is undertaken to mitigate the Group's principal risks as detailed in the Risk Management Report.

The outcome of this review is that the Directors are satisfied that the Society and the Group have adequate resources to continue in business and meet their liabilities as they fall due throughout the period of assessment. Accordingly the financial statements of the Society and the Group have been prepared on a going concern basis with no material uncertainties that the going concern basis of accounting is appropriate.

Risk Management, Principal Risks and Uncertainties

The Risk Management Report sets out the principal risks and uncertainties faced by the Group together with the risk management framework and risk governance structure. The Risk Management Report also details how the Group mitigates the specific key risks to which it is exposed, which are credit, conduct, liquidity, interest rate, pension fund obligation, operational, capital and Brexit risks. In addition, Note 31 sets out the metrics associated with the key risks including sensitivity analysis and exposure level.

Mortgage arrears

As at 31 December 2019 there were 18 cases (2018: 18) where payments were 12 months or more in arrears. The capital balances of these loans were £1.4m (2018: £1.1m). The total amount of arrears on these loans was £0.2m (2018: £0.2m).

Political and charitable gifts

Charitable donations: The Society is pleased to be able to give back to its heartland communities, through charitable donations, colleague fundraising and volunteering. A total of £1.6m was donated to the Newcastle Building Society Community Fund in 2019, £688,000 through the Newcastle Community Saver and £943,000 via the Reclaim Fund Alternative Scheme.

Our colleagues undertook a variety of fundraising activities during 2019 in aid of the Newcastle Building Society Community Fund, Children in Need and McMillan Cancer Support raising in excess of £28,500 for important causes. Throughout 2019, colleagues volunteered over 4,650 hours of their time making an important contribution to a variety of different causes across our heartland. Further details on the Society's charitable donations and community activities during 2019, can be found in the Community Support Round-up.

The Group has not made any political donations during 2019 (2018: nil).

Supplier Payment Policy

The Group follows an internal policy that payment to suppliers will be made within 30 days from receipt of an invoice and endeavours to meet individual supplier payment terms which may be set at shorter timescales. At 31 December 2019, the number of creditor days was 22 (2018: 17 days).

Directors

As at 31 December 2019, the members of the Board, who have served at any time during the year and continue to act as Directors, are as follows:

Adam Bennett (joined the Board on 24 April 2019), Bryce Glover, Andrew Haigh*, Karen Ingham, Anne Laverack (business name: Anne Shiels), Phil Moorhouse, John Morris, Stuart Miller*, David Samper*, Mick Thompson (joined the Board on 29 January 2019) and Ian Ward.

David Buffham resigned from the Board on 24 June 2019 and Patrick Ferguson* resigned from the Board on 21 June 2019.

At the Annual General Meeting (AGM), to be held on 22 April 2020, all of the current Directors will offer themselves up for either election or re-election.

Directors and Officers insurance has been put in place by the Society.

*Executive Directors

All Directors are Members of the Society. Please see the Remuneration Committee Report for further information

Independent Auditors

A resolution to re-appoint PricewaterhouseCoopers LLP will be proposed at the Annual General Meeting.

Statement of Disclosure to Auditors

So far as each Director is aware, there is no relevant audit information of which the Society's auditors are unaware. Each of the Directors, whose names and functions are listed in the Our Directors section have taken all steps that he or she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Society's auditors are aware of that information.

Corporate Governance

The Society's statement on corporate governance can be found in the Report of the Directors on Corporate Governance.

Statement of Directors' Responsibilities

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

The Directors are responsible for preparing the Annual Report and Accounts, Annual Business Statement and Directors' Report in accordance with the appropriate law and regulations. The Building Societies Act 1986 (the Act) requires the Directors to prepare Group and Society Annual Accounts for each financial year. Under the Act they are required to prepare the Group and Society Annual Accounts in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), and applicable law.

The Group and Society Annual Accounts are required by law and IFRS, as adopted by the EU, to give a true and fair view of the state of affairs of the Group and Society as at the end of the financial year and of the income and expenditure of the Group and Society for the financial year, and which provide details of Directors' emoluments in accordance with part VIII of the Act and the regulations made under it.

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

- Select appropriate accounting policies and apply them consistently;
- Make judgements and accounting estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed subject to any material departures disclosed and explained in the Annual Accounts; and
- Prepare the Annual Accounts on the Going Concern basis unless it is inappropriate to presume the Group will continue in business.

In addition to the Accounts, the Act requires the Directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Group.

The Directors are responsible for ensuring that the Group:

- Keeps adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Society in accordance with the Financial Services and Markets Act 2000; and
- Takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its businesses in accordance with the rules made by the Financial Services Authority and Markets Act 2000.

They are also responsible for safeguarding the assets of the Society and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The Directors are responsible for the maintenance and integrity of the financial information included on the Group's website.

Legislation in the UK governing the preparation and dissemination of Annual Accounts may differ from legislation in other jurisdictions

On behalf of the Board

Phil Moorhouse

25 February 2020

Report of the Directors on Corporate Governance

Introduction

In discharging its responsibilities, to be accountable to the Society's Members for the operation of the Society, the Board regards good corporate governance as extremely important. A revised UK Corporate Governance Code (the Code), issued by the Financial Reporting Council (FRC) in July 2018, is addressed to companies with a premium listing, although the Society's Board considers it to be best practice to have regard to the Code when establishing and reviewing corporate governance arrangements. The Code applies to accounting periods beginning on or after 1st January 2019, and therefore the Society has regard to this Code within the 2019 Annual Report & Accounts.

This latest Code is designed to place emphasis on the culture and purpose of an organisation: putting the relationship between organisations and their stakeholders at the heart of a set of principles designed to promote long-term sustainable growth in the UK economy. The Code includes the responsibility for a board to have appropriate workforce policies and practices, which re-inforce a healthy culture, and to address this point the Society is in the process of setting up a "Colleague Forum", chaired by a member of the Executive team. This formally recognised group will consist of colleagues who represent areas across the full organisation and will support leaders in the delivery of key organisational/people matters that are focused on creating a great colleague experience. Another change relates to culture in that Boards are asked to create a culture which aligns corporate values with strategy and to assess how they preserve value over the long-term. The Society has already gone a long way to ensure the compliance of this last point by, for example, putting in place a set of values and behaviours that all colleagues are expected to embrace. In addition, a third party agency has been used to organise surveys and capture, in confidence, comments made by colleagues, which are then acted upon by senior management. It has also been agreed that culture should be formally reviewed by the Board at six monthly intervals, to coincide with the reporting of annual and half-year results.

A working party operates to ensure that on an ongoing basis the corporate governance procedures and processes within the Society are appropriately aligned with the Code, including when updates or revised guidance are published. This report outlines the approach taken by the Society and how the Board considers it has demonstrated application of the principles of the 2018 Code.

The Board

The Society recognises that it must be headed by an effective Board which is responsible for the long-term success of the Society. The composition of the Board is detailed in the Our Directors section. In carrying out its role, the Board aims to ensure that excellent service is delivered to its Members and customers. The Board has responsibilities for contributing to and supporting the values of the Group set by management and believes that the interests of all stakeholders can be best served by remaining a strong and forward looking mutual building society.

There is a clear division of responsibilities between the running of the Board and the Executive responsibility for the running of the Society's business. No one individual has unfettered powers of decision and the roles of Chairman and Chief Executive are exercised by different people within the Society.

The Nominations Committee (NomCo) carries out a review of the independence of Non-Executive Directors as set out within the Nominations Committee section of this report.

An effective Board should not necessarily be a comfortable place with challenge, as well as teamwork, being an essential feature. Challenge by Non-Executive Directors is something which is encouraged by the Chairman and, where appropriate, training is provided to support the challenge process. A culture of openness exists within the Society and Non-Executive Directors are encouraged to meet with members of the Executive team.

Phil Moorhouse was appointed Chairman of the Society on 24th April 2013 and John Morris was appointed Deputy Chairman and Senior Independent Director on 1st June 2019. The position of Deputy Chairman and Senior Independent Director provides a sounding board for the Chairman and where necessary serves as an intermediary for the other Directors.

Board balance and independence is important and the Board should include an appropriate combination of Executive and Non-Executive Directors (and in particular independent Non-Executive Directors) such that no individual or small group of individuals can dominate the Board's decision making. The composition of the Board, through NomCo, reflects an appropriate balance of skills and comprises of eight Non-Executive Directors and three Executive Directors.

Details of the various Board Committees in existence are set out later in this report.

Matters Reserved to the Board

The Board's Terms of Reference are reviewed on a regular basis and were last agreed by the Board in January 2020. A schedule is maintained of matters reserved to the Board which includes the following:-

- **Strategy and Management –** determining the overall strategy of the Group including approval of the Strategic Plan, with the responsibility for its implementation delegated to the Executive team; monitoring operational and financial performance in pursuit of the strategy; overseeing and approving the Society's recovery plans, playbook and resolution pack on an annual basis; monitoring the indicators and overseeing any proposed actions in accordance with the playbook; and approving budgets, forecasts and major capital expenditure.
- **Culture –** overseeing and setting the tone for the culture, values and behaviours of the Group.
- **Structure, Capital and Liquidity –** approval of the Society's Internal Liquidity Adequacy Assessment Process (ILAAP); approval of the Society's Internal Capital Adequacy Assessment Process (ICAAP); approval of changes to the Group's corporate structure; and approval of any programme for the issuance of long-term debt or capital.
- **Financial Reporting and Internal Controls –** approval of Stock Exchange announcements, half year and final annual results; approval of the Annual Report and Accounts including the Strategic Report, Risk Management Report, Report of the Directors on Corporate Governance, and the Remuneration Committee Report; approval of the Pillar 3 disclosures; ratification of the Going Concern and Business Viability review following review and approval by the Audit Committee; approval of any significant changes in accounting

policies or practice based on the recommendations of the Audit Committee; and ensuring an adequate internal control environment is in existence. The Board delegates oversight of internal controls to the Audit Committee.

- **Risk Management and Regulatory –** ensuring an adequate risk management framework is in place. This includes approval of risk appetite, oversight of risk governance, reviewing the top risks, ensuring the strategy and risk appetite are consistent and approving the ICAAP. The Board delegates oversight of risk management to the Group Risk Committee, as well as oversight of compliance with regulations (including by the Prudential Regulation Authority and the Financial Conduct Authority).
- **Senior Managers and Certification Regime –** ensuring that the Society meets its obligations under the Senior Managers Regime (SMR), including: reviewing at least annually the SMR Policy; and maintaining a responsibilities map for all prescribed responsibilities and ensuring all prescribed responsibilities have been allocated.
- **Board Membership and Senior Management Issues –** approval of changes to the structure, size and composition of the Board, following recommendations from NomCo; ensuring that adequate succession planning for the Board and senior management is in place following recommendations from NomCo; and approving and overseeing appointments to the boards of subsidiary companies.
- **Appointment and/or re-appointment or removal of the external auditor -** to be put to Members for approval, following a recommendation from the Audit Committee.
- **Remuneration –** agreeing the remuneration policy for the Directors and other Senior Executives, following recommendations from the Remuneration Committee.
- **Delegation of Authority –** ratifying the terms of reference for Board Committees and Subsidiary Companies; and receiving minutes and/or reports from the chairs of the Board Committees and Subsidiary Companies
- **Corporate Governance Matters –** ensuring that a formal evaluation of the effectiveness of the Board is undertaken on an annual basis and to consider whether an external assessment using outside consultants as a facilitator is undertaken; determining the independence of Directors; reviewing the Group's overall corporate governance arrangements; and agreeing the Directors' Conflicts of Interest Policy and other relevant policies.

The Board's Terms of Reference are included on the Society's website (http://www.newcastle.co.uk).

Board Changes and Elections/Re-elections

It is recognised that changes need to be made to the Board from time to time. In 2019, David Buffham and Patrick Ferguson resigned from the Board, and Adam Bennett and Mick Thompson were appointed as Non- Executive Directors.

Copies of the Terms of Engagement for all of the Society's Directors are available on request, and at the Annual General Meeting (AGM).

All of the Society's Directors are standing for either election or re-election at the AGM. The biographies of all of the Directors are detailed in the Our Directors section.

Management Information

The Chairman is responsible for ensuring that the Directors receive accurate, timely and clear information. Board members receive meeting packs on a regular basis, although the Board does not normally meet in August or December. Management Information is provided to Directors throughout the year. A rolling Board agenda is tabled at each Board meeting to ensure that all key areas are covered appropriately during the year and sufficient time is set aside at each meeting to ensure that constructive discussion and challenge can take place.

All Directors have access to independent professional advice, if required, and also access to the services of the Group Secretary.

Board Effectiveness

The Board conducts an internal review of its effectiveness on an annual basis, with the last review undertaken in January 2020, based on feedback from Directors and the Principles at the heart of the UK Corporate Governance Code. The Board concluded it was effective.

Board Committees

The Board has a number of Committees, all of which have their own Terms of Reference, which are reviewed on an annual basis and further details are provided below. The Chair of each Committee reports to the Board at a subsequent meeting on matters discussed at each Committee meeting.

Similar to the Board, each Committee carries out a review of its own effectiveness, and where improvement opportunities have been identified the individual Committees are responsible for tracking action points. These reviews are carried out on an annual basis and concluded satisfactorily.

Information concerning attendances at the meetings is detailed in the Board and Board Committee Membership Attendance Record section of this report. Terms of Reference for the Audit Committee, Group Risk Committee, Remuneration Committee and Nominations Committee are included on the Society's website (http://www.newcastle.co.uk).

Audit Committee

Details of the Audit Committee are contained in the Audit Committee Report. Through the work of the Audit Committee and the Internal Audit Services department during 2019, the Directors have carried out a review of the Group's risk management and internal control systems, covering all material controls, including financial, operational and compliance controls.

Remuneration Committee

Details of the Remuneration Committee are contained in the Remuneration Committee Report.

Group Risk Committee

Details of the Group Risk Committee are contained in the Risk Management Report.

Nominations Committee (NomCo)

The Society has a separate NomCo comprising only of Non-Executive Directors and which operates within the Terms of Reference agreed by the Board. The Terms of Reference and the effectiveness of NomCo are reviewed on an annual basis, with the last review carried out in January 2020.

The main objectives of NomCo are summarised as follows:-

- To oversee the structure of the Board, Board Committees and Subsidiary Company Boards;
- To identify suitable candidates to fill Board vacancies;
- To ensure that the Board has the appropriate balance of skills, diversity and experience; and
- To oversee the Board's succession plan.

All key decisions of NomCo, for example, Board appointments, must also be ratified by the full Board.

Members of NomCo are Phil Moorhouse (Committee Chairman), John Morris, Anne Shiels and Mick Thompson. NomCo operates to a rolling agenda to ensure it discharges its full responsibilities and in 2019 it met on four occasions.

NomCo is supported by the Chief Executive and the Human Resources Director who attend meetings in an advisory capacity only.

Appointments to the Board

NomCo follows a stringent recruitment process when making appointments to the Board. This process is tailored to meet the requirements of each particular vacancy and the method of attracting candidates is adapted depending on the nature of the skills required for the vacancy. External consultants and advisers are normally utilised to ensure there is a robust list of suitable candidates with which to fill a vacancy. During 2019, the Society utilised the services of independent recruitment specialists, Warren Partners, and HW Global Talent Partner in the appointment of new Directors.

Whenever a new Director is appointed, the Financial Conduct Authority and Prudential Regulation Authority have the right, for certain key roles, to carry out formal Significant Influence Function (SIF) interviews in order that the Director becomes an Approved Person.

All Directors have been issued with Service Agreements, Role Descriptions and Terms of Engagement (for Non-Executive Directors), to ensure that all Directors fully understand and comply with their roles and the responsibilities of being a Director of the Society.

Diversity of the Board

The Board recognises and embraces the benefits of having a diverse Board which utilises a range of factors including skills, industry experience, background, race, gender and the other characteristics, experience and qualities of its Directors. Giving specific regard to gender ratios, there were two female directors on the Board last year, Karen Ingham and Anne Shiels.

It is important to note that all Board appointments are made on the basis of individual competence, skills and expertise measured against identified objective criteria. Appointment is therefore based on merit.

Election or re-election to the Board

All Directors, as appropriate, are required to seek election or re-election at the forthcoming Annual General Meeting (AGM), to be held on 22nd April 2020.

Non-Executive Directors are usually expected to serve more than one three year term, subject to satisfactory performance evaluations and re-election by Members. Only in exceptional circumstances would Non-Executive Directors be able to seek re-election when they have served nine years on the Board. NomCo has in place a risk based succession plan which is reviewed on a regular basis.

Independence of Directors

The Terms of Engagement for Non-Executive Directors require that they declare to the Society any other external interests.

NomCo carries out an annual review of the independence of Non-Executive Directors, against the circumstances set out in the Code. This does not include the Chairman, Phil Moorhouse, who was appointed Chairman of the Society on 24th April 2013 and at the time of appointment was considered to be independent by the Board (the Code states that the Chair should be independent on appointment, when assessed against the circumstances set out in the Code). The last review of the independence of Non-Executive Directors was carried out by NomCo in January 2020, where it was confirmed they considered them to be independent; this was subsequently agreed by the Board in January 2020.

One of the Non-Executive Directors, Ian Ward, is a Director of OneSavings Bank PLC and a number of companies within the Charter Court Financial Services Group PLC. He has advised the Board of the existence of the relationship under the Policy for dealing with Conflicts of Interest, and procedures exist within the Society to manage the position.

The Society recognises that it is good corporate governance to have a Senior Independent Director, a role currently carried out by John Morris.

During 2019, the Chairman met separately with the Non-Executive Directors and regularly, without the Executive Directors present, in addition to regular telephone contact with the Non-Executive Directors throughout the year.

Assessment of Directors

All Directors are subject to a formal appraisal of their performance on an annual basis. The Chairman conducted the appraisals of the Chief Executive and Non-Executive Directors, the Chief Executive conducted the appraisals of the Executive Directors, whilst the Senior Independent Director led the appraisal of the Chairman.

Report of the Directors on Corporate Governance

Continued

Skills and Continuous Development

All Directors are required, as part of their terms of engagement, to follow a process of continuous development to ensure their skills and experience meet the needs of the Society and the regulatory environment in which it operates. The training and development plans of Non-Executive Directors are reviewed at least annually during their performance appraisal.

NomCo oversees the on-going training and development of Non-Executive Directors including a formal induction programme for newly appointed Directors. The Chief Executive oversees the programmes for Executive Directors.

In order to ensure that NomCo discharges its duties in this area effectively, a Board skills matrix and a training menu for Non-Executive Directors are in place.

Newcastle Strategic Solutions Limited (NSSL)

NSSL Board Members are:

Phil Moorhouse (NSSL Chair), Karen Ingham, Ron McCormick, Stuart Lynn, Phil Grand (Managing Director NSSL) and Andrew Ward (Finance Director NSSL).

In 2019, NSSL acquired substantially all of the business and assets of Newcastle Systems Management Limited (NSML) and in doing so, brought together our technology subsidiary and our savings management outsourcing business. As a result, our corporate structure was simplified whilst the services provided continue unchanged.

The main responsibilities of NSSL, as delegated by the Society's main Board, are as follows:-

- To oversee the strategic direction of NSSL ensuring this is consistent with the Society's agreed Strategic Plan;
- To evaluate and monitor the financial and operational performance of NSSL against pre-determined objectives, which includes assessing performance in terms of contract contribution, profitability, efficiencies, risk, compliance and development of the savings management proposition;
- To ensure that appropriate mechanisms are in place to inform the Society's Board about the performance of NSSL and any key issues identified;
- To ensure that NSSL complies with all relevant legislation, including the General Data Protection Regulation and associated data protection legislation and the appropriate regulations relating to NSSL activities;
- To establish and review a risk appetite statement for NSSL, and to review, at least annually, the position of NSSL against that risk appetite statement;
- To ensure that an annual review of service resilience is conducted and that there is ongoing development to enhance resilience;
- To approve the NSSL budget on an annual basis (prior to inclusion in the Group budget which is approved by the Society's Board);
- To approve the NSSL statutory accounts;
- To consider and act upon the findings of any external/internal audits or reviews;
- To ensure that information assets are protected sufficiently that their confidentiality, integrity and availability are maintained in line with the ISO27001 standard along with company and client requirements; and
- To ensure that a formal evaluation of the effectiveness of the NSSL Board is undertaken on an annual basis. The last review was undertaken in February 2020 where it was concluded the NSSL Board was effective.

Further details of the activities of NSSL are given in the Strategic Report.

Newcastle Systems Management Limited (NSML)

NSML Board Members are:

Ian Ward (NSML Chair), Phil Moorhouse, Stuart Lynn, Steve Watchman and Andrew Ward.

Newcastle Financial Advisers Limited (NFAL)

NFAL Board Members are:

Ian Ward (NFAL Chair), Stuart Dodson (Managing Director NFAL) and Stuart Miller (the Society's Customer Director). The Society's Chairman, Phil Moorhouse, also attends NFAL Board meetings on a regular basis in an advisory capacity.

The NFAL Board will also use external consultants to provide challenge and advice to the Board, as required. At least once a year Directors from Openwork Limited usually attend an NFAL Board meeting to provide a financial and market update; NFAL is an appointed representative of Openwork Limited.

The main responsibilities of NFAL, as delegated by the Society's main Board, are as follows:-

- To oversee the strategic direction of NFAL ensuring this is consistent with the Society's agreed Strategic Plan;
- To evaluate and monitor the performance of NFAL against the objectives set, which includes assessing performance in terms of sales quality, customer satisfaction and outcomes, complaints, risk and compliance oversight (including consideration of the aspects that are specifically the responsibility of Openwork Limited) and profitability;
- To ensure that appropriate mechanisms are in place to inform the Society's Board about the performance of NFAL and any key issues identified;
- To review and approve the bonus scheme for NFAL ensuring that quality and customer outcomes are central to performance assessment;
- To review, at least annually, the reputational and consumer risks associated with NFAL and the controls in place in respect of this risk. The review will be presented to the NFAL Board in the first instance and ratified by the Society's Group Risk Committee;
- To ensure that NFAL complies with all relevant legislation including the General Data Protection Regulation and associated data protection legislation, and the appropriate regulations relating to NFAL activities;
- To approve the NFAL budget on an annual basis (prior to inclusion in the Group budget which is approved by the Society's Board);
- To approve the NFAL statutory accounts;
- To receive the minutes of strategic partner governance meetings and to be made aware of any changes to the framework for managing relationships with strategic partners;
- To consider and act upon the findings of any external/internal audits or reviews and make suitable recommendations as appropriate; and
- To ensure that a formal evaluation of the effectiveness of the NFAL Board is undertaken on an annual basis. The last review was undertaken in January 2020 where it was concluded the NFAL Board was effective.

Relations with Members

Member engagement is at the heart of our strategy and the Society develops relationships with Members on a number of different levels. The first and most obvious is through the AGM voting process where Members are encouraged, as owners of the business, to use their vote to register their views. We try to make this process as easy as possible, providing the convenience of voting online or by post and providing an additional incentive through a small charity contribution for every vote cast.

We run a number of Member engagement events every year in locations across the North East where Members can share their feedback with the Chief Executive, members of the Executive team, and Non- Executive Directors. We have implemented a daily online Customer Satisfaction Survey which is reviewed daily by senior management within the Society and we continue to engage with our Online Customer Panel. Our social media channels are also used by customers to provide feedback / request additional information. As part of our branch refurbishment and extension programme we invite local customers along to branch re-launch events, taking the opportunity to gain their feedback and understand their perspectives. In addition, we have a range of marketing communications designed to inform Members about our progress, products, community activities, and the numerous ways we can help them.

Mortgage brokers play an important role in introducing mortgage business to the Society. We regularly conduct broker satisfaction surveys and run dedicated forum events for these intermediaries to help to develop and improve our offering.

Big Talk financial events for Members are held on a regular basis and are designed to provide useful information to help them understand and make sense of what is becoming an increasingly complex financial world.

Through our community and charity support activities we are able to engage with both our Members and the communities we serve. Following the launch of the Newcastle Building Society Community Fund at the Community Foundation, we have provided a growing volume of financial grants to North East community projects, all of which are nominated by our Members. We intend this financial support for our heartland communities will continue to grow in scope and scale.

Our Community Champions programme involves our Directors (both Non-Executive and Executive) and colleagues visiting community groups which have received a grant for a project. This provides an opportunity to build authentic relationships and for colleagues to connect our grant giving back to our Purpose and to identify how else we might support these community groups.

Our colleagues have helped to raise money for our Community Fund, delivered a continuing financial education programme to local junior and middle schools, and provided careers skills support and guidance in senior schools.

Our Dementia Friends Champion has delivered dementia awareness sessions to many people, including Members, colleagues, community groups and businesses on the high street.

We work hard to make a difference and help our communities make positive changes. Our colleagues are similarly encouraged to support our communities by volunteering their time and skills, and their enthusiasm and commitment continues to grow. Further details regarding our Member and Community Engagement are given in the Community Support Round-up.

Report of the Directors on Corporate Governance

Continued

Board and Board Committee Membership Attendance Record

The table below sets out the number of meetings attended by Directors during 2019 with the number in brackets representing the maximum number of meetings the Director was eligible to attend.

Director	Board	Audit Committee	Group Risk Committee	Remuneration Committee	Nominations Committee	NSSL	NSML	NFAL
Adam Bennett	6 (6)	-	3 (3)	-	-	-	-	-
Bryce Glover	11 (11)	-	5 (5)	2 (2)	-	-	-	-
Andrew Haigh	11 (11)	-	-	-	-	-	-	-
Karen Ingham	11 (11)	-	-	5 (5)	-	6 (7)	-	-
Stuart Miller	11 (11)	-	-	-	-	-	-	5 (5)
Phil Moorhouse	9 (11)	-	-	-	4 (4)	6 (7)	5 (5)	4 (5)*
John Morris	11 (11)	5 (5)	5 (5)	5 (5)	4 (4)	-	-	-
David Samper	11 (11)	-	-	-	-	-	-	-
Anne Shiels	10 (11)	5 (5)	-	4 (5)	4 (4)	-	-	-
Mick Thompson	10 (11)	5 (5)	-	-	1 (1)	-	-	-
Ian Ward	11 (11)	-	5 (5)	-	-	-	5 (5)	5 (5)
David Buffham	6 (7)	-	3 (3)	2 (3)	2 (3)	2 (2)	2 (2)	-
Patrick Ferguson	5 (6)	-	-	-	-	-	-	-

*attended in an advisory capacity.

Annual General Meeting (AGM)

The AGM provides an opportunity for Members to question the Chairman, Chief Executive, Committee Chairmen and fellow Directors on the resolutions to be proposed at the meeting, the Annual Report and Accounts, and on any other aspect of the Society's business.

All Members who are eligible to vote at the Annual General Meeting are encouraged to participate, either in person or by using their proxy voting form. The use of the online voting system is encouraged and for each vote placed online, the Society will be donating 30p to The Newcastle Building Society Community Fund at the Community Foundation.

All votes are counted by independent scrutineers. As soon as practicable after the AGM, full details of the results of the voting are placed on the Society's website.

On behalf of the Board

Phil Moorhouse

25 February 2020

Audit Committee Report

Audit Committee

Members of Audit Committee at 31 December 2019 were:

Mick Thompson (Committee Chair), John Morris and Anne Shiels.

The Audit Committee's extensive experience and qualifications are detailed in the Our Directors section of the Annual Report and Accounts. The Committee's combined financial sector experience and competence remains considerable and wide-ranging with specific relevance to the Group's core building society activities and commercial subsidiaries. At least one member of the Committee meets the requirements of the UK corporate governance code to have significant recent, relevant financial experience. The Committee members were selected for appointment by recommendation of the Nomination Committee in consultation with the Audit Committee Chair.

Directors' remuneration, including for members of the Audit Committee, is detailed within the Remuneration Committee Report. The Report of the Directors on Corporate Governance also sets out the process for review of effectiveness of Board sub-committees including the Audit Committee. The Committee concluded that it was operating effectively as part of its 2019 review on 25 November 2019.

Committee meetings:

The Committee meets at least four times each year coinciding with key dates in the Group's financial reporting calendar following a rolling schedule of items for discussion, agreed and reviewed on an ongoing basis. Meetings are attended by Audit Committee members with other regular attendees at meetings including the Chief Executive, Chief Financial Officer, Interim Chief Risk Officer, Head of Internal Audit Services and a representative of the External Auditors, PricewaterhouseCoopers LLP (PwC), as well as other management, as the Committee feels is appropriate and necessary. For details of Committee meeting attendance see the Board and Board Committee Membership Attendance Record in the Report of the Directors on Corporate Governance.

The Committee formally invites the External Auditors after each meeting, and the Internal Auditors at least once a year, to meet the Committee without senior management present. These meetings cover matters relating to the Audit Committee's terms of reference and any issues arising from audits, including matters required to be discussed by relevant law or regulations. The Chair and Head of Internal Audit also meet outside of the Committee on a regular basis.

Key roles and responsibilities as delegated by the Board:

The main function of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

i) Financial reporting:

The Audit Committee's primary role regarding financial reporting is to monitor the integrity of the financial statements of the Group including the interim and annual reports, and any other formal announcements relating to the Group's financial performance.

This responsibility is discharged though:

- Review of interim and year-end announcements, the Annual Report and Accounts and Summary Financial Statement, covering their clarity, completeness and compliance with relevant accounting standards and other regulatory and legal requirements;
- Reporting to the Board on the consistency and appropriateness of critical accounting policies and any changes thereto, taking into account the views of the External Auditor;
- Review and challenge of significant financial reporting judgements, estimates and the actions and judgements of management;
- Advice to the Board on whether the Annual Report and Accounts, taken as a whole are fair, balanced and understandable and provide the information necessary for Members to assess the performance, strategy and business model of the Group;
- Review of any correspondence from regulators in relation to financial reporting;
- Review of the going concern and business viability assessment produced by the Chief Financial Officer on a six monthly basis;
- Evaluate the risks to the quality and effectiveness of the financial reporting process, especially in light of the External Auditors' communications with the Audit Committee; and
- Review and monitor management's responsiveness to the External Auditors' findings and recommendations.

The main areas of financial reporting significance considered by the Audit Committee in 2019 were as follows:

- **IFRS 9 (Financial Instruments), IFRS 15 (Revenue From Contracts With Customers) and IFRS 16 (Leases) disclosures:** The Financial Reporting Council's (FRC) thematic review of institution's IFRS 9, 15 and 16 disclosures were published during quarter 4 of 2019. The Group is committed to providing high quality and compliant disclosures with the Audit Committee kept appraised of the key highlights from the FRC's review and of the Group's response to ensure meaningful disclosures are provided in the Group's interim and annual financial reporting.
- **IFRS 9 provisioning:** The Audit Committee maintain oversight of the key model inputs driving the Group's residential IFRS 9 provisioning models, with particular focus paid towards the Group's forward looking macroeconomic forecast inputs. The Group's Model Risk Committee makes non-binding recommendations on the Group's IFRS 9 scenarios, scenario inputs and scenario weightings with the Audit Committee's attention focused in 2019 towards inclusion of additional severely stressed negative scenarios to the Group's existing IFRS 9 scenarios (base, upside and downside). The Audit Committee also reviewed the source of the Group's key forecast information and management adjustments made to externally sourced forecast data, concluding satisfactorily on the Group's methodology and management judgement. In an uncertain forward climate, the Audit Committee also gave particular focus to the Group's residential mortgage portfolio sensitivity to model adjustments: including scenario weighting and sensitivity disclosures given in the notes to the 2019 Annual Report and Accounts.

Audit Committee Report

Continued

- **Equity release accounting and valuation:** The Audit Committee consider the Society's valuation of the equity release portfolio and the corresponding IFRS 4 insurance liability provisions and disclosures. The Committee reviews and challenges management's core model inputs and ensures appropriate third party actuarial advice around sensitive model inputs, including mortality tables and surrenders is factored into the Group's calculations.
- **Effective interest rate:** The Audit Committee oversees the Group's implementation of effective interest rate (EIR) accounting considering in 2019 enhancements made to internal EIR models. The Committee concluded positively on the Group's re-assessment of fees and costs deemed integral to the origination of mortgages, proposals to reflect more granular assessment of mortgage terms and behaviours and the inclusion of early redemption charges to the Group's EIR modelling. The Committee reviewed key historic patterns of customer behaviour concluding satisfactorily on the Group's methodology.
- **Going Concern:** Preparing the Annual Reports and Accounts under the Going Concern assumption requires the Board and Audit Committee to be satisfied about the long term viability of the Group's business operations, business planning, business management and risk management. Long term liquidity, capital and funding budgets and forecasts alongside capital, cash flow and business viability considerations are assessed formally at the half year and year-end to coincide with the approval of the interim and annual accounts. A balanced consideration of positive and negative plan aspects is considered with supporting narrative provided by the Chief Financial Officer. The Audit Committee concluded that the adoption of the Going Concern basis to prepare the accounts is appropriate.
- **Provisions for other liabilities and charges:** The Audit Committee reviews and challenges the estimates and assumptions made by management when calculating provisions at the end of the reporting period. The Committee was satisfied with provisions in relation to potential consumer redress.
- **Hedge accounting:** The Audit Committee is appraised of the Group's derivative and hedge accounting position and strategy and also agrees the accounting policy for hedging, including revised disclosures to reflect the implementation of IFRS 9 in the Annual Report and Accounts. The Committee has concluded satisfactorily in this area.
- **Taxation:** The Audit Committee reviewed the Group Tax Risk Policy which sets out compliance with relevant jurisdictional legislation, identifying areas of tax risk for appropriate focus and managing the overall Group tax risk.
- The Committee considers matters raised by the External Auditors and the Committee concluded there were no adjustments required that were material to the Annual Report and Accounts.

Having undertaken the above responsibilities and considerations throughout the Group's 2019 financial year the Audit Committee recommended to the Board that approval be given to the audited Annual Report and Accounts and Summary Financial Statement as at 31 December 2019.

ii) Internal Control and Risk Management

The Audit Committee works closely with the Group Risk Committee to ensure that management and colleagues take appropriate responsibility for departmental, business unit and subsidiary risk mitigation and internal control. The Audit Committee also reviews Internal Audit and management reports on the effectiveness of systems for internal control and risk management across the Group.

Further details of risk management activities are given in the Risk Management report.

The Audit Committee is responsible for:

- Review of the scope and effectiveness of the Group's internal controls and risk management systems including those for ensuring compliance with the regulatory environment in which the Group operates;
- Review of the Society's resolution pack arrangements and oversight of the Society's recovery plan self assessment; and
- Review and approval of the statements to be included in the annual report concerning internal controls and risk management.

The Group's Internal Audit department forms a core component of the Group's risk management and internal control process.

During the year the Audit Committee, through the Internal Audit department and from other management reports, reviewed the scope and effectiveness of the Group's internal controls. The coverage of the reviews in 2019 included reviewing the controls in operation for; lending, savings, information technology and cyber security, treasury, finance, risk management, operational resilience, regulatory compliance and reporting, and key projects. The Internal Audit department utilised KPMG LLP and Deloitte LLP where necessary for co-sourced internal audits to provide specialist expert input and promote knowledge transfer to the Internal Audit department.

The Internal Audit department reflects the Audit Committee's primary available resource however the Committee retain the authority to obtain outside legal or independent professional advice as it sees fit. Reports from the Interim Chief Risk Officer, Internal Audit, External Auditors and senior management provide input on key risks, uncertainties and controls direct to the Audit Committee.

iii) Internal Audit

The Audit Committee is responsible for monitoring and reviewing the effectiveness of the Group's Internal Audit function in the context of the Group's risk management system, ensuring that professional standards are applied, resource is adequate in terms of number, skills, knowledge, and standing within the Group to execute its responsibilities in an independent and objective manner. This review includes assessment of the Head of Internal Audit with respect to appointment, remuneration, performance evaluation and assessment of their objectivity and independence. A formal internal review of the qualification and effectiveness of Internal Audit is undertaken by the Committee annually and most recently in November 2019.

Additionally and in accordance with good practice, the Audit Committee also requires an external effectiveness review of the Internal Audit function at least every five years, which considers the quality, experience and expertise of the function. A review was carried out during 2019 by an external firm appointed by the Audit Committee. In performing their review, information was gathered from a variety of sources including interviews with key business stakeholders, and the Internal Audit team, stakeholder questionnaires, and a review of key documentation covering all aspects of the operation of the Internal Audit function (including file reviews). The review concluded that Internal Audit was operating effectively, and confirmed that the Internal Audit function conforms to the standards expected by the Institute of Internal Auditors.

The Committee approves and reviews the Internal Audit strategy, work programme and results and ensures the Internal Audit department maintains sufficient access to the Board, management and the books and records of the Society and its subsidiaries. This oversight allows the Audit Committee to monitor and assess the role and effectiveness of the Internal Audit function in the overall context of the Group's internal control framework, ensure appropriate management responsiveness to audit findings and recommendations given and promote open communication between the Group's Risk, Compliance, Finance and Internal Audit functions and the External Auditors.

iv) External Audit:

The Audit Committee is responsible for overseeing the Group's relationship with the External Auditors; PricewaterhouseCoopers LLP (PwC). This role extends to:

- Appointment, reappointment, removal and assessment of independence, objectivity and effectiveness of the External Auditors;
- Approval of terms and remuneration in respect of audit services provided;
- Annual approval of the Society policy on the use of the External Auditors for non-audit work; and
- Consideration of audit quality including reports by the Audit Quality Review Team.

The Audit Committee assesses annually the qualification, expertise and resources of the External Auditors seeking reassurance that the auditors and their staff have no family, financial, employment, investment or business relationship with the Society that is considered to impact their independence. The External Auditors communicate their formal independence annually and appraise the Audit Committee of policies, processes and monitoring in place for maintaining their independence. The Audit Committee seek annual feedback from internal stakeholders to facilitate a robust assessment of the effectiveness of the External Auditors.

Prior to an External Audit engagement the Audit Committee discuss the nature and scope of the audit. They review findings of the auditors' work and assess the effectiveness of the audit process. This assessment reviews whether the auditor has met the agreed audit plan, considers the robustness and perceptiveness of the auditors in responding to questions from the Audit Committee and obtaining feedback about the conduct of the audit from key people involved.

The Audit Committee ensures that non-audit services provided by the External Auditors will not adversely impact the independence and objectivity of the audit firm in performing their duties. A formal Society policy on use of the External Auditors for non-audit work is reviewed annually encompassing pre-approved, low risk non-audit services alongside permitted and prohibited services requiring Audit Committee approval.

During 2019 the External Auditors were engaged to provide non-audit data audit services and structured training. These engagements were in accordance with our policy for the engagement of the external auditor for non-audit services. PwC were selected in each instance by virtue of their expertise across these areas. Where necessary to maintain independence, audit work is carried out by PwC partners and staff that have no connection to the external audit team. The fees paid to the External Audit firm for audit and non-audit services are set out in Note 6 to the Accounts.

PwC have been external auditors to the Group since 1994. A formal external audit tender process was undertaken in 2013 which followed a rigorous assessment process including the appointment of an audit selection panel comprising the Chair of Audit Committee, the Society's Chairman, the Deputy Chief Executive and Finance Director, the Head of Group Finance, the Chief Executive and one other member of the Audit Committee. Following submission of detailed proposals and a series of presentations a recommendation was made to Audit Committee and the Board to retain PwC as external auditors. The recommendation was made in light of a challenging and robust external audit and satisfaction with previous audits undertaken. The next formal external audit tender process will be conducted in advance of the 2020 audit cycle for the 2021 financial year audit.

v) Whistle Blowing

The Audit Committee reviews the Group's procedures for detecting fraud and whistle blowing and ensures that arrangements are in place by which colleagues may, in confidence, raise concerns about possible improprieties in matters of financial reporting, financial control or any other matters, and to ensure that arrangements are in place for independent investigation and appropriate follow up action. The outcome of the review is reported to the Board.

M.R. Thompson.

On behalf of the Board

Mick Thompson
Chair of the Audit Committee

25 February 2020

Remuneration Committee Report

Introduction

This report details the Society's approach to pay for the period 1 January to 31 December 2019. It sets out the remuneration policy and remuneration details for the Executive and Non-Executive Directors of the Society and how it applies the principles of the UK Corporate Governance Code relating to remuneration, the Regulators' Remuneration Code and the disclosure requirements arising under the EU Capital Requirements Directive IV (CRD IV). The report is split into three sections; i) the Statement by the Chairman of the Remuneration Committee, ii) the Report on Remuneration and iii) the Directors' Remuneration Policy which includes details of changes to the Policy which came into effect in 2019.

i) Statement by the Chairman of the Remuneration Committee

The Remuneration Committee's purpose is to consider, agree and recommend to the Board an overall remuneration policy and approach that promotes achievement of the Society's long-term business strategy and business objectives and is aligned with the long term interests of the Society's Members, other stakeholders and risk appetite.

The Committee is responsible for oversight of the Society's overall compliance with the Remuneration Code with main objectives as follows:

- To ensure that competitive remuneration packages are in place that attract, retain and reward the Society's Executive and Senior Management to deliver business objectives in support of the Society's strategy whilst providing value for our Members;
- To ensure compliance with the Regulators' Remuneration Code through at least annual review and to ensure the remuneration policy is consistent with regulatory requirements and the Society's financial situation and future prospects;
- To determine and agree with the Board the framework for Executive and senior management remuneration and conditions of employment;
- To approve the salaries, and any salary adjustments, variable pay awards and payments for Executive and senior management and to approve the terms of the annual pay review for all colleagues;
- Approve the design of any variable remuneration schemes and approve the total annual payments under such schemes;
- To approve the Society's Remuneration Policy Statement and Remuneration Committee Reports in the Group's Annual Report and Accounts and Summary Financial Statements, and the remuneration section of the Society's Pillar 3 disclosures;
- To approve service agreements for the appointment of Executive Directors;
- To consider and make recommendation to the Board on the general framework of colleague bonus schemes; and
- To consider recommendations made by the Chief Executive on fees paid to Non-Executive Directors.

The Board believes remuneration should be sufficient to attract, retain and motivate colleagues and senior managers to continue to run the Society successfully. The Remuneration Policy, therefore, focuses on rewarding our colleagues and Executives in line with the achievement of our goals set out in the Strategic Plan and Corporate Key Performance Indicators thus ensuring long-term value for money for our Members.

The Remuneration Committee operates within the Terms of Reference (TOR) agreed by the Board. The TOR are reviewed annually and were last reviewed in November 2019. The effectiveness of the committee is also reviewed on an annual basis and was last reviewed, and found effective, on 26th November 2019.

Composition of the Committee

The Committee comprises solely of Non-Executive Directors who have no personal financial interest in the recommendations. The Chairman of the Committee is John Morris, the other members are Bryce Glover, Karen Ingham and Anne Shiels. The Chairman, Chief Executive and HR Director (except for items relating to their remuneration) also attend meetings but are not members of the Committee. The Company Secretary acts as Secretary to the Committee.

During the year the Committee met 5 times and activities included:

- Overseeing compliance of the Society's approach to remuneration against the requirements of the Regulators' Remuneration Code;
- Considering and agreeing pay and benefits for Executive Directors, senior managers and the Chairman;
- Overseeing remuneration matters across the Society and its subsidiaries;
- Reviewing the performance for the full year and approving the level of Executive and Corporate Bonus to be paid based on achievement of various financial and non-financial key performance measures; and
- Considering the disclosure requirements for the Remuneration Report including Pillar 3 disclosures.

ii) Report on Remuneration

The total remuneration received by Executive Directors is shown opposite. The information has been audited and shows remuneration for the years ended 31 December 2018 and 31 December 2019 as required under the Building Society (Accounts and Related Provisions) Regulations 1998. There is a requirement under Para 14 of the Society's Rules to have deposits to the value of not less than £1,000 in a Society share account in order to qualify as a Director. This means all Directors are Members of the Society. There are no requirements for a Director to own shares in the Society's subsidiary companies.

Details of other non-Society Board positions held by the Society's Executive Directors are shown in the Annual Business Statement of the Annual Report and Accounts. None of the current Executive Directors retained any remuneration as a result of their non-Society positions.

Directors' Emoluments (Audited)

Emoluments of the Society's Directors from the Society and its subsidiaries are detailed below:

	Year	Salary or fees	Other benefits	Annual bonus (Note 1)	Defined Contribution Pension (Notes 2,3 & 4)	Total contractual benefits
Executive Directors		£000	£000	£000	£000	£000
AS Haigh	**2019**	**314**	**41**	**108**	**-**	**463**
	2018	306	41	9	-	356
D Samper (Appointed 20 December 2018)	**2019**	**215**	**21**	**61**	**11**	**308**
	2018	6	-	-	-	6
S Miller	**2019**	**157**	**24**	**63**	**-**	**244**
	2018	147	18	5	5	175
P Ferguson (5) (Resigned 21 June 2019)	**2019**	**74**	**5**	**-**	**7**	**86**
	2018	150	10	5	14	179
AM Russell (Retired 25 April 2018)	**2019**	**-**	**-**	**-**	**-**	**-**
	2018	64	14	-	-	78
Total for Executive Directors	**2019**	**760**	**91**	**232**	**18**	**1,101**
	2018	673	83	19	19	794
Non-Executive Directors						
PJ Moorhouse	**2019**	**77**	**-**	**-**	**-**	**77**
	2018	69	-	-	-	69
DJ Buffham (Resigned 24 June 2019)	**2019**	**27**	**-**	**-**	**-**	**27**
	2018	56	-	-	-	56
J Morris	**2019**	**58**	**2**	**-**	**-**	**60**
	2018	53	2	-	-	55
IW Ward	**2019**	**53**	**1**	**-**	**-**	**54**
	2018	52	1	-	-	53
BP Glover	**2019**	**43**	**3**	**-**	**-**	**46**
	2018	39	4	-	-	43
A Laverack (Business name: Anne Shiels)	**2019**	**42**	**2**	**-**	**-**	**44**
	2018	40	1	-	-	41
K Ingham	**2019**	**41**	**-**	**-**	**-**	**41**
	2018	40	-	-	-	40
RJ Bottomley OBE (Retired 24 September 2018)	**2019**	**-**	**-**	**-**	**-**	**-**
	2018	32	2	-	-	34
MR Thompson (Appointed 29 January 2019)	**2019**	**40**	**-**	**-**	**-**	**40**
	2018	-	-	-	-	-
GA Bennett (Appointed 24 April 2019)	**2019**	**26**	**1**	**-**	**-**	**27**
	2018	**-**	**-**	**-**	**-**	-
Total for Non-Executive Directors	**2019**	**407**	**9**	**-**	**-**	**416**
	2018	381	10	-	-	391
Total for all Directors	**2019**	**1,167**	**100**	**232**	**18**	**1,517**
	2018	1,054	93	19	19	1,185

Notes:

1. During 2019 the Society's Executive Directors participated in the Group's annual Executive Bonus Scheme. A proportion of the Executive bonus payments has been deferred and is payable in future years as shown in the Executive Director Bonus Payable table overleaf.

   During 2018 the Society's Executive Directors participated in the Group's annual Corporate Bonus Scheme. Payments under this scheme were paid in 2019 and are shown in the table above.
2. Mr AS Haigh has elected to take his pension contribution amounting to £28,297 (2018: £27,506) as a cash payment. He is liable for his own tax and national insurance contributions on this payment.
3. Mr S Miller has elected to take his pension contribution amounting to £14,149 (2018: £8,072) as a cash payment. He is liable for his own tax and national insurance contributions on this payment.
4. None of the Society's Directors participate in the Group's defined benefit pension scheme.

Remuneration Committee Report

Continued

Termination Payment

In 2019, upon Mr P Ferguson ceasing to be a Director and leaving the Group, a redundancy payment of £176,845 was made to him. This was calculated by reference to the agreed terms of his employment contract and reflects nine years of service. The payment is in addition to the amounts disclosed in the table.

Chief Executive Remuneration

The Chief Executive is the Society's most highly paid employee and no employee earns more than any Executive Director. The 2019 pay rise for all colleagues ranged from 0% to 12%, with an average 3.39% received by all colleagues. Mr A Haigh received a 3% pay rise on base salary in April 2019.

Calculation of Annual Bonus

Throughout 2019, the Society operated an Executive Bonus Scheme that applied to Executive Directors and other members of the Executive Committee and a Corporate Bonus Scheme that applied to all other colleagues across the Society.

In agreeing the level of Executive bonus the Committee considers performance and a mix of financial and non-financial measures as well as personal objectives. For 2019 awards under the Executive Bonus scheme resulted in the amounts shown in the Executive Director Bonus Payable table below,

A proportion of the Executive bonus payments has been deferred and is payable in future years as shown in the table below. Payment of any deferred award is subject to review by the Remuneration Committee and approval by Board and may be reduced or cancelled as appropriate. Deferred awards payable in 2020 have subsequently been approved by the Board for payment.

Executive Director Bonus Table

		Payable			
Executive Director	**Deferred from**	**2020**	**2021**	**2022**	**Total deferred**
		£000	**£000**	**£000**	**£000**
Andrew Haigh	2019	36	36	36	108
David Samper	2019	20	20	21	61
Stuart Miller	2019	21	21	21	63
Total		**77**	**77**	**78**	**232**

In agreeing the level of colleague corporate bonus for the year the Committee considers the Group's delivery of the Corporate Key Performance Indicators (KPIs) which include profitability, underlying business performance, people and customer satisfaction. Further information on KPI performance can be found in the Strategic Report. The Committee assesses the above measures when establishing the range of bonus payments that may be made with the annual assessment rating of each colleague determining where they fall into the agreed range.

Bonuses are paid as a percentage of basic salary. A corporate bonus in the range of 0% to 10% of basic salary has been awarded to all other colleagues (excluding Executive Committee), with the majority of colleagues receiving a 5% corporate bonus in relation to 2019.

iii) Directors' Remuneration Policy

This section sets out the Directors' Remuneration policy applied during 2019.

The Society's Remuneration Policy is designed to provide competitive remuneration packages that attract, retain and reward our Executives, including our Executive Directors, to deliver business objectives in support of the Society's strategy while providing value for Members.

With regard to Directors' annual pay rise, the percentage increases are dependent on performance in the same way that this applies to the Society's wider employee base, unless there is a change in their responsibilities.

In implementing the Policy, the following key principles are to be observed:

- The Policy is clearly linked to the Society's Purpose, Strategic Plan, objectives and values;
- Policy, process and practice are consistent with and promote effective risk management in line with the Group risk appetite statement and detailed policies;
- Basic pay and total remuneration are set at a competitive level to attract and retain the appropriate calibre of people;
- The approach to pay satisfies regulatory requirements and good Corporate Governance practice;
- Remuneration arrangements are transparent, consistent and fair, reflecting individual responsibilities and performance; and
- Remuneration arrangements are straightforward to understand, communicate and administer.

Key changes to the Directors' Remuneration Policy for 2019

In February 2019, the Board approved the introduction of an Executive Bonus Scheme in relation to 2019 performance. The key driver for the introduction of the Executive Bonus Scheme was to ensure that the Society continues to attract, retain and motivate senior managers in an increasingly competitive market place. The Executive Bonus Scheme applies to the Society's Executive Directors and other members of the Executive Committee.

The Executive Bonus Scheme is performance dependent and is paid in three equal parts, with the first payment in the year after the bonus is earned and the remainder over the following two years. This allows the Committee to review whether the payment remains appropriate, providing the ability to reduce or cancel the payment. The Executive Bonus Scheme is dependent on performance, and a mix of financial and non-financial measures, together with personal objectives form the key metrics of the Executive Bonus Scheme. Should all metrics be met, on target bonus payments are set at 30% of base salary with a maximum bonus potential of 50% of base salary for exceptional business and personal performance.

As the introduction of the Executive Bonus Scheme constituted a material change to our Remuneration Policy, Members were invited to make an advisory vote on the Policy at the 2019 AGM, and this received a 90.88% vote in favour of the Policy.

The Corporate Bonus Scheme has remained in place for other colleagues, however the Scheme is currently being reviewed with the intention of replacing it in performance year 2020.

Directors' service agreements and notice periods

Executive Directors are employed on service agreements which can be terminated by either the Society or the Director giving 6 months' notice.

Non-Executive Directors do not have service agreements. Non-Executive Directors are appointed for an initial three-year term. They will generally be expected to serve more than one three-year term.

Documents may be served on any of the Society's current Directors c/o Addleshaws Goddard LLP, One St Peter's Square, Manchester, M2 3DE.

All of the Society's Directors volunteer for annual re-election.

Policy on termination pay

The Committee aims to treat departing Executive Directors fairly, taking into account the circumstances of their departure, but is always careful to ensure that the interests of Members are considered and that there are no rewards for failure. Executive Directors are entitled to be paid their basic salary and contractual benefits (including pension contributions) during their notice period. The Society has the discretion to pay these as a lump sum in lieu of notice.

The rules of the Executive Bonus Scheme set out the treatment for an individual who ceases to be an employee or Director of the Society.

Consideration of remuneration for individuals elsewhere in the Society

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

When setting salary increases for Executive Directors, the Committee considers the level of salary increases across the Society and Group. No colleague consultation on Executive Director remuneration has been undertaken. All colleagues of the Society receive basic salary and benefits consistent with market practice, and are eligible to participate in the Society's Corporate Bonus Scheme and pension arrangements.

Consideration of Member views

The Committee does not consult with the Society's Members on its Executive Remuneration Policy but takes into account feedback given by Members. The Committee has for a number of years, invited Members to vote on the annual remuneration report, and Members have always voted in favour.

The Society's Remuneration Report and Policy was last voted on in April 2019. Member approval was given to the 31 December 2018 Directors' Remuneration Report (91.50% approval with 14,412 votes for, 1,339 against and 300 withheld). Member approval was given similarly to the Directors' Remuneration Policy (90.88% approval with 14,302 votes for, 1,436 against and 312 withheld).

Remuneration Committee Report

Continued

Remuneration for Executive Directors

The table below shows the elements of remuneration for Executive Directors and the way they operate. These elements would be expected to apply equally to any new Executive Directors appointed in the future.

How elements support our strategy	Operation	Maximum potential value	Performance conditions and assessment
Basic Salary Supports the recruitment and retention of Executive Directors, reflecting their individual roles, skills and contribution.	Basic salary reflects the size of the role and responsibilities, individual performance (assessed annually) and the skills and experience of the individual. In setting appropriate salary levels, the Committee takes into account data for similar roles in comparable organisations as determined by the Group Job Evaluation Policy. The Society aims to position Executive Directors competitively within the reference group.	Increases to base salary are determined annually by the Committee taking into account: - Individual performance; - The scope of the role; - Pay levels of comparable organisations; and - Pay increases elsewhere in the Group.	None applicable however individual performance is taken into account when considering base increases.
Pension Supports recruitment and retention of Executive Directors at a cost that can be controlled by the Society.	Generally the Society contributes to a defined contribution pension scheme for the Executive Directors. The contribution can instead be paid in cash (which is excluded from bonus calculations) if the Executive Director is likely to be affected by the limits for tax approved pension saving.	9% of basic salary.	None applicable.
Benefits - To attract and retain Executive Directors; and - Provides a competitive level of benefits to assist Executive Directors to carry out their roles effectively.	A number of benefits are provided to Executive Directors, including cash or car allowance, private medical insurance, life insurance, relocation allowance and permanent health insurance. The Committee reviews benefits and from time to time may make changes, for example to reflect market practice or the needs of the business.	The Society bears the cost of providing benefits which may vary from year to year.	None applicable.
Executive Bonus Scheme* - Supports attraction and retention of Executive Directors; - Supports the development of a high performance culture; and - Rewards performance within the context of achieving corporate goals and objectives as set out in the corporate strategy.	- Based on a number of performance measures and targets linked to the delivery of corporate strategy; - Measures include financial, customer, people and personal objectives; - Targets will be set annually and payments are to be made at the discretion of the Remuneration Committee; and - Payments will be made in cash in equal instalments over a three year period.	The maximum potential bonus opportunity is 50% of base salary. On target bonus opportunity is 30% of base salary.	The measures will be assessed by the Remuneration Committee on an annual basis and will be subject to discretion. - Performance measures are weighted as follows: - 40% financial - 30% non-financial - 30% personal objectives

Notes to the table

*As noted above, the Committee has complete discretion to make payment under the Executive Bonus Scheme and also has discretion to amend or remove that Scheme where necessary to ensure the arrangements continue to meet the Committee's overriding remuneration principles.

Remuneration of Non-Executive Directors

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

Element	Approach
Basic Fees	Reviewed annually based on time commitment and responsibility required by Board and Board Committee meetings. Review takes into account fees paid by comparable financial services organisations.
Additional Fees	Additional fees are payable for additional responsibilities such as Committee chairmanship or membership.
Other items	Non-Executive Directors are not eligible to participate in any form of performance pay and do not receive pensions or other benefits in kind.

The Remuneration Committee also determines the Chairman's fee.

Summary of the Remuneration of Code Staff

A summary of the remuneration of Code Staff during 2019 and the business areas in which they operate is shown below.

Category	Typical Functions	Year	Number in Category During the Year	Fixed Remuneration £000	Other taxable benefits £000	Variable Remuneration (Note 1) £000	Total Remuneration £000
Executive Directors	Chief Executive Officer, Chief Financial Officer, Customer Director, Strategy, Planning & Risk Director	**2019**	**4**	**760**	**109**	**232**	**1,101**
		2018	4	673	102	19	794
Other Executives	HR Director, MD NSSL, Chief Information Officer, Interim Finance Director	**2019**	**3**	**333**	**54**	**102**	**489**
		2018	4	484	60	9	553
Control Functions	Compliance, Underwriting, Internal Audit, Customer Outcomes, Treasury, Balance Sheet Management	**2019**	**8**	**469**	**80**	**36**	**585**
		2018	7	436	65	16	517
Total		**2019**	**15**	**1,562**	**243**	**370**	**2,175**
		2018	15	1,593	227	44	1,864

Notes:

Note 1: Variable remuneration reflects participation in the Group's Executive Bonus Scheme for Executive Directors and other members of the Executive Committee and the Group's annual Corporate Bonus Scheme for all other code staff.

John Morris

Chair of the Remuneration Committee

25 February 2020

Risk Management Report

Overview

The Society's risk management framework is designed to pro-actively identify and manage risk while supporting senior management in the delivery of the strategy, managing costs and making decisions that are more effective.

The framework compromises the monitoring and controlling of significant risks to which the Society is exposed to while ensuring the security and resilience of the Group. The Society's ability to identify, measure, monitor, report and control risks is key to delivering sustainable and resilient business performance, including fair outcomes for Members and customers.

The Society's Chief Risk Officer has ultimate accountability for the maintenance and enhancement of the organisations risk management framework.

Risk Framework

The Society, during the course of 2018 conducted an independent review of the risk management framework and practices employed by the Group. As a result, during 2019 an internal review was completed which set the direction and evolution plan for the risk function.

The Society continues to adopt the traditional 'Three Lines of Defence' approach to risk management. The first line of defence compromises of core business units, which ultimately hold the responsibility of identifying and managing risk while adhering to corporate risk appetite, policies and standards. The first line also hold the responsibility for implementing and maintaining regulatory compliance.

The second line risk function facilitates and monitors the implementation of effective risk management while developing and maintaining risk management policies and methodologies. The second line reports primarily to senior management and risk governance committees.

The third line of defence is the Society's Internal Audit team. The third line of defence provide independent assurance to the Board and senior management on the adequacy of the design and operational effectiveness of internal control systems and measures across the business.

The risk framework includes the use of Board approved risk appetite statements covering a variety of principle risks that the organisation faces. There is a demonstrated level of balance within the framework with evidence of stress testing, scenario analysis and recovery planning.

Overall, there is a high degree of awareness and understanding of risk across the organisation. Senior management understand and champion the basis for risk measures with detailed understanding of strengths and limitations. The culture across the organisation supports the development of risk skills which is articulated from the top down and gives due focus to risk management.

Risk Governance

The Board is ultimately responsible for ensuring that adequate systems of risk management are in place, and that the Society's strategy, risk appetite, and risk management are aligned. To assist the Board a Group Risk Committee (GRC) oversees the management of risk across the Group (see below).

The GRC is supported by a second line of defence risk department, whose role is to ensure that appropriate risk management is applied across the organisation. This includes the provision of reports on risks, and risk management for the GRC and its sub-committees.

The Chief Risk Officer provides formal updates on risk management to the Board, in relation to the Group, at least quarterly.

Group Risk Committee

The GRC oversees the Society's risk management and governance framework, and the Society's overall risk profile. The Committee meets at least quarterly and more frequently when required.

During 2019, the members of the GRC, all of whom are Non-Executive Directors included Bryce Glover (Committee Chair), Adam Bennett, John Morris, and Ian Ward.

The duties of GRC include:

- Oversight of overall risk appetite, risk management strategy and framework, including oversight of both prudential and conduct risk appetites;
- Oversight of compliance with risk policies;
- Oversight of the risk sub-committees (see below);
- Review and assessment of the adequacy of risk management information to monitor and control risks;
- Approval of risk management of new initiatives and projects, and in particular the risks those initiatives and projects expose the Group to;
- Consideration and approval of the top risks for the Society and Group including low likelihood, high impact risks; and
- Approval of stress testing and scenario testing.

During 2019 the committee met five times and in particular considered the following matters:

- Review of the risk appetites for prudential, and conduct risk;
- Review of the Group's Risk Management Strategy;
- Oversight of the annual stress testing report including low likelihood high impact risks;
- Review and ratification of key risk policies covering lending, treasury, and operational risk;
- Review and approval of the Society's compliance plan; and
- Review of compliance with Building Society Sourcebook limits.

The Credit Risk Committee (CRC) is responsible for the oversight of the retail and commercial credit risk framework. This committee acts under the authority of the GRC and has delegated authority to make decisions and recommendations in accordance with the agreed terms of reference.

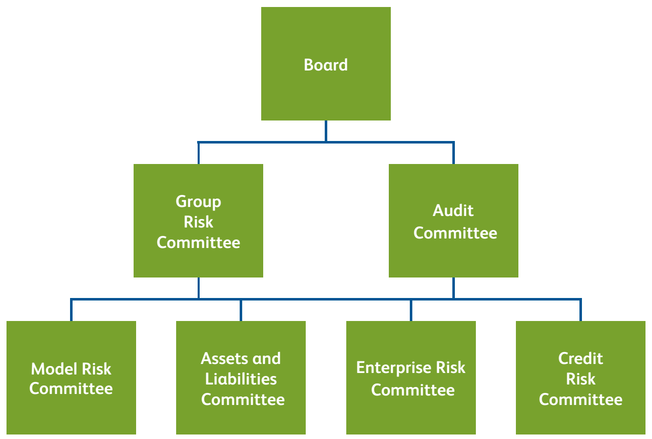
This committee also has the responsibility for the Group's non-retail mortgage portfolio. The CRC ensures the use of regular stress testing and scenario modelling that are reflective of the nature of the associated risk. The CRC met ten times during 2019.

The Enterprise Risk Committee (ERC) has responsibility for overseeing the risk framework for Operational Risk, Conduct Risk, IT Risk and Operational Resilience. This committee ensures that risk event trends are monitored appropriately with robust action plan management. The ERC also has the responsibility for key group-wide policies to ensure they are appropriate for the business before they are submitted to the GRC for final ratification. All relevant operational risk management information is reported to the ERC on a monthly basis to assess compliance with overall limits and corporate risk appetites. The ERC met ten times during 2019.

The Model Risk Committee (MRC) is a newly established committee that the Society introduced to ensure compliance with SS3/18 'Model Risk Management'. The MRC acts under the authority of the GRC in an advisory capacity and makes non-binding recommendations concerning the Group's adherence to the Model Risk policy. Recommendations are made to the GRC on suitable macro-economic scenarios, model risk appetite, model performance (monitoring) and model limitations. Approval of the Group's macro-economic scenarios remain the responsibility of the Board. The MRC met five times during 2019.

The Assets and Liabilities Committee (ALCO) is charged by the GRC with setting the risk framework for the Society's balance sheet, including liquidity risk, funding risk, interest rate risk and basis risk. The tools available to ALCO include risk limits and guidelines, return on capital employed benchmarks and funds transfer pricing for all aspects of treasury risk management including liquidity risk, interest rate risk, counterparty credit risk, and balance sheet management. During 2019, ALCO met ten times.

Risk Governance Structure



Risk Management Report

Continued

Risk and Impact	Mitigation	Change in Risk Profile	Commentary
Credit Risk The primary credit risks relate to commercial, residential, and investment (see below).			
Residential Retail borrowers do not repay the Society and the Society's collateral is insufficient to meet the debt obligations. The risk is sensitive to unemployment rates, house prices, and interest rates. For example, if a borrowing customer loses their job they may be unable to meet their repayments. If the Society takes possession of the property, it may not realise enough on subsequent sale to repay the loan balance. In a recession when unemployment rises and house prices can fall the risk is greater.	Loans are underwritten individually based on affordability, credit score and history, acceptable collateral (including loan to value), and the Society's lending criteria. The Society does not undertake sub-prime or self-certification lending. The Society's lending policy is subject to review at least annually. The residential book is subject to monthly reporting to CRC in relation to its credit risk characteristics (including loan to value, loan to income, arrears, credit score profile, early delinquencies, and arrears arising from cohorts of lending). The Society's risk appetite is expressed in terms of losses arising in a stressed scenario, and stress testing is used to ensure that the portfolio is within the Society's risk appetite.		The Society has maintained its' lending to retail borrowers in 2019, including Buy to Let (BTL) lending to individuals, and has a strategy to increase such lending. The Society's risk appetite in respect of residential lending has remained proportional to the increased book size. Loans that are 3 months or more in arrears remain within appetites. The retail book remains within the Society's risk appetite. Actual losses on the residential book remain very low.
Commercial Commercial borrowers do not repay the Society and the Society's collateral is insufficient to meet the debt obligations. The risk is sensitive to economic conditions that can impact the viability of tenants and commercial real estate values. For example, if a commercial borrower has a property where the tenant is lost they may be unable to meet repayments. If the Society takes possession of the property it may not realise enough on subsequent sale to repay the loan balance. In a recession when more tenants may fail and commercial property values can fall the risk is greater.	The commercial loan book is being actively managed down. Commercial loans over £500k are subject to annual reviews reporting to CRC. Higher risk loans are subject to quarterly review. In the event of a breach a report is provided to the Credit Risk Committee. Borrower and tenant watchlists are maintained by the credit risk team, and are reviewed monthly. Watchlists for borrowers and tenants are updated on a real time basis. Stress testing is used to determine the risk associated with the portfolio and with individual loans within it.		The Society withdrew from new Commercial lending in 2008. Lending balances on commercial property continue to reduce. Loans to registered social landlords (RSL) are subject to the same controls as commercial loans. However, the risk of default in relation to an RSL loan is extremely low with no history of default within the portfolio. The assessment of risks continues to reduce based on the size of the remaining book, and stress test losses.
Investment/Liquidity Credit Wholesale counterparties the Society lends to default, or the value of the investment falls and the Society is obliged to crystallise that fall in value. This risk arises in relation to the treasury investments made by the Group in order to meet liquidity requirements. The risk is sensitive to market volatility and credit spreads (both general credit spreads and name specific credit spreads). For example, if the Society invests in Residential Mortgage Backed Securities, and subsequently the market value of the assets falls, the Society may have to sell the assets at a loss. The risk is higher when there is greater market volatility.	Investments are subject to a GRC approved policy, which sets out what instruments, countries, and counterparties investments can be made in, and sets limits on exposures to instruments, countries, and counterparties. Investments are monitored and reported to management daily, and reported to ALCO on a monthly basis, including compliance with the policy. The credit default swap rates for the Society's counterparties are monitored, and alerts raised if certain criteria are met in relation to those spreads. The mark to market value of the Society's investments in gilts, residential mortgage backed securities, and covered bonds are monitored daily and reported to ALCO monthly.		The Society's overall risk exposure has remained constant. Overall liquidity has been increased in response to Brexit and potential market volatility. The proportion of liquid assets held with highly rated counterparties has been maintained.
Conduct Risk Conduct risk is the risk of customer detriment arising from the Society's activities. Examples include products that do not perform as customers expected them to, or products being sold to customers for whom they are not suitable. Conduct risk and operational risk (see below) are closely aligned where the operational risk results in customer detriment (e.g. a failure to protect customer data is an operational risk which may result in customer detriment). For example, if the Society provides a mortgage product to a customer where the information the customer needed to make an informed decision was absent, and the product does not meet the customer's needs.	Conduct risk is wide-ranging, and the key mitigants are:- The Society maintains a risk appetite statement relating to customer outcomes and measures performance relative to that statement monthly, reporting to the ERC with oversight from the GRC. All new products are approved by a Mortgage and Savings Committee, which includes consideration of an assessment of risks to customer outcomes. The Society maintains a Customer Outcomes dashboard, which looks at evidence supporting good customer outcomes (or suggesting poor outcomes) and this is reviewed monthly and reported to ERC. The Society maintains an annual Compliance Plan, which is risk based, reporting to ERC with oversight from the GRC.		The Society has a simple product range covering mortgages, savings, insurance, and financial advice via Newcastle Financial Advisers Limited (an Appointed Representative of Openwork).
Liquidity Risk Liquidity risk is the risk of loss or failure caused by the Group being unable to meet its liabilities or commitments as they fall due, or to be able to do so only at excessive cost. For example, if there are exceptionally high withdrawals at a time when there is illiquidity in financial markets preventing the Society from selling its liquid assets, then it may have to sell assets at a discount to obtain cash.	Liquidity is subject to a GRC approved Policy, which sets out limits in relation to liquidity. Liquidity is monitored and reported to management daily, and reported to the Assets and Liabilities Committee (ALCO) on a monthly basis, including compliance with the policy. Cashflow forecasts are used to forecast liquidity, and ensure compliance with the limits in the future. Wherever appropriate the Group ensures it takes any necessary steps to ensure it has access to Bank of England schemes designed to support financial institutions. Stress tests are used to ensure that liquidity risk is within the risk appetite.		The Society has increased its internal liquidity in response to potential market volatility as a result of Brexit, and continuing market expectations regarding an EU trade deal by the end of 2020. In addition, the increase in lending overall has increased our liquidity requirements. However, liquidity risk overall remains within our risk appetite.
Interest Rate Risk Interest rate risk is the risk that the value of the Society's net assets or net interest income falls as a result of a change in interest rates. Basis risk is the risk that net interest income falls because of a change in the relationship between two market rates. For example, the Society has assets which earn interest based on the LIBOR rate, and liabilities where the rate is set by the Society. For example, if LIBOR falls at a time when base rate and savings rate do not, then the Society's assets realise lower income, but the costs remain unchanged.	Interest rate risk is subject to a GRC approved policy. Interest rate risk and basis risk are subject to policy limits. They are monitored and reported to ALCO monthly, including compliance with policy. The Society's uses interest rate swaps to manage interest rate risk. Derivatives are only used, in accordance with the Building Societies Act 1986, to mitigate risks arising from interest rates or indices. Forecasts are used to assess future compliance with limits and determine the need for management action. Stress tests are used to assess the Society's exposure to interest rate and basis risk.		The overall interest rate risk to which the Society is exposed is broadly unchanged. Note 31 gives details of the derivative financial instruments held at 31 December 2019, together with the impact of a rate shock of 1% and 2%.
Brexit Risk Brexit risk is the risk that Brexit results in adverse outcomes for the Group. Brexit results in uncertainty to the regulatory environment, and economic environment.	Brexit is monitored via the Group's existing framework. The Group does not trade outside the UK and Gibraltar, and does not rely on EU employees. As such the impact of Brexit is limited.		Regulatory bodies (primarily the PRA and FCA) have largely clarified the post Brexit arrangement for regulation. However, the transition period requires the UK to reach an EU trade deal by the end of 2020. Negotiations will continue throughout 2020 and it is unclear whether an agreement can be achieved in this timescale. The wider economy remains subject to the ongoing risks of Brexit.

Risk Management Report

Continued

Risk and Impact	Mitigation	Change in Risk Profile	Commentary
Pension Fund Obligation Risk The Group has funding obligations for a defined benefit scheme, which is closed to new entrants. It was closed to future benefit accrual with effect from 30 November 2010. Pension fund obligation risk is the risk that the value of the Scheme's assets, together with any agreed employer contributions, will be insufficient to cover the projected obligations of the Scheme over time. The return on assets, which includes equities and bonds, will vary with movements in equity prices and interest rates. For example, if yields on gilts or corporate bonds fall then the value of liabilities rises, resulting in a larger deficit. If the value of shares falls then the value of the pensions fund assets fall and the deficit rises.	The pension fund is overseen by the Trustees of the Scheme, within an agreed Investment Strategy. Reports prepared by the Scheme's independent actuary are reviewed by the Trustees quarterly and, if appropriate, management action is taken. The Group performs stress testing on the pension scheme liabilities and assets at least annually. The Board received quarterly updates on the Society's Pension Scheme including mitigation strategies.	↓	The pension fund surplus on an IAS 19 basis was £8.0m at 31 December 2019 compared to a surplus of £9.2m at the end of 2018. The scheme is still exposed to market volatility, particularly in long term gilt and corporate bond rates. For accounting purposes, the IAS 19 asset has not been recognised on balance sheet as the Group expects that surpluses will be used to reduce risk and volatility within the Scheme with the long term objective of eliminating the pension obligation risk all together.
Operational Risk Operational risk is the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events. For the Group this definition includes legal risk, strategic risk and reputational risk. Operational risk covers examples such as a fire or accident, fraud or theft, or for example, a failure of IT systems resulting in customers being unable to log in.	Operational risk is subject to a GRC approved policy, which covers the framework for operational risk, including the measurement and management of risk, operational risk appetite, use of scenario testing for operational risk, tracking of risk events and operational losses, timescales for implementation of action plans and escalation procedures for more serious risk events that require immediate action to mitigate loss. Key risks and controls are identified for all areas of the business. Risk assessments remain the responsibility of the relevant departmental managers and Executives, and are updated regularly for new risks, the results of risk events and following internal audit reviews. Corporate Insurance policies are negotiated with regard to the key risks within the Group requiring greater mitigation.	↑	As the Society's business model includes diversification via the Solutions Business, this increases exposure to operational risk particularly in relation to IT systems capability and human error. The Society has invested significantly in a programme of Operational Resilience which is predicated on reducing the impact of operational events within the business. The value of savings balances managed by the Solutions business and the level of income increased during 2019 (see segmental analysis in Note 9).
Capital Risk Capital risk is the risk that the Society is or becomes inadequately capitalised to address the risks to which it is exposed.	The Society updates its ICAAP on an annual basis. Capital adequacy is monitored on a monthly basis by the Board and the 5 year capital plan has been updated on a regular basis between ICAAP reviews against the background of changing economic circumstances and updated budgets and forecasts. The Group maintains its capital at a level in excess of its Individual Capital Guidance. The Group publishes further information about risk exposures in its Pillar 3 disclosures, available on the Society's website (www.newcastle.co.uk).	←	The Society's Common Equity Tier 1 ratio has fallen to 13.9% from 15.7%.
Climate Change Risk Climate change risk recognises the risk associated with adverse climate change and the impact on the operation of the Society, the impact on borrowers and, a wider impact on the Society of a decrease in the value of security in support of Mortgage lending.	The Group has robust operational resilience processes including work place recovery options to manage the impact of any transient localised climate change events. We have developed climate change scenarios to be used in our ICAAP process. We are active in our engagement with the industry as a whole to consider the potential impacts and longer term scenarios.	↑	Scenario planning and modelling of climate change impacts is an evolving industry wide activity. We have an active programme in support of our overall climate change strategy.

Bryce Glover
Chair of the Group Risk Committee
25 February 2020

Customer testimonial

"Joining Newcastle Building Society is one of the best decisions I have ever made. An outstanding service with knowledgeable, friendly and helpful staff."

Eileen

Whitley Bay customer

Independent Auditors' Report

to the Members of Newcastle Building Society

Report on the audit of the financial statements

Opinion

In our opinion, Newcastle Building Society's Group and Society annual accounts (the "annual accounts"):

- Give a true and fair view of the state of the Group's and of the Society's affairs as at 31 December 2019 and of the Group's and the Society's profit and cash flows for the year then ended;
- Have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- Have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group annual accounts, Article 4 of the IAS Regulation.

We have audited the annual accounts, included within the Annual Report and Accounts ("Annual Report"), which comprise: the Group and Society Balance Sheets as at 31 December 2019; the Group and Society Income Statements and Statements of Comprehensive Income, the Group and Society Cash Flow Statements, and the Group and Society Statement of Movements in Members' Interests for the year then ended; and the notes to the annual accounts, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the annual accounts section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the annual accounts in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society.

Other than those disclosed in note 6 to the annual accounts, we have provided no non-audit services to the Group or the Society in the period from 1 January 2019 to 31 December 2019.

Our audit approach

Overview

Materiality:

- Overall Group materiality: £1,128,000 (2018: £1,240,000), based on 0.5% of net assets.
- Overall Society materiality: £1,119,000 (2018: £1,155,000), based on 0.5% of net assets.

Audit Scope:

- We conducted all of our audit work from the Group's offices in Newcastle upon Tyne using one team.
- Audit procedures were performed over all material account balances and financial information in the Society due to its significance to the Group's financial performance and position.
- Audit procedures were also performed over specific account balances and financial information in three other Group undertakings that materially contributed to the Group's financial performance and/or position.

Key audit matters

- Risk of material misstatement in the valuation of the equity release portfolio as a result of use of inappropriate assumptions including discount rate, mortality and HPI growth rate (Group and Society).
- Risk of inappropriate judgements and estimates relating to staging and use of multiple economic scenarios as they apply to the expected credit loss allowance on loans and advances to customers (Group and Society).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the annual accounts.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of banking regulations such as, but not limited to, the Consumer Credit Act and we considered the extent to which non-compliance might have a material effect on the annual accounts. We also considered those laws and regulations that have a direct impact on the preparation of the annual accounts such as the Building Societies Act 1986, the Listing Rules, Pensions legislation, UK tax legislation, the Financial Conduct Authority's Client Asset Sourcebook and the Prudential Regulation Authority's regulations. We evaluated management's incentives and opportunities for fraudulent manipulation of the annual accounts (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to reduce expenditure and increase income and inappropriate management bias in accounting estimates. The Group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the Group engaged team and/or component auditors included review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the FCA and PRA, enquiries of management including the Group's legal team, and review of internal audit reports as they related to the annual accounts.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the annual accounts, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the annual accounts of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit. The following key audit matters apply to both the Group and the Society.

Key audit matter

Risk of material misstatement in the valuation of the equity release portfolio as a result of use of inappropriate assumptions including discount rate, mortality and HPI growth rate.

See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates and note 14 for detailed disclosures.

The Society has legacy equity release loans with a total value of £187.2m (2018: £200.6m). The valuation of these loans is judgemental, and is based on a number of assumptions.

The Society has 'standard' equity release products, where the return to the Society is unknown, as it is based on the future loan value at the point of redemption which is not a fixed point in time given that redemption occurs on the death of the borrower or on entering long-term care.

In addition, there are fixed reversion products, where the repayment amount to the Society is fixed, but there is significant judgement around the time of the redemption.

As a result of the above factors, there is a significant level of judgement applied by the directors in valuing the equity release portfolios. These judgements are based on identifying a trigger event on loans, and once identified as impaired, the estimate of loss on a loan is calculated by comparing the expected loan balance at maturity (i.e. death of the borrower) with the expected value of the property on maturity.

We have focused our work on the assumptions made by management which underpin the estimated loan and property valuations at the date of redemption.

This calculation is impacted by several assumptions which we focussed on, including, but not limited to:

- The value of the underlying security, including the long term HPI growth assumption;
- Mortality rates;
- Early redemption rates; and
- The discount rate applied

How our audit addressed the key audit matter

- Where the directors have relied on HPI growth rates to forecast expected property values, we have assessed the appropriateness of the rates used through reference to external sources and tested the controls which management operate to ensure that HPI rates are entered and calculated correctly by the system.
- We have also reviewed the reasonableness of the HPI assumptions used to update historic property valuations, and note that management uses a recognised independent source which is, appropriately disaggregated by region.
- We obtained the data inputs for the model and have reperformed the calculation of the model.
- We evaluated the completeness of management's listing of accounts which are at risk, i.e. those where the current value of the property is below the current outstanding loan balance, and have identified no further balances which we consider to be at risk for which there is not a provision.
- We have challenged management on the appropriateness of key assumptions such as the mortality rates, and early redemption rates.

Based on the above procedures, we did not identify any material matters to be drawn to the attention of the Audit Committee.

Risk of inappropriate judgements and estimates relating to staging and use of multiple economic scenarios as they apply to the expected credit loss allowance on loans and advances to customers.

See note 12 to the annual accounts and also note 31 for the directors' IFRS9 impairment disclosures.

The Group held £5.0m of impairment provisions against total loans and advances to customers of £3,300.1m (2018: £12.0m against £2,784.2m).

We focussed our audit work on the areas of the accounting methodology that we identified as most judgemental. These were:

- The appropriateness of the 'staging' thresholds selected by management to determine whether a significant increase in credit risk has arisen. This determines whether a 12 month or a lifetime expected loss provision is recorded against each loan; and
- The severity and likelihood of alternative downside economic scenarios that form part of the forward economic guidance and their impact on ECL.

Independent Auditors' Report

to the Members of Newcastle Building Society (continued)

We also considered the probabilities of default and loss rates, their impact on the determination of significant increases in credit risk and the appropriateness of post model adjustments made to reflect model and data limitations.

Whilst the credit environment has remained relatively benign as a result of low interest rates and low unemployment, broader economic risks including the impact of the UK departure from the EU remain, which increases the estimation uncertainty in the ECL.

The ECL provision for loans and advances has a significant number of data inputs.

How our audit addressed the key audit matter

We performed the following procedures:

- Critically assessed the methodology applied in the impairment models, using modelling specialists to confirm that the implemented methodology was compliant with IFRS 9;
- Considered whether the staging criteria set by management in assessing whether a significant increase in credit risk has taken place are capturing unlikeliness to pay characteristics and other indicators of customer delinquency ahead of a default event taking place;
- Independently reviewed the model changes made over the course of the year to validate that they reflected approved updates to models, parameters and inputs;
- Performed tests over critical data inputs to the staging assessment and tested the model implementation code to ensure that loans which have suffered a significant increase in credit risk have a provision calculated based on expected lifetime losses;
- Compared the forward-looking economic assumptions to independent forecasts and those used by comparable peers when testing their reasonableness. The severity and magnitude of the scenarios were compared to external forecasts and data from historical economic downturns, and the sensitivities of the scenarios on the ECL were considered. Tests were performed to consider whether the economic scenarios applied were appropriately severe so as to capture nonlinear effects in credit losses which may arise in economic downturns; and
- Tested management's monitoring controls performed throughout the year and independently re-performed monitoring tests to ensure that changes to customer behaviour are reflected in the ECL calculation.

No material issues arose as a result of our work in this area.

Appropriateness of assumptions used within the effective interest rate accounting models

See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates.

Loans and advances are recognised at amortised cost, and interest income is recognised using the Effective Interest Rate (EIR) method. The majority of interest income is calculated by automated systems and requires little or no judgment.

Therefore we focused our work in relation to revenue recognition on EIR accounting and specifically the appropriateness of key assumptions used in the calculation of EIR, including the income and costs included in the calculation and the estimated life of the product.

The loans and advances to customers line item (note 12) includes effective interest rate accounting adjustments of £6.3m at the balance sheet date (2018: £3.4m).

This adjustment is released to the income statement in accordance with the forecast behavioural life of the Group's loan book which is a key judgement. Management makes this judgement by considering past repayment behaviour on the loan book.

How our audit addressed the key audit matter

We performed the following procedures:

- Confirmed that those fees and charges included within the effective interest rate calculation are implicit in the origination of loan assets;
- Performed substantive testing over the input of data from the loan book system to the effective interest rate accounting model and tested the mathematical accuracy of the calculations;
- Tested the completeness and accuracy of the customer redemption data used to generate the behavioural life profile, and assessed whether the current loan book is likely to perform in a similar manner to past experience; and
- Performed a sensitivity analysis on a range of possible outcomes to assess the range of estimation uncertainty within the calculation.

No material issues arose as a result of our work in this area.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the annual accounts as a whole, taking into account the structure of the Group and the Society, the accounting processes and controls, and the industry in which they operate.

Substantially all of the Group's activities are in the United Kingdom and it reports its operating results along two business lines, being the Member business and the Solutions business (refer to note 9 of the annual accounts).

We performed an audit of all material account balances and other financial information for the Society, together with the assessment of management's going concern assumption.

We determined it necessary to perform specific audit procedures over account balances and other financial information in certain subsidiary undertakings where such entities significantly contributed to the amount recorded in the Group annual accounts. As a result, we performed audit procedures on revenue recorded by Newcastle Strategic Solutions Limited, fee and commission income in Newcastle Financial Advisers Limited, and leasehold land and buildings in Newcastle Portland House Limited.

Taken together, our audit procedures on the Society and its subsidiary undertakings provided us with sufficient audit evidence as a basis for our opinion on the Group annual accounts as a whole.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the annual accounts as a whole.

Based on our professional judgement, we determined materiality for the annual accounts as a whole as follows:

Group Annual Accounts

Overall materiality	£1,128,000 (2018: £1,240,000).
How we determined it	0.5% of net assets
Rationale for benchmark applied	We believe that net assets is the most appropriate benchmark to use for the Society and Group, whose strategy is not one of profit maximisation. Regulatory capital is a key benchmark for management and regulators and hence we consider net assets to be a GAAP equivalent to regulatory capital, as our benchmark.

Society Annual Accounts

Overall materiality	£1,119,000 (2018: £1,155,000).
How we determined it	0.5% of net assets
Rationale for benchmark applied	We believe that net assets is the most appropriate benchmark to use for the Society and Group, whose strategy is not one of profit maximisation. Regulatory capital is a key benchmark for management and regulators and hence we consider net assets to be a GAAP equivalent to regulatory capital, as our benchmark.

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £135,000 to £509,000. Certain components were audited to a local statutory audit materiality that was also less than our overall Group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £56,300 (Group audit) (2018: £62,000) and £56,000 (Society audit) (2018: £57,750) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation

We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the accounts about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the annual accounts and the directors' identification of any material uncertainties to the Group's and the Society's ability to continue as a going concern over a period of at least twelve months from the date of approval of the annual accounts.

Outcome

We have nothing material to add or to draw attention to.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Society's ability to continue as a going concern. For example, the terms of the United Kingdom's withdrawal from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the Group's trade, customers, suppliers and the wider economy.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the annual accounts and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the annual accounts does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the annual accounts, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the annual accounts or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the annual accounts or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

Independent Auditors' Report

to the Members of Newcastle Building Society (continued)

With respect to the Annual Business Statement and Directors' Report, we also considered whether the disclosures required by the Building Societies Act 1986 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Building Societies Act 1986 and ISAs (UK) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Building Society Act 1986 – Opinion on Annual Business Statement and Directors' Report

In our opinion, based on our work undertaken in the course of the audit:

- 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 year ended 31 December 2019 is consistent with the accounting records and the annual accounts; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Responsibilities for the annual accounts and the audit

Responsibilities of the directors for the annual accounts

As explained more fully in the Statement of Directors' Responsibilities set out on page 38, the directors are responsible for the preparation of the annual accounts in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the directors are responsible for assessing the Group's and the Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the annual accounts

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

A further description of our responsibilities for the audit of the annual accounts is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 78 of the Building Societies Act and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Building Societies Act 1986 exception reporting

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

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

We have no exceptions to report arising from this responsibility

Appointment

Following the recommendation of the audit committee, we were appointed by the members on 25 April 1994 to audit the annual accounts for the year ended 31 December 1994 and subsequent financial periods. The period of total uninterrupted engagement is 26 years, covering the years ended 31 December 1994 to 31 December 2019.

Other voluntary reporting

Directors' remuneration

The Society voluntarily prepares a Directors' Remuneration Report in accordance with the provisions of the Companies Act 2006. The directors requested that we audit the part of the Directors' Remuneration Report specified by the Companies Act 2006 to be audited as if the Society were a quoted company.

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Catrin Thomas (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Newcastle upon Tyne
25 February 2020

Customer testimonial

"We've been customers for many years, always had great customer service from the staff."

Jacqueline and Michael

Cramlington customers

Income Statements for the year ended 31 December 2019

	Note(s)	GROUP		SOCIETY	
		2019 £m	2018 £m	**2019 £m**	2018 £m
Interest receivable and similar income					
Interest income calculated using effective interest rate	2	**106.1**	96.4	**107.6**	97.7
Interest receivable and similar income	2	**(18.8)**	(21.2)	**(18.8)**	(21.2)
Total interest receivable and similar income	2	**87.3**	75.2	**88.8**	76.5
Interest payable and similar charges	3	**(48.7)**	(41.0)	**(48.7)**	(41.0)
Net interest income		**38.6**	34.2	**40.1**	35.5
Other income	4	**40.1**	33.0	**14.4**	15.9
Other charges	4	**(4.3)**	(2.8)	**(4.3)**	(2.8)
Gains less losses on financial instruments and hedge accounting		**0.5**	0.1	**0.5**	0.1
Income from shares in subsidiary undertakings (dividends)	4	**-**	-	**1.3**	1.3
Total operating income		**74.9**	64.5	**52.0**	50.0
Administrative expenses	6	**(54.4)**	(46.9)	**(36.5)**	(34.2)
Depreciation	16,17	**(4.2)**	(2.9)	**(2.3)**	(1.2)
Operating profit before impairments and provisions		**16.3**	14.7	**13.2**	14.6
Impairment charges on loans and advances to customers	12	**(1.5)**	(1.5)	**(1.5)**	(1.5)
Provisions for liabilities and charges	25	**(0.1)**	0.1	**(0.1)**	0.1
Profit for the year before taxation		**14.7**	13.3	**11.6**	13.2
Taxation expense	8	**(3.3)**	(2.5)	**(2.5)**	(2.3)
Profit after taxation for the financial year		**11.4**	10.8	**9.1**	10.9

The notes on pages 72 to 121 form part of these Accounts.

Statements of Comprehensive Income for the year ended 31 December 2019

	Note	GROUP		SOCIETY	
		2019 £m	2018 £m	**2019 £m**	2018 £m
Profit for the financial year		**11.4**	10.8	**9.1**	10.9
Other comprehensive income / (expense):					
Items that may be reclassified to income statement					
Movement on fair value through other comprehensive income / (expense)		**0.9**	(1.7)	**0.9**	(1.7)
Income tax on items that may be reclassified to income statement	18	**(0.1)**	0.3	**(0.2)**	0.3
Total items that may be reclassified to income statement		**0.8**	(1.4)	**0.7**	(1.4)
Items that will not be reclassified to income statement					
Actuarial remeasurements on retirement benefit obligations	19	**-**	-	**-**	-
Income tax on items that will not be reclassified to income statement	19	**-**	-	**-**	-
Derecognition of pensions surplus	19	**(0.8)**	(1.1)	**(0.8)**	(1.1)
Total items that will not be reclassified to income statement		**(0.8)**	(1.1)	**(0.8)**	(1.1)
Total comprehensive income for the financial year		**11.4**	8.3	**9.0**	8.4

The notes on pages 72 to 121 form part of these Accounts.

	Note(s)	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Assets					
Cash and balances with the Bank of England		**215.7**	152.9	**215.7**	152.9
Loans and advances to banks	10	**230.5**	210.5	**219.8**	200.4
Debt securities	11	**416.3**	329.0	**416.3**	329.0
Derivative financial instruments	31	**0.1**	3.5	**0.1**	3.5
Loans and advances to customers	12	**3,295.1**	2,772.2	**3,292.8**	2,769.4
Fair value adjustments for hedged risk	13	**186.6**	175.9	**186.6**	175.9
Investment in subsidiary undertakings	15	**-**	-	**43.2**	41.8
Property, plant and equipment and investment properties	16,17	**48.7**	38.8	**21.1**	12.5
Deferred tax assets	18	**1.0**	2.3	**1.1**	2.2
Retirement benefit asset	19	**-**	-	**-**	-
Other assets	20	**18.1**	12.7	**15.1**	15.5
Total Assets		**4,412.1**	3,697.8	**4,411.8**	3,703.1

The notes on pages 72 to 121 form part of these Accounts.

Balance Sheets as at 31 December 2019

	Note	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Liabilities					
Due to Members	21	**3,400.9**	2,713.7	**3,400.9**	2,713.7
Fair value adjustments for hedged risk	13	**-**	0.4	**-**	0.4
Due to other customers	22	**189.8**	142.6	**189.8**	143.7
Deposits from banks	23	**389.6**	409.8	**389.6**	409.8
Derivative financial instruments	31	**185.9**	178.3	**185.9**	178.3
Current tax liabilities		**1.2**	-	**0.6**	-
Other liabilities	24	**18.1**	11.8	**20.3**	15.5
Provisions for liabilities and charges	25	**0.8**	0.9	**0.8**	0.9
Subordinated liabilities	26	**-**	25.0	**-**	25.0
Subscribed capital	27	**20.0**	20.0	**20.0**	20.0
Reserves		**205.8**	195.3	**203.9**	195.8
Total Liabilities		**4,412.1**	3,697.8	**4,411.8**	3,703.1

These Accounts were approved by the Board of Directors on 25th February 2020 and signed on its behalf by:

Phil Moorhouse, Chairman
Mick Thompson, Chair of Audit Committee
Andrew Haigh, Chief Executive

The notes on pages 72 to 121 form part of these Accounts.

Statements of Movements in Members' Interests for the year ended 31 December 2019

Group

	General Reserve £m	Fair Value Through Other Comprehensive Income £m	Total £m
At 1 January 2019	193.8	0.6	194.4
Movement in the year	10.6	0.8	11.4
At 31 December 2019	**204.4**	**1.4**	**205.8**

	General Reserve £m	Fair Value Through Other Comprehensive Income £m	Total £m
At 1 January 2018	185.0	2.0	187.0
Movement in the year	9.7	(1.4)	8.3
At 31 December 2018	**194.7**	**0.6**	**195.3**
IFRS16 Day 1 Transition	(0.9)	-	(0.9)
At 1st January 2019	**193.8**	**0.6**	**194.4**

Society

	General Reserve £m	Fair Value Through Other Comprehensive Income £m	Total £m
At 1 January 2019	194.3	0.6	194.9
Movement in the year	8.3	0.7	9.0
At 31 December 2019	**202.6**	**1.3**	**203.9**

	General Reserve £m	Fair Value Through Other Comprehensive Income £m	Total £m
At 1 January 2018	185.4	2.0	187.4
Movement in the year	9.8	(1.4)	8.4
At 31 December 2018	**195.2**	**0.6**	**195.8**
IFRS16 Day 1 Transition	(0.9)	-	(0.9)
At 1st January 2019	**194.3**	**0.6**	**194.9**

Movements in the year reflects changes disclosed in the Statements of Comprehensive Income, net of tax.

The notes on pages 72 to 121 form part of these Accounts.

Cash Flow Statements for the year ended 31 December 2019

	Note	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Net cash inflows / (outflows) from operating activities	29	**186.8**	(50.6)	**183.6**	(60.6)
Payment into defined benefit pension scheme		**(0.8)**	(1.5)	**(0.8)**	(1.5)
Cash inflows / (outflows) from operating activities		**186.0**	(52.1)	**182.8**	(62.1)
Cash (outflows) / inflows from investing activities					
Purchase of property, plant and equipment		**(8.6)**	(2.9)	**(4.7)**	(1.7)
Sale of property, plant and equipment		**0.4**	-	**0.4**	-
(Increase) / decrease in loans to subsidiary undertakings		**-**	-	**(1.4)**	0.2
Purchase of investment securities		**(213.5)**	(72.5)	**(213.5)**	(72.5)
Sale and maturity of investment securities		**127.2**	121.2	**127.2**	121.2
Net cash (outflows) / inflows from investing activities		**(94.5)**	45.8	**(92.0)**	47.2
Cash outflows from financing activities					
Interest paid on subordinated liabilities		**(0.8)**	(0.8)	**(0.8)**	(0.8)
Interest paid on subscribed capital		**(2.3)**	(3.5)	**(2.3)**	(3.5)
Repayment of subordinated liabilities		**(25.0)**	-	**(25.0)**	-
Repayment of subscribed capital		**-**	(10.0)	**-**	(10.0)
Net cash outflows from financing activities		**(28.1)**	(14.3)	**(28.1)**	(14.3)
Net increase / (decrease) in cash		**63.4**	(20.6)	**62.7**	(29.2)
Cash and cash equivalents at start of year		**163.0**	183.6	**153.0**	182.2
Cash and cash equivalents at end of year	29	**226.4**	163.0	**215.7**	153.0

The notes on pages 72 to 121 form part of these Accounts.

1 Significant Accounting Policies

Basis of Preparation

The Annual Accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC); as adopted for use in the EU; and with those parts of the Building Societies (Accounts and Related Provisions) 1998 applicable to building societies reporting under IFRS.

The Board has reviewed medium and long term plans with particular emphasis on examining liquidity, capital and profitability of the Group and the risks to those forecasts through a variety of stress testing scenarios. The outcome of this review is that the Directors are satisfied that the Society and the Group have adequate resources to continue in business and meet its liabilities throughout the period of assessment.

Accordingly the financial statements of the Society and the Group have been prepared on a going concern basis with no material uncertainties that the going concern basis of accounting is appropriate.

A summary of the Group's principal accounting policies is set out below:

Basis of Consolidation

The Group Accounts include the results of the Society and its subsidiary undertakings, all of which have accounting periods ending 31 December. Subsidiaries are entities over which the Society has the power to control the financial and operating policies so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and are deconsolidated from the date that control ceases. Upon consolidation, inter-company transactions, balances and unrealised gains on transactions are eliminated. The accounting policies of subsidiaries are consistent with Group accounting policies.

Income Recognition

Interest Income and Expense

For all interest-bearing financial instruments, interest receivable calculated using the effective interest rate method (EIRM) and interest receivable and similar income for instruments held at fair value are recognised separately in the consolidated income statement.

Interest payable for all interest-bearing financial instruments is recognised within 'Interest payable and similar charges' in the consolidated income statement.

EIRM 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 cash flows (excluding credit losses) to zero, through the expected life of the instrument. In calculating the effective interest rate all contractual terms of the financial instrument (for example, early redemption charges) are taken into account.

Other income and charges

Fees and Commissions

Fees and commissions relating to creating loans and advances to customers are deferred and spread using the EIRM. Other fees and commissions are recognised as 'Other income' on the accruals basis as services are provided.

Financial Assets

In accordance with IFRS 9, Financial Instruments: Recognition and Measurement, the Group classifies its financial assets into the following categories:

Amortised cost

Under IFRS 9, Financial Instruments, where the contractual cash flow characteristics of an asset reflect "solely payments of principal and interest on the principal amount outstanding" (SPPI), an asset may be classified at 'amortised cost', with income recognised under the EIRM, where the asset's objective business model is 'held to collect contractual cash flows'. Cash flows are typically deemed to be SPPI in nature where there is a pre-determined date of repayment and where interest on the underlying financial assets is analogous to interest on 'simple debt instruments'- dominated by compensation for credit risk, the time value of money and a profit margin.

In assessing the business model applicable to its financial assets, the Society has considered how financial asset performance is evaluated and reported to senior management, the key risks affecting this performance and how these are managed, and how managers of the business are compensated in respect of asset performance. This analysis was undertaken at a more granular level than is presented in the Group's Balance Sheet or Notes to the Accounts.

The Society operates under a simple and straightforward Building Society model and does not trade in financial instruments. This allows for a more objective assessment of the business model under which financial assets are managed as typically there is no history, appetite or expectation that the Society will 'sell' its financial assets. Similarly, there is no compensation paid to staff with respect to fair value gains and no risk reporting geared at the speculative realisation of profit.

The Society's core business of mortgage lending is undertaken with a view to long term recovery of contractual cash flows. Interest charged on mortgage lending and subsequent mortgage cash flows are agreed by the Society's Mortgages and Savings Committee and calculated to ensure that the 'time-value of money' and the credit risk that lending exposes the Society to is adequately compensated via the interest rates agreed. The Group's mortgage assets and similar loans are held on Balance Sheet as 'loans and advances to customers'. In accordance with EIRM, incremental up-front costs and fees receivable which are directly related to the loans (including administration and completion fees, arrangement fees, procuration fees and commissions paid to agents) are deferred and released to income over the effective life of the mortgage assets. Historical and forecast mortgage redemption data and management judgement are used to estimate the expected lives of mortgage assets.

1 Significant Accounting Policies (continued)

The Society's non-mortgage lending, typically loans and advances to banks, is similarly undertaken with a view to recovery of contractual cash flows and with interest charged that meets the SPPI requirements.

The Society's cash balances, where interest generative, are held to collect contractual interest flows (and to ensure appropriate liquidity is on hand to meet the Society's liabilities as they fall due.

The Society's trade receivables, whether due from third parties or intra-group companies, are held to collect the contractual cash balances as they fall due. The Society does not engage in debt factoring activities.

The Group's equity release mortgage assets are accounted for under IFRS 4, Insurance Contracts, as they contain no-negative equity guarantees that meet the IFRS 4 criteria for classification as insurance contracts. The Group's accounting treatment recognises all of the obligations, through provision for anticipated recovery shortfalls due to no-negative equity guarantees, and rights, through recognition of interest income, in respect of its equity release mortgages. As such, the Group is not required, and has not elected to 'unbundle' the insurance and deposit components of its equity release mortgages, with the mortgages therefore accounted in full under IFRS 4.

Income on the equity release mortgage assets is recognised in line with the Group's disclosed loans and receivables accounting policy on an amortised cost basis. This amortised cost basis also quantifies the asset component of the Group's equity release mortgages before calculation of any related insurance liability.

The Group performs liability adequacy testing on its insurance liabilities to ensure that the carrying amount of liabilities is sufficient to cover current estimates of future cash flows. See note 14 to the accounts for further information.

At Fair Value through Other Comprehensive Income

Under IFRS 9, where the contractual cash flow characteristics of an asset reflect SPPI, an asset may be classified at 'fair value through comprehensive income' with fair value movements recognised through other comprehensive income, where the asset's objective business model is 'held to collect contractual cash flows, or for sale'. Interest received on fair value through other comprehensive income assets continues to be recognised in the Income Statement.

While the Group does not trade in financial instruments, it is required to demonstrate the liquidity through occasional sale of its debt security portfolio (held for liquidity purposes and to generate an interest income return that typically exceeds the interest return on cash or Bank of England reserve account holdings). This requirement, while regulatory in nature, is sufficient to indicate a business model conclusion that the assets are held to collect contractual cash flows, 'or for sale'.

The Group's primary debt security holdings are in covered bonds, residential mortgage backed securities (RMBS) and government gilts. Each attract a rate of interest analogous with a simplified debt instrument (the Society assessing that the interest rate receivable is sufficiently compensating for the time value of money and perceived credit risk inherent in each investment).

The Group's current treasury policy ensures that investment in RMBS is at a sufficiently 'senior secured' level to conclude that RMBS cashflows continue to meet the SPPI requirements.

At Fair Value through Profit and Loss

Under IFRS 9, where the contractual cash flow characteristics of an asset do not reflect SPPI, or where neither of the above business models (held to collect contractual cashflows, or held to collect contractual cashflows or for sale) suitably reflect management of the asset, an asset is to be classified at 'fair value through profit or loss', with fair value movements recognised through the Income Statement.

The Group enters into derivative financial instruments to hedge its exposures relating to interest rates and longevity risk on equity release mortgages. At the balance sheet date the Group has entered into contracts which lead to derivatives designated as either fair value hedges or cash flow hedges in accordance with the risks that the hedges have been set up to mitigate. In accordance with the Treasury Policy and the Building Societies Act 1986 the Group does not hold or issue derivative financial instruments for trading purposes.

Derivatives are recognised at fair value on the date the derivative contract is entered into, and subsequently re-measured at their fair value. In accordance with IAS 39, applicable to the Society's macro-hedging activities, derivative financial instruments designated as hedging instruments (both assets and liabilities) are initially, and on an ongoing basis, assessed to determine whether they are highly effective in offsetting the changes in fair value of hedged items.

Under IFRS 9, which is applicable to the Society's non-macro hedging activities, an assessment is made as to the continued identified economic relationship between the hedged item and the hedging derivative, conclusion that credit risk is not considered to 'dominate' value changes of the identified economic relationship, and that an appropriate 'hedge ratio' is used to account for the hedge relationship: i.e the ratio of hedged items to hedging derivatives is aligned with the actual quantities of hedged items to hedging derivatives that the Group would use in practise results in an effective hedge relationship.

Changes in derivative fair values are recognised through the Income Statements along with changes in fair value attributable to the hedged risk of the hedged items.

The carrying value of the hedged item is included on the balance sheet under the heading "Fair value adjustments for hedged risk". Any gain or loss arising from an ineffective portion is recognised immediately in the Income Statements under the heading "Gains less losses on financial instruments and hedge accounting".

When a hedging instrument expires, is sold, or no longer meets the criteria for hedge accounting, then hedge accounting is discontinued and any cumulative gain or loss is recognised in the Income Statements.

1 Significant Accounting Policies (continued)

Cash and Cash Equivalents

For the purpose of the Cash Flow Statements, 'Cash and cash equivalents' comprises cash in hand, balances with the Bank of England, loans and advances to banks available on demand or with original maturities of three months or less and investment securities with a maturity period of three months or less i.e. highly liquid assets readily convertible into cash. For operational purposes, the Group's debt security portfolio is maintained for liquidity purposes with the assets therein demonstrably convertible into cash regardless of maturity.

The Group does not include encumbered assets in its cash and cash equivalents. The Group does not consider the timing of derivative collateral inflows to be sufficiently reliably estimated to include such collateral placed with counterparties as a liquid asset for cash flow presentation.

Impairment of Financial Assets

The Group provides for expected credit losses across applicable financial assets based on whether there has been a significant increase in credit risk since the asset's origination.

Loss allowances for expected credit losses are recognised on all financial assets held at either amortised cost, in which case loss allowances impact the Income Statement, or at fair value through other comprehensive income, in which case loss allowances impact other comprehensive income and become reserves reductions. A simplified approach is adopted for trade receivables and contract assets.

Loss allowances are recognised differently depending upon the initial credit risk of the assets at their origination, and the movement in said credit risk up to the current reporting date.

Scenarios are modelled to determine 12 month and lifetime expected credit losses against assets under said scenarios. The Group runs three scenarios (base, upside and downside) to allow a probability weighted outcome.

Where an asset has not seen a significant increase in credit risk since its origination ('Stage 1 assets'), 12 month expected credit losses are recognised as a loss allowance. These are the portion of lifetime expected credit losses that result from default events on the asset that are possible within the 12 months after the reporting date.

Where an asset has seen a significant increase in credit risk since origination, but there is no objective evidence of impairment at the reporting date ('Stage 2 assets'), lifetime expected credit losses are recognised.

Where an asset has seen significant increase in credit risk since origination and there is objective evidence of impairment at the reporting date ('Stage 3 assets'), lifetime expected credit losses are recognised and interest income is to be calculated against the net carrying amount of the financial asset, rather than the typical gross amount.

Financial Liabilities

All financial liabilities are initially measured at fair value, being the issue proceeds, net of premia, discounts and transaction costs incurred. Derivative financial liabilities remain accounted for at fair value on the balance sheet date. Hedged risk fair value adjustments are also held on the balance sheet at fair value. The remaining Group financial liabilities including shares, deposits, debt securities and Permanent Interest Bearing Shares are subsequently measured at amortised cost, using the EIRM.

Property, Plant, Equipment and Depreciation Intangible Assets and Amortisation

On transition to IFRS, the Group elected to adopt the exemption in IFRS 1 which permits an entity to use, on transition to IFRS, a value, which is not depreciated cost, as the 'deemed cost' of the asset. Property, plant and equipment and intangible assets are stated at cost (or 'deemed cost') less accumulated depreciation/amortisation and any provisions for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. The Group's intangible assets reflect externally purchased software. No internally generated intangible assets have been capitalised as at 31 December 2019. Depreciation/amortisation on assets commences when they are ready for their intended use and is provided at rates calculated to write down the assets to their estimated residual values over the course of their anticipated useful lives, on the following bases:

Freehold buildings and leasehold buildings:

With a residual lease term of greater than 50 years	- 2% per annum straight line
Other leasehold buildings	- over the term of the lease

Equipment, fixtures and fittings:

Refurbishment expenditure	- 6.67% to 10% per annum, straight line
Equipment, fixtures and fittings	- 10% per annum, straight line
Computer equipment	- 20% per annum, straight line
Computer software	- 20% per annum, straight line

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying amount of the asset and are included in the income statement in the period in which they arise.

Investment Property

The Group's investment properties reflect purchased or finance leased properties that are rented out in full or part to external tenants. All of the Group's investment properties have been elected to be held at their depreciated cost in line with IAS 40. Cost includes the purchase price of the assets and any directly attributable expenditure, primarily legal fees associated with the purchases. Depreciation commenced when the properties were purchased and is provided for over a 50 year term- 2% per annum straight line for owned property and over the term of the lease for finance leased property.

1 Significant Accounting Policies (continued)

Taxation

Corporation tax is charged on profits adjusted for tax purposes. Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements of the individual entities. Deferred tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and that are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Pension Scheme Costs

The Society operates a defined contribution scheme on behalf of directors and staff. For the defined contribution scheme, contributions are charged to the Income Statements, as they become payable, in accordance with the rules of the Scheme.

The Society historically operated a defined benefit scheme; this was closed to future accrual from 30 November 2010, and was funded by contributions partly from employees and partly from the Society at rates determined by an independent actuary. These contributions are invested separately from the Group's assets.

Under the revised IAS 19, the Scheme assets are measured at bid value at each Balance Sheet date and the obligations are measured by an independent actuary using the projected unit valuation method, discounted using a high quality corporate bond rate. The Group, through its pension accounting policy, does not recognise IAS 19 pensions surpluses on balance sheet. IAS 19 pensions deficits are recognised immediately on balance sheet with relevant actuarial remeasurements recognised in the Statement of Comprehensive Income. IAS 19 service costs are recognised in the income statements.

Provisions

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated. Contingent liabilities have not been recognised.

Segment Information

The operating segments disclosed (Member business and Solutions business) are those used in the Group's management and internal reporting structures (for the Chief Operating Decision Maker) in accordance with IFRS 8. No segment information is presented on geographical lines, because substantially all of the Group's activities are in the United Kingdom.

Accounting Estimates and Judgements in applying Accounting Policies

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the Annual Accounts. These judgements are based on management's best knowledge but the eventual outcome may differ from them. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following year. The most significant areas where judgements and assumptions are made are as follows:

Pensions

Significant judgements are required in relation to the assumptions for the valuation of the pension scheme surplus or deficit including discount, interest and mortality rates, inflation, take up of the Pension Increase Exchange offer and future salary increases. The Board receives independent external advice from actuarial consultants in arriving at the scheme assumptions which are outlined together with sensitivity analysis in Note 19 to the Annual Accounts.

Effective Interest Rate (EIR)

To calculate the appropriate EIR, certain assumptions are made in respect of the expected lives of specific asset portfolios which take into account such factors as the terms of the particular product, historic repayment data and prevailing economic conditions. These estimates are reviewed on a regular basis to ensure they reflect the portfolio's actual performance. During 2019, the Society revised its interpretation of integral fees and incremental costs and now includes early redemption charges as part of its EIR modelling. The EIR adjustment included in loans and advances to customers. See note 10.

Impairment of Financial Assets

Implementation of high quality IFRS 9 impairment models requires significant management experience and judgement, both in assessing historic performance trends and factors and in projecting these into uncertain future economic environments. External professional modelling assistance has been coupled with the Society's extensive internal expertise to facilitate a robust and compliant implementation. Best practise guidance issued by consolidated professional audit and accountancy firms, IFRS implementation guidance, and banking centric governance and modelling guidance from European and domestic authorities form the foundation of the Society's IFRS 9 impairment response.

The key assumptions used in the discounted future value calculations used to determine the level of impairment required in respect of individual financial assets include:

- Predictions about future Bank of England base rates, UK unemployment rates, UK nominal Gross Domestic Product, UK Household Income and UK House Price averages.
- The predictive capacity of the following key indicators with respect to whether a borrower will ultimately default on their mortgage obligations: forbearance, mortgage fraud, borrower insolvency, bankruptcy, voluntary repossession and falling into 1 month and 3 months arrears.
- The average time taken to sell defaulted property and the average sale adjustments suffered when selling.

Further details are given in Note 31 to the Annual Accounts.

1 Significant Accounting Policies (continued)

Fair Value of Derivatives and Financial Assets

Fair values are determined by the three tier valuation hierarchy as defined within IFRS 7, Financial Instruments. Where available, quoted market prices are used to facilitate valuations made. Financial valuation models using observable input data are used to value derivative financial instruments for which no active market exists. Further details are given in Note 31 to the Accounts.

Taxation

The Group is subject to tax in two jurisdictions and, consequently, estimates are required in determining the provision for corporation tax. As shown in Note 8 to the Annual Accounts the Group has deferred tax assets which are considered recoverable given the Society and Group plans over the planning horizon.

Accounting Developments

At the date of approval of these financial statements the following new and amended International Financial Reporting Standards are mandatory for the first time for the financial year beginning 1 January 2019.

IFRS 16, Leases, superseded IAS 17, Leases, on 1 January 2019 and sets out new principles for the recognition, measurement, presentation and disclosure of leases. The standard requires a lessee to recognise a right-of-use asset and corresponding lease liability on the Balance Sheet for all leases other than short term leases or leases for which the underlying asset is of low value. The Group has adopted IFRS 16 retrospectively from 1 January 2019 but has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 January 2019.

Lease commitments are recognised under IFRS 16 at the minimum present value of the remaining lease payments, discounted at a rate reflecting the Group's typical borrowing costs. Likely lease extensions are factored into the Group's remaining payments and the Group also includes expected rates and insurance payments on leased properties as part of the discounted remaining lease payments. The Group discounts its lease payments at the rate it would expect to pay to borrow funding for a similar duration to each lease. The Group's weighted average incremental borrowing rate applied to its lease liabilities on 1 January 2019 was 2.4%. For further information see note 17 to the accounts.

Developments not effective at 31 December 2019

There are a number of new or amended standards which become effective in 2020, and beyond, which allow for early adoption but the Society is not adopting any of those standards before their mandatory date.

IFRS 17, Insurance Contracts, is expected to replace IFRS 4, Insurance Contracts on 1 January 2022. The Society is closely monitoring the development of IFRS 17.

2 Interest receivable and similar income

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
On loans and advances to customers	**97.6**	89.5	**99.2**	90.9
On debt securities				
- interest and other income	**4.7**	4.1	**4.6**	4.0
- profits net of losses on realisation	**0.4**	0.3	**0.4**	0.3
On other liquid assets				
- interest and other income	**3.4**	2.5	**3.4**	2.5
Net expense on derivatives hedging assets	**(18.8)**	(21.2)	**(18.8)**	(21.2)
	87.3	75.2	**88.8**	76.5

Interest receivable and other income includes **£4.6m** (2018: £4.0m) from fixed income securities.

3 Interest payable and similar charges

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
On shares held by individuals	**40.4**	34.8	**40.4**	34.8
On subscribed capital	**2.3**	3.5	**2.3**	3.5
On deposits and other borrowings				
- subordinated liabilities	**0.8**	0.8	**0.8**	0.8
- to other depositors and borrowers	**5.5**	3.9	**5.5**	3.9
On Finance Leases	**0.2**	-	**0.2**	-
Net income on derivatives hedging liabilities	**(0.5)**	(2.0)	**(0.5)**	(2.0)
	48.7	41.0	**48.7**	41.0

Net income on derivatives hedging liabilities includes £nil from basis risk derivatives that were not formally designated in hedge relationships during 2019.

4 Other income and charges

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Other income				
Fee and commission income	**9.1**	7.0	**4.6**	2.9
Other operating income	**31.0**	26.0	**9.8**	13.0
	40.1	33.0	**14.4**	15.9

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Other charges				
Fee and commission expense	**4.3**	2.8	**4.3**	2.8

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Dividend income				
Received from subsidiary undertakings	**-**	-	**1.3**	1.3

5 Revenue from contracts with customers

1. Disaggregation of revenue from contracts with customers

The Group and Society derives revenue from the transfer of services at a point in time and over time in the following business segments and service areas.

	GROUP		SOCIETY	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Solutions Business				
Savings management services				
Recognised at a point in time	**-**	-	**-**	-
Recognised over time	**27.5**	24.8	**0.7**	3.5
	27.5	24.8	**0.7**	3.5
Savings management project and change services				
Recognised at a point in time	**-**	-	**-**	-
Recognised over time	**0.9**	1.3	**-**	0.1
	0.9	1.3	**-**	0.1
IT Services				
Recognised at a point in time	**-**	-	**-**	-
Recognised over time	**0.6**	0.7	**-**	-
	0.6	0.7	**-**	-
Member Business				
Regulated advice services				
Recognised at a point in time	**2.5**	2.3	**-**	-
Recognised over time	**2.0**	1.8	**-**	-
	4.5	4.1	**-**	-
Third Party Services				
Recognised at a point in time	**0.7**	0.7	**0.7**	0.7
Recognised over time	**-**	-	**-**	-
	0.7	0.7	**0.7**	0.7
Total revenue from contracts with customers	**34.2**	31.6	**1.4**	4.3

In accordance with IFRS 8, 'Operating Segments', the Group reports the following segments; Member business and Solutions business. When the Group prepares financial information for management, it disaggregates revenue by segment and service type. Revenue from contracts with customers generated by the Solutions business and the Member business can be seen in 'Other income and charges' within the Segment information note, Note 9.

Disaggregation of intercompany income for the Society is included in the Related party note, Note 30.

Notes to the Accounts for the year ended 31 December 2019

5 Revenue from contracts with customers Continued

2. Unsatisfied long-term service contracts

The following table shows partially unsatisfied performance obligations resulting from fixed-price long-term contracts as at 31 December 2019:

	GROUP	
	2019 £m	2018 £m
Aggregate amount of transaction price allocated to long-term savings management contracts	**3.3**	5.3
Aggregate amount of transaction price allocated to long-term savings management systems contracts	**2.2**	2.7
	5.5	8.0

In relation to savings management contracts, the Group expects to recognise approximately £1.4m of the unearned amount in 2020, and £1.9m thereafter. In relation to savings management systems contracts, the Group expects to recognise approximately £0.4m of the unearned amount in 2020, and £1.8m thereafter.

3. Assets and liabilities related to contracts with customers

The Group has recognised the following assets and liabilities related to contracts with customers:

	GROUP	
	2019 £m	2018 £m
Asset recognised for costs incurred to fulfil a contract	**0.1**	0.1
Contract liability for IT savings management systems	**0.1**	0.1

In adopting IFRS 15, the Group recognised an asset in relation to costs to fulfil a long-term IT contract, and a liability for income received in advance of performance under a long-term IT contract. The amounts for each are included within Other assets and Other Liabilities on the Balance Sheet.

The costs to fulfil a contract had been expensed as incurred in 2017. The asset is amortised on a straight-line basis over the term of the specific contract it relates to, which is consistent with the pattern of recognition of the associated revenue.

The income in advance of performance had been recognised as received in 2017. The liability is reduced, and deferred income recognised, on a straight-line basis over the term of the specific contract it relates to.

5 Revenue from contracts with customers Continued

4. Accounting polices

Savings management, and savings project and change services

Savings management, and savings project and change services are provided by the Society's subsidiary, Newcastle Strategic Solutions Limited (NSSL). NSSL provide outsourced savings management services which cover the full lifecycle of a savings management contract, including implementation, operation, and decommission.

Revenue for implementation, project, and change services is recognised over time, in-line with milestones achieved by NSSL. Each milestone has a corresponding transaction price which represents the portion of the service provided to the customer at that point in time. Revenue for savings management administration is recognised over time in discrete monthly amounts which are calculated based on actual work completed by NSSL in the relevant month. Revenue for providing an ongoing savings management service and data storage service is recognised monthly in-line with the time elapsed in each individual contract. The amount of revenue recognised for ongoing savings management and data storage is spread evenly throughout the contractual term, consistent with the pattern of transfer of the service to the customer.

NSSL receive consideration for all services based on an invoicing schedule set out in the contracts with customers. Implementation, project, and changes services are invoiced upon achievement of each milestone. Savings management services are invoiced each month within the contract. With the exception of data storage services, all invoices relate to performance completed up to the invoice date. NSSL invoice and receive consideration for data storage services annually in advance of performance, for which a contract liability is recognised. All other consideration is unconditional, and is recognised as a receivable on the Balance Sheet until payments is received, which is typically the month following the invoice date in-line with contractual payment terms.

IT services

IT Services were provided by the Society's subsidiary, Newcastle Systems Management Limited (NSML) before migrating in the year to NSSL. NSML and later NSSL have provided managed IT services to the Group and external customers, which include managed IT solutions for savings management and client account systems, and data storage services.

Revenue for all services is recognised monthly in line with the time elapsed in each individual contract. The amount of revenue recognised for savings management systems and data storage services is spread evenly throughout the contractual term, consistent with the pattern of transfer of the service to the customer. The amount of revenue recognised for client account systems is calculated based on to the actual asset balance held by a customer in the relevant month.

NSSL and NSML receive consideration for all services based on an invoicing schedule set out in the contracts with customers. With the exception of some data storage services, all invoices relate to performance completed up to the invoice date, and are invoiced in either annual or quarterly periods. Consideration is unconditional, and is recognised as a receivable on the Balance Sheet until payment is received, which is typically the month following the invoice date in-line with the contractual payment terms. They receive consideration for data storage services annually in advance of performance, for which a contract liability is recognised.

Regulated advice services

Regulated advice services are provided by the Society's subsidiary, Newcastle Financial Advisers Limited (NFAL). All services derive from the company's principal activity, the provision of financial planning services, and include regulated advice, ongoing advice, and life protection plans. The company is an appointed representative of Openwork Limited, and provides services on behalf of Openwork Limited. For the purposes of IFRS 15, Openwork Limited are the sole customer of the company and all consideration for the services provided by the company is received from Openwork Limited.

Revenue for regulated advice and protection plans is recognised when confirmation of the investment or plan is received by Openwork Limited, and the service is complete. Revenue for ongoing advice is recognised on a straight-line basis at the end of each month the service is in place. Consideration for regulated advice and protection plans is calculated using contractually stated and agreed rates, on an ad valorem basis for regulated advice, and dependent upon specific product lines for protection plans. Consideration for ongoing service is calculated on an annual basis at a percentage of an investment portfolio.

NFAL receive consideration for all services based on an invoicing schedule set out in the contract with Openwork Limited. Consideration is received monthly and relates to performance completed in the previous month. Consideration is unconditional, and is recognised as a receivable on the Balance Sheet until payment is received, which is typically the month following the invoice date inline with the contractual payment terms.

Third party services

Third party services are provided by the Society through its branch network and online. The Society introduces customers to third parties who provide funeral plans, estate management services, and general insurance. The Society is the principal in the relationship with each third party provider and has no contractual relationship for the third party service with the customer.

The service provided by the Society of introducing or referring customers to a third party is complete once the third party provider has agreed a sale with the customer. Revenue for all services is recognised when cash is received, which in all instances is in line with, or shortly after, completion of the third party contract in-line with contractual payment terms. Consideration for all services is calculated based on discrete, and contractually agreed, transaction prices which are noted as a commission amount to the Society. The Society receives consideration based on an invoicing schedule agreed with each third party and all payments received relate to performance completed up to the invoice date.

All services

Due to the nature of services provided, the Society's subsidiary companies, NSSL, NFAL, and previously NSML are more greatly impacted by the implementation of IFRS 15 than the Society. Details of transactions which are not material to the Group, but are material to the individual companies, can be found in the specific company's annual report and accounts.

The transaction prices for all services provided by the Group are calculated using contractually stated and agreed rates. There are no elements of variable consideration and no critical judgements in allocating the transaction price.

The Group measures impairment losses on receivable balances as of the end of the reporting period at an amount equal to lifetime expected credit losses in accordance with IFRS 9, 'Financial Instruments'. Provisions held against receivable balances at 31 December 2019 are not material.

6 Administrative expenses

	Note	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Staff costs	7	**39.1**	33.4	**18.7**	16.7
Rentals under operating leases for land and buildings					
- payable to third parties		**0.4**	0.9	**0.2**	0.8
- payable to subsidiary undertaking		**-**	-	**0.1**	0.9
Other administrative expenses		**14.9**	12.6	**17.5**	15.8
		54.4	46.9	**36.5**	34.2

During the year the Group and Society obtained the following services from the Society's external auditors and these are included in other administrative expenses.

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Fees payable to the Society's auditors for audit of Society and consolidated financial statements	**0.3**	0.2	**0.3**	0.2
Fees payable to the Society's auditors for other services	**-**	-	**-**	-
	0.3	0.2	**0.3**	0.2

Fees payable to the Society's auditor for the audit of consolidated financial statements includes **£20k** (2018: £19k) attributable to subsidiary companies. Fees payable to the Society's auditors for other services includes **£35k** (2018: £25k) related to the review of the interim financial statements and the Client Asset audit. Both services are deemed other non-audit services.

7 Staff costs

	Note	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Wages and salaries		**32.5**	27.8	**15.3**	13.7
Social security costs		**2.9**	2.6	**1.3**	1.2
Pension costs for defined contribution scheme		**3.7**	3.0	**2.1**	1.8
	6	**39.1**	33.4	**18.7**	16.7

Directors' emoluments are disclosed in the Remuneration Committee Report.

The monthly average number of persons employed, including Executive Directors, during the year was:

	GROUP 2019	GROUP 2018	SOCIETY 2019	SOCIETY 2018
Full time	**928**	829	**372**	342
Part time	**240**	219	**155**	144
	1,168	1,048	**527**	486
Head Office	**978**	856	**361**	330
Branches	**190**	192	**166**	156
	1,168	1,048	**527**	486

8 Taxation expense

	Note	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Current tax					
Current year		**2.0**	0.7	**1.3**	0.6
Adjustments in respect of previous years		**-**	0.6	**-**	0.3
Total deferred tax		**2.0**	1.3	**1.3**	0.9
Deferred tax					
Current year		**1.1**	1.7	**1.0**	1.8
Adjustments in respect of prior years		**0.2**	(0.5)	**0.2**	(0.4)
Total deferred tax	18	**1.8**	1.2	**1.2**	1.4
Total taxation expense in Income Statements		**3.3**	2.5	**2.5**	2.3

Analysis of taxation expense for the year

The tax on the Group and Society profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits as follows:

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Analysis of taxation expense for the year				
Profit for the year before taxation	**14.7**	13.3	**11.6**	13.2
Profit before taxation at the standard rate of corporation tax in the UK of **19%** (2018: 19%)	**2.8**	2.5	**2.2**	2.5
Expense not deductible for tax purposes:				
Non-taxable dividend income received	**-**	-	**(0.2)**	(0.2)
Other	**0.4**	(0.2)	**0.4**	-
Expenses	**-**	0.1	**(0.1)**	0.1
Rate change	**-**	-	**-**	-
Adjustments in respect of previous years	**0.1**	0.1	**0.2**	(0.1)
Total taxation expense	**3.3**	2.5	**2.5**	2.3

Factors affecting future tax charges

The Society has brought forward trading losses for tax purposes which are expected to affect future taxable profits (see further details in Note 18).

9 Segment information

The Chief Operating Decision Maker has been identified as the Board of Directors. The Board reviews the Group's internal reporting in order to assess performance and allocate resources. Management has determined the operating segments based on these reports.

Following the management approach of IFRS 8, operating segments are reported in accordance with the internal reporting provided to the Board of Directors. The operating segments used by the Group meet the definition of a reportable segment under IFRS 8.

The 'Member business' segment provides mortgage, savings, investment and insurance products to Members and customers. The 'Solutions business' segment (also referred to as NSSL) provides business to business services through people, processes and technology. The Board assesses performance based on profit before tax after the allocation of all central costs. Operating profit before impairments and provisions is also assessed as this provides information on underlying business performance.

Income and directly attributable costs are allocated to each segment and support costs are apportioned, based on direct salary costs and detailed allocations by budget holders.

Year to 31 December 2019	**Member Business £m**	**Solutions Business £m**	**Total £m**
Net interest receivable	**38.6**	**-**	**38.6**
Other income and charges	**5.8**	**30.5**	**36.3**
Administrative expenses	**(31.4)**	**(23.0)**	**(54.4)**
Depreciation	**(2.8)**	**(1.4)**	**(4.2)**
Operating profit before impairments and provisions	**10.2**	**6.1**	**16.3**
Impairment charges on loans and advances to customers	**(1.5)**	**-**	**(1.5)**
Provisions for liabilities and charges	**(0.1)**	**-**	**(0.1)**
Profit for the year before taxation*	**8.6**	**6.1**	**14.7**
Taxation expense			**(3.3)**
Profit after taxation for the financial year			**11.4**
Total assets	**4,394.3**	**17.8**	**4,412.1**

Year to 31 December 2018	Member Business £m	Solutions Business £m	Total £m
Net interest receivable	34.2	-	34.2
Other income and charges	4.8	25.5	30.3
Administrative expenses	(27.9)	(19.0)	(46.9)
Depreciation	(1.7)	(1.2)	(2.9)
Operating profit before impairments, provisions and exceptional items	9.4	5.3	14.7
Impairment charges on loans and advances to customers	(1.5)	-	(1.5)
Provisions for liabilities and charges	0.1	-	0.1
Profit for the year before taxation*	8.0	5.3	13.3
Taxation expense			(2.5)
Profit after taxation for the financial year			10.8
Total assets**	3,679.4	19.1	3,698.5

*There exists additional costs of the Solutions business that are borne by the Member business. Therefore this does not reflect the stand-alone profit of the Member business.

**Please note the comparative figures have been restated.

10 Loans and advances to banks

Repayable from the date of the Balance Sheets in the ordinary course of business as follows:

	GROUP **2019 £m**	GROUP 2018 £m	SOCIETY **2019 £m**	SOCIETY 2018 £m
Accrued interest	**0.1**	0.1	**0.1**	0.1
On demand	**10.7**	10.1	**-**	-
In not more than three months	**221.2**	201.8	**221.2**	201.8
Gross loans and advances to banks	**232.0**	212.0	**221.3**	201.9
Less: allowance for losses on loans and advances to banks	**(1.5)**	(1.5)	**(1.5)**	(1.5)
	230.5	210.5	**219.8**	200.4

Allowance for losses on loans and advances to banks

	GROUP and SOCIETY **2019 £m**	2018 £m
Balance at 1 January	**1.5**	1.5
Amounts utilised during the year	**-**	-
At 31 December	**1.5**	1.5

At 31 December 2019 the Society had loans and advances to Icelandic banks totalling **£1.5m** (2018: £1.6m), against which allowance for losses of **£1.5m** (2018: £1.5m) has been made.

11 Debt securities

Transferable debt securities	GROUP and SOCIETY **2019 £m**	2018 £m
Issued by public bodies - listed	**95.1**	73.3
Issued by other borrowers - unlisted	**321.2**	255.7
	416.3	329.0
These have remaining maturities as follows:		
Accrued interest	**1.0**	1.0
In not more than one year	**101.0**	21.0
In more than one year but not more than five years	**262.6**	234.1
In more than five years	**51.7**	72.9
	416.3	329.0

The Directors consider that the primary purpose of holding securities is to comply with prudential requirements. All transferable debt securities are held with the intention of use on a continuing basis in the Group's activities. They are designated by management on initial recognition as being available for sale and are recognised, both initially and subsequently, at fair value with changes recognised directly in other comprehensive income.

Unlisted debt securities are AAA rated holdings of Residential Mortgage Backed Securities and Covered Bonds.

12 Loans and advances to customers

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Loans fully secured on residential property	**3,249.9**	2,723.2	**3,247.6**	2,720.4
Loans fully secured on land	**47.6**	57.7	**47.6**	57.7
Other loans	**2.6**	3.3	**2.6**	3.3
Gross loans and advances	**3,300.1**	2,784.2	**3,297.8**	2,781.4
Less: allowance for losses on loans and advances	**(5.0)**	(12.0)	**(5.0)**	(12.0)
	3,295.1	2,772.2	**3,292.8**	2,769.4

Loans and advances to customers have remaining contractual maturities as follows:

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
On demand	**4.3**	5.3	**4.3**	5.3
In not more than three months	**22.0**	28.6	**22.0**	28.6
In more than three months but not more than one year	**59.5**	53.4	**59.5**	53.4
In more than one year but not more than five years	**320.0**	281.6	**319.9**	281.4
In more than five years	**2,894.3**	2,415.3	**2,892.1**	2,412.7
Gross loans and advances	**3,300.1**	2,784.2	**3,297.8**	2,781.4
Less: allowance for losses on loans and advances	**(5.0)**	(12.0)	**(5.0)**	(12.0)
	3,295.1	2,772.2	**3,292.8**	2,769.4

Where a loan is repayable by instalment, each such instalment has been treated as a separate repayment in the maturity analysis set out above. The Group's experience is that some mortgages are redeemed before their scheduled maturity date.

As a consequence, the maturity analysis illustrated above may not reflect actual experience.

Notes to the Accounts for the year ended 31 December 2019

12 Loans and advances to customers Continued

Allowance for losses on loans and advances

Group and Society

	Loans fully secured on residential property		**Loans fully secured on land**		**Other loans**		**Total**		
	Individual £m	**Collective £m**	**Individual £m**	**Collective £m**	**Individual £m**	**Collective £m**	**Individual £m**	**Collective £m**	**Total £m**
Balance at 1 January 2019	0.8	1.5	8.0	1.4	0.3	-	9.1	2.9	12.0
Charge for the year	0.1	0.8	1.2	(0.6)	-	-	1.3	0.2	1.5
Utilised during the year	-	-	(7.7)	(0.5)	(0.3)	-	(8.0)	(0.5)	(8.5)
Balance at 31 December 2019	**0.9**	**2.3**	**1.5**	**0.3**	**-**	**-**	**2.4**	**2.6**	**5.0**

Group and Society

	Loans fully secured on residential property		Loans fully secured on land		Other loans		Total		
	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Total £m
Balance at 1 January 2018	0.2	1.3	7.7	1.3	0.3	-	8.2	2.6	10.8
Charge for the year	0.7	0.2	0.3	0.1	0.2	-	1.2	0.3	1.5
Utilised during the year	(0.1)	-	-	-	(0.2)	-	(0.3)	-	(0.3)
Balance at 31 December 2018	0.8	1.5	8.0	1.4	0.3	-	9.1	2.9	12.0

13 Fair value adjustments for hedged risk

As disclosed in the statement of accounting policies, when specific criteria are met, the Group applies fair value hedge accounting and the adjustments to assets and liabilities are included on the balance sheet under the heading 'Fair value adjustments for hedged risk'.

The cumulative fair value adjustment for hedged risk for assets for the Group and Society was **£186.6m** (2018: £175.9m).

The cumulative fair value adjustment for hedged risk for liabilities for the Group and Society was **£nil** (2018: £0.4m).

14 Insurance contracts

The Group's equity release mortgage assets are accounted as insurance contracts under IFRS 4. The mortgages were advanced as indeterminate length fixed interest rate contracts to be repaid in full at maturity through sale of the mortgaged properties. Where the value of a mortgaged property at the point of sale falls short of the contractual amount due to the Group, the shortfall is written off. Equity release mortgages are presented on Balance Sheet as part of the Group's loans and advances to customers net of any anticipated recovery shortfall identified through IFRS 4 liability adequacy testing.

	Gross mortgage balances £m	Insurance liability £m	Net position presented on balance sheet £m
31 December 2019	**187.2**	**(1.5)**	**185.7**
31 December 2018	200.6	(1.1)	199.5

The gross mortgage balances above reflect the Group's maximum exposure (pre collateral) to credit risk at 31 December 2019. The Group typically expects its equity release mortgages to be repaid through sale of the underlying properties. In all instances the Group holds the contractual right to sales proceeds required to repay a borrower's mortgage at the time of sale. Property collateral of £507.1m is held against the Group's equity release exposures at 31 December 2019. By their nature, equity release mortgages are not considered to hold a pre-determined maturity date.

The insurance liability of £1.5m reflects discrete provisions made against equity release mortgages with an expected shortfall.

Against equity release insurance contract assets the following income and charges have been recognised through the income statements:

	Interest income £m	Insurance liability charge £m	Insurance liability release £m
31 December 2019	**13.6**	**0.4**	**-**
31 December 2018	14.0	0.3	-

There were no significant amounts re-credited to the income statement during 2019 that reflected repayment of mortgage assets earlier than expected against which insurance liability charges had been previously accrued.

The Group recognises interest income on a per asset basis using the effective interest rate method. For equity release mortgages, the effective interest rate is considered to be the contractual fixed rate of interest detailed in the mortgage contracts. The gross mortgage balances, as presented above, reflect both the amortised cost and contractual balance of the Group's equity release mortgages.

Insurance liabilities are calculated on a per mortgage basis. The Group makes use of an actuarial model to calculate the difference between discounted contractual amounts due to the Group and the discounted expected value of property collateral across a range of probability weighted maturity dates. Maturity dates are derived from the actuarial model's S2PxA (pensioner mortality projection) tables.

Interest income recognised is not sensitive to modelled assumptions. Annual liability charges and releases are sensitive to the Group's house price growth, mortality dates, prepayment and discount rate assumptions.

	Base variables %	Sensitivity analysis vs. base	Additional insurance liability charge in 2019 £m
Surrenders per annum	2.00	-1%	0.8
HPI growth	2.50	-1%	3.1
Discount rate	0.79	-0.5%	0.2

The above sensitivities are presented as three discrete sensitivities and not a cumulative alternate scenario for calculating insurance liabilities. Were all three variables run simultaneously, the additional insurance liability charge would total £7.7m. The base variables reflect the Group's best estimates towards future positions in house prices, mortality rates and discount rates as at 31 December 2019. These are supported by the use of standard pensioner mortality tables and observable long term market rates.

The Group's equity release mortgages' primary identified risk is interest rate risk, as discussed in the Risk Management Report in the Annual Report and Accounts.

The Group does not consider the insurance risk arising from no negative equity guarantees across its equity release mortgage books to be a material risk. The Group's equity release books are closed to new entrants with limited further advances available to existing customers at the discretion of the Group. The Group's equity release lending was conducted at low loan to values, protecting the Group from adverse movements in originally expected prepayment and mortality rates alongside appreciation in house prices. However, while we do not deem the risk to be material we acknowledge that there the balances are highly sensitive to HPI growth.

15 Investments in subsidiary undertakings

Society

Investments in subsidiary undertakings	Shares £m	Loans £m	Total £m
Cost			
At 1 January 2019	12.0	33.5	45.5
Additions	1.0	1.8	2.8
Repayments received	-	(1.4)	(1.4)
At 31 December 2019	**13.0**	**33.9**	**46.9**
Provisions			
At 1 January and 31 December 2019	**0.6**	**3.1**	**3.7**
Net book amount at 31 December 2019	**12.4**	**30.8**	**43.2**

Investments in subsidiary undertakings	Shares £m	Loans £m	Total £m
Cost			
At 1 January 2018	12.0	33.7	45.7
Additions	-	2.1	2.1
Repayments received	-	(2.3)	(2.3)
At 31 December 2018	**12.0**	**33.5**	**45.5**
Provisions			
At 1 January and 31 December 2018	**0.6**	**3.1**	**3.7**
Net book amount at 31 December 2018	**11.4**	**30.4**	**41.8**

The Society directly holds 100% of the issued ordinary share capital of all its subsidiary undertakings.

The Directors believe that the carrying value of the investments in subsidiary undertakings is supported by their underlying net assets.

Name of principal subsidiary undertakings	**Principal activity**
Newcastle Financial Advisers Limited	Provision of financial services
Newcastle Mortgage Loans (Jersey) Limited	Mortgage lending
Newcastle Portland House Limited	Commercial property rental
Newcastle Strategic Solutions Limited	Provision of specialised savings management services
Newcastle Systems Management Limited	Provision of managed IT and property services

All the above subsidiary undertakings, except for Newcastle Mortgage Loans (Jersey) Limited, which is incorporated and operates in Jersey, are incorporated in England and Wales and operate in the United Kingdom.

Further information on transactions between Group entities can be found in Note 30 Related Parties.

16 Property, plant and equipment

Group

	Freehold buildings £m	Leasehold land and buildings £m	Equipment, fixtures, fittings and motor vehicles £m	Intangible Assets £m	Total £m
Cost					
At 1 January 2019	3.1	21.1	22.6	7.4	54.2
IFRS16 Day 1 Transition	-	6.6	-	-	6.6
Additions	-	1.8	5.8	1.0	8.6
Transfers	-	5.8	-	-	5.8
Write Offs	-	(1.2)	-	-	(1.2)
Disposals	(0.2)	-	(0.3)	-	(0.5)
At 31 December 2019	**2.9**	**34.1**	**28.1**	**8.4**	**73.5**
Accumulated depreciation					
At 1 January 2019	0.7	4.6	13.6	5.6	24.5
Charge for the year	0.1	1.1	2.0	0.6	3.8
Transfers	-	0.3	-	-	0.3
Write Offs	-	(0.6)	-	-	(0.6)
Disposals	(0.1)	-	(0.2)	-	(0.3)
At 31 December 2019	**0.7**	**5.4**	**15.4**	**6.2**	**27.7**
Net book amount at 31 December 2019	**2.2**	**28.7**	**12.7**	**2.2**	**45.8**

Group

	Freehold buildings £m	Leasehold land and buildings £m	Equipment, fixtures, fittings and motor vehicles £m	Intangible Assets £m	Total £m
Cost					
At 1 January 2018	3.1	21.1	20.7	7.0	51.9
Additions	-	-	2.6	0.4	3.0
Disposals	-	-	(0.7)	-	(0.7)
At 31 December 2018	**3.1**	**21.1**	**22.6**	**7.4**	**54.2**
Accumulated depreciation					
At 1 January 2018	0.6	4.2	12.5	5.1	22.4
Charge for the year	0.1	0.4	1.7	0.5	2.7
Disposals	-	-	(0.6)	-	(0.6)
At 31 December 2018	**0.7**	**4.6**	**13.6**	**5.6**	**24.5**
Net book amount at 31 December 2018	**2.4**	**16.5**	**9.0**	**1.8**	**29.7**

16 Property, plant and equipment Continued

Society

	Freehold buildings £m	Leasehold land and buildings £m	Equipment, fixtures, fittings and motor vehicles £m	Intangible Assets £m	Total £m
Cost					
At 1 January 2019	3.1	-	14.5	2.0	19.6
IFRS16 Day 1 Transition	-	6.6	-	-	6.6
Additions	-	1.0	3.5	0.2	4.7
Disposals	(0.2)	-	(0.3)	-	(0.5)
At 31 December 2019	**2.9**	**7.6**	**17.7**	**2.2**	**30.4**
Accumulated depreciation					
At 1 January 2019	0.8	-	8.3	1.6	10.7
Charge for the year	0.1	0.6	1.2	0.1	2.0
Disposals	-	-	(0.3)	-	(0.3)
At 31 December 2019	**0.9**	**0.6**	**9.2**	**1.7**	**12.4**
Net book amount at 31 December 2019	**2.0**	**7.0**	**8.5**	**0.5**	**18.0**

Society

	Freehold buildings £m	Leasehold land and buildings £m	Equipment, fixtures, fittings and motor vehicles £m	Intangible Assets £m	Total £m
Cost					
At 1 January 2018	3.1	-	13.5	1.9	18.5
Additions	-	-	1.6	0.1	1.7
Disposals	-	-	(0.6)	-	(0.6)
At 31 December 2018	**3.1**	**-**	**14.5**	**2.0**	**19.6**
Accumulated depreciation					
At 1 January 2018	0.7	-	7.9	1.5	10.1
Charge for the year	0.1	-	1.0	0.1	1.2
Disposals	-	-	(0.6)	-	(0.6)
At 31 December 2018	**0.8**	**-**	**8.3**	**1.6**	**10.7**
Net book amount at 31 December 2018	**2.3**	**-**	**6.2**	**0.4**	**8.9**

The Group leases a number of branches under IFRS 16 leases. On 1st January 2019 the Group recognised a 'right-of-use asset' of £6.6m and a corresponding lease liability of £6.9m in relation to these lease contracts as disclosed within note 24. The day 1 adjustment of £0.7m was taken against opening reserves at 1st January 2019. Due to the election applied on transition to value the right-of-use assets the group does not expect a material change to the expense recognised within the Income Statement.

16 Property, plant and equipment Continued

Changes to accounting policies

IFRS 16, Leases, superseded IAS 17, Leases, on 1 January 2019 and sets out new principles for the recognition, measurement, presentation and disclosure of leases. The standard requires a lessee to recognise a right-of-use asset and corresponding lease liability on the Balance Sheet for all leases other than short term leases or leases for which the underlying asset is of low value.

The Group has adopted IFRS 16 retrospectively from 1 January 2019 but has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 January 2019.

At 31 December 2018 the Group was committed to minimum payments under non-cancellable operating lease agreements totalling £4.5m. These commitments were recognised on 1 January 2019 under IFRS 16 at the minimum present value of the remaining lease payments, discounted at a rate reflecting the Group's typical borrowing costs. Under IFRS 16, likely lease extensions are factored into the Group's remaining payments and the Group also now includes expected rates and insurance payments on leased properties as part of the discounted remaining leased payments.

The Group discounts its lease payments at the rate it would expect to pay to borrow funding for a similar duration to each lease. The Group's weighted average incremental borrowing rate applied to its lease liabilities on 1 January 2019 was 2.5%.

Reconciliation of operating lease commitments to IFRS16 lease liability

	£m
Operating lease commitments disclosed at 31 December 2018	**4.5**
If discounted at the Group's incremental borrowing rate of 2.5%	-
Less short term operating leases not accounted for under IFRS16	-
Plus finance leases recognised on balance sheet at 31 December 2018	0.8
Plus property taxes recognised under IFRS16	-
Plus rates, insurance and extension options	6.1
Plus expected dilapidation expenses	0.4
IFRS16 lease liability at 1 January 2019	**7.3**

The associated right-of-use assets were measured on a retrospective basis as if the new rules had always been applied. Right-of-use assets of £6.3m were recognised on Balance Sheet at 1 January 2019 including £0.3m of accelerated depreciation on an impaired finance lease with the difference between lease assets and liabilities recognised as an adjustment to the Group's opening reserves.

The Group has applied IFRS 16 on a per lease basis and has taken the practical expedient not to apply IFRS 16 accounting to leases of short duration or of small value. The Group has also adopted the standard's practical expedients to apply IFRS 16 to contracts that were previously identified as leases under IAS 17.

IFRS 16 recognises the costs of leasing as depreciation of right-of-use assets, recognised on a straight line basis over the term of the leased asset, and interest charges on the lease liability. Interest charges decrease as the lease liability is repaid over time, typically leading to a higher expense in the earlier years of a lease even where cash payments remain consistent. In any given future year, with respect to the Group's operating lease commitments held at 31 December 2018, the Income Statement impact of applying IFRS 16 in place of IAS 17, is not expected to be material.

17 Investment Property

	GROUP		SOCIETY	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Cost				
At 1 January	**10.0**	10.0	**4.2**	4.2
Additions	**-**	-	**-**	-
Transfers	**(5.8)**	-	**-**	-
Disposals	**(0.2)**	-	**(0.2)**	-
At 31 December	**4.0**	10.0	**4.0**	4.2
Accumulated depreciation				
At 1 January	**0.9**	0.7	**0.6**	0.6
Charge for the year	**0.4**	0.2	**0.3**	-
Disposals	**(0.2)**	-	**-**	-
At 31 December	**1.1**	0.9	**0.9**	0.6
Net book amount at 31 December	**2.9**	9.1	**3.1**	3.6

Included within Investment property are freehold and leasehold commercial buildings, which are owned by the Society and Group, and held to earn rental income. The opening balance has been restated to reflect the value of leased investment property under IFRS 16. Furthermore it should be noted that the transfer relates to Cobalt, which now is occupied exclusively by the Group, and has therefore been reclassified within fixed assets.

Management consider the purchase price less depreciation to represent a fair value for properties held. No formal third party valuation of the Society or Group investment property holdings was undertaken during 2019 with the properties managed to facilitate continued operation (via rental to third parties or otherwise) and not towards view of speculative sale.

During 2019 rental income from investment properties of **£0.2m** (2018: £0.6m) was recognised by the Group, and **£0.2m** (2018: £0.2m) by the Society. Directly attributable operating expenses to investment property are not measured as both Group and third parties occupy the properties.

18 Deferred tax

The movement on the deferred tax account is shown below.

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
At 1 January	**2.3**	3.2	**2.2**	3.3
Income Statement expense	**(1.1)**	(1.7)	**(1.0)**	(1.8)
Other	**0.1**	-	**0.3**	-
Previous Year adjustment	**(0.2)**	0.5	**(0.2)**	0.4
Credited on items taken directly through reserves	**(0.1)**	0.3	**(0.2)**	0.3
At 31 December	**1.0**	2.3	**1.1**	2.2

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

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Deferred tax assets				
Other items	**(0.2)**	(0.1)	**(0.1)**	(0.1)
Trading losses	**0.8**	1.4	**0.8**	1.4
Depreciation in excess of capital allowances	**0.4**	1.0	**0.4**	0.9
	1.0	2.3	**1.1**	2.2

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Deferred tax assets				
Deferred tax asset to be recovered in less than 12 months	**1.0**	1.2	**0.9**	0.9
Deferred tax asset to be recovered in more than 12 months	**-**	1.1	**0.2**	1.3
	1.0	2.3	**1.1**	2.2

The deferred tax expense in the Income Statements comprises the following temporary differences:

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Other items	**-**	-	**-**	-
Prior Year adjustment	**(0.2)**	(0.5)	**(0.2)**	0.4
Trading losses	**(0.6)**	(1.5)	**(0.6)**	(1.5)
Depreciation in excess of capital allowances	**(0.5)**	(0.2)	**(0.4)**	(0.3)
	(1.3)	(1.2)	**(1.2)**	(1.4)

Deferred tax assets are recognised for tax losses carried forward only to the extent that realisation of the related tax benefit is probable. Deferred tax assets are recognised based on the expected prevailing rate of tax at the time of utilisation. Where there is a reduction in the expected tax rate an adjustment is made to write down deferred tax assets.

19 Retirement benefit obligations

Group and Society Pension schemes

The Society operates a UK registered trust based pension scheme, Newcastle Building Society Pension and Assurance Scheme, that provides defined benefits. The Scheme was closed to new entrants in 2000 and closed the future accrual of benefits in 2010. Pension benefits are linked to the members' final pensionable salaries and service at their retirement (or date of leaving if earlier).

The Trustees are responsible for running the Scheme in accordance with the Scheme's Trust Deed and Rules, which sets out their powers. The Trustees of the Scheme are required to act in the best interests of the beneficiaries of the Scheme. There is a requirement that one-third of the Trustees are nominated by the members of the Scheme.

There are two categories of pension scheme members:

- Deferred members: members with deferred benefits in the Scheme who are not yet receiving their pension; and
- Pensioner members: members in receipt of a pension.

The defined benefit obligation is valued by projecting the best estimate of future benefit obligations (allowing for revaluation to retirement for deferred members and annual pension increases for all members) and then discounting to the balance sheet date. The majority of benefits receive increases linked, at least partly, to inflation (subject to a cap of no more than 5% pa). The valuation method used is known as the Projected unit Method.

The approximate overall duration of the Scheme's defined benefit obligation as at 31 December 2019 was 17 years. (2018: 18 years).

Future funding obligation

The Trustees are required to carry out an actuarial valuation every 3 years. The last actuarial valuation of the Scheme was performed by the Scheme Actuary for the Trustees as at 30 June 2019. Following the actuarial valuation at 30 June 2016 and in respect of the deficit in the Scheme as at 30 June 2016, the Society agreed to pay £1.7m per annum for 5 years from September 2016 to September 2021, unless a trigger is reached for employer contributions to reduce or cease. In addition, the Society will pay £0.3m per annum to meet the cost of running the Scheme.

During 2019, the Scheme funding level hit the trigger resulting in deficit reduction contributions being able to cease.

Assumptions

The assumptions and data underpinning the triennial valuation at 30 June 2019 have been fed through to the position at 31 December 2019 to arrive at the most accurate position at the year end. The assumptions used for the IAS19 year end valuation are as follows:

Significant actuarial assumptions	**2019**	2018
Discount rate	**2.05%**	2.80%
RPI inflation	**3.00%**	3.20%
CPI inflation	**2.00%**	2.20%
Mortality assumptions		
Mortality (post-retirement)	**SAPS 'S3'CMI 2018 [1.25%] (yob)**	SAPS 'S2'CMI 2017 [1.25%] (yob)
Other actuarial assumptions		
RPI pension increases	**2.95%**	3.10%
Pension increases in deferment	**2.10%**	2.20%
Life expectancies (in years)		
For an individual aged 62		
Male	**24.5 years**	24.7 years
Female	**26.9 years**	26.7 years
At age 62 for an individual aged 42 in 2019		
Male	**25.9 years**	26.2 years
Female	**28.4 years**	28.3 years

19 Retirement benefit obligations Continued

Risks

Through the Scheme, the Society is exposed to a number of risks:

- **Asset volatility:** The Scheme's DBO is calculated using a discount rate set with reference to corporate bond yields, however only c.25% of the Scheme's assets are invested in corporate bonds, with around 40% invested in equities and other growth funds. These return seeking assets are expected to outperform corporate bonds in the long term, but provide volatility and risk in the short term.
- **Changes in bond yields:** As the Scheme's DBO is calculated using a discount rate set with reference to corporate bond yields, a decrease in corporate bond yields would increase the Scheme's DBO. However this would be partially offset by an increase in the value of the Scheme's bond and Liability Driven Investment (LDI) holdings.
- **Inflation Risk:** The majority of pension increases received before and after retirement are linked to inflation, therefore higher inflation will result in a higher DBO, although the Scheme's LDI holdings hedge inflation rate changes to some extent.
- **Mortality risk:** If Scheme members live longer than expected, the Scheme benefits will need to be paid for longer, increasing the Scheme's DBO.

The Trustees and Society manage risks in the Scheme through the following strategies:

- **Diversification:** The Scheme holds a well-diversified portfolio of assets. This means that the failure of any single investment is unlikely to have a material impact on the overall level of assets.
- **Investment Strategy:** The trustees are required to review their investment strategy on a regular basis.
- **Liability Driven Investment (LDI):** The Scheme invests in LDI assets, whose long term investment returns are expected to partially hedge interest rate and inflation rate movements.
- **Pension increase exchange:** The Trustees currently offer retiring members an option to exchange future pension increases for a higher immediate pension. This has reduced the Scheme liabilities for retired members who have already taken up the option and, based upon the assumption of future take up, for deferred members who will retire in future.

Sensitivity analysis Assumption	Change in assumption	Change in defined benefit obligation
Discount rate	+ 0.25% / – 0.25%	– 4% / + 4%
RPI and CPI inflation	+ 0.25% / – 0.25%	+ 1.5% / – 1.5%
Assumed life expectancy	+ 1 year / –1 year	– 3% / +3%

Approximately 49% of the Scheme's pension obligations are in respect of members yet to retire (deferred members) and 51% by current pensioners and dependants. The average duration of the Scheme's pension obligation is approximately 17 years.

Limitations of the sensitivity analysis

These calculations provide an approximate guide to the sensitivity of results and may not be as accurate as a full valuation carried out on these assumptions. Each assumption change is considered in isolation, which in practice is unlikely to occur, as changes in some of the assumptions are correlated.

Assets

The assets of the Scheme were invested as follows:

Asset class at market value	**2019 %**	2018 %
Equities and growth	**36.1**	34.6
Bonds	**26.7**	26.5
Gilts	**31.7**	33.5
Cash	**5.5**	5.4
Total	**100.0**	100.0
Actual return on assets over the year	**16.9**	(2.1)

All assets listed above have a quoted market price in an active market.

19 Retirement benefit obligations Continued

Reconciliation to the Balance Sheet

	2019 £m	2018 £m
Market total value of assets	**116.1**	102.6
Present value of defined benefit obligation	**(108.1)**	(93.4)
Funded status	**8.0**	9.2
Accounting policy: derecognition of pensions surplus	**(8.0)**	(9.2)
Pension asset recognised in the Balance Sheets before allowance for deferred tax	**-**	-
	-	-

Analysis of changes in the value of the defined benefit obligation over the period

	2019 £m	2018 £m
Value of defined benefit obligation at start of year	**93.4**	102.0
Interest on liabilities	**2.6**	2.4
Past service cost	**-**	0.5
Benefits paid	**(4.3)**	(9.2)
Actuarial losses: experience differing from that assumed	**4.5**	-
Actuarial (gains): changes in demographic assumptions	**(0.2)**	(4.3)
Actuarial losses: changes in financial assumptions	**12.1**	2.0
Value of defined benefit obligation at end of period	**108.1**	93.4

Analysis of changes in the value of the Scheme assets over the period

	2019 £m	2018 £m
Market value of assets at start of period	**102.6**	112.8
Interest income	**2.8**	2.6
Actual gains/(losses) on assets	**14.1**	(4.7)
Employer contributions	**1.2**	1.4
Benefits paid	**(4.3)**	(9.2)
Administration costs	**(0.3)**	(0.3)
Market value of assets at end of period	**116.1**	102.6

Amount recognised in Income Statements

	2019 £m	2018 £m
Administration costs	**0.3**	0.3
Net interest	**-**	-
Amount charged to Income Statements	**0.3**	0.3

Amounts recognised in Statements of Comprehensive Income

	2019 £m	2018 £m
Actuarial (losses)/gains on defined benefit obligations	**(16.4)**	2.3
Actual gains/(losses) on assets	**14.1**	(4.7)
Change in effect of limit on scheme surplus	**1.5**	1.3
Amounts recognised in Statements of Comprehensive Income	**(0.8)**	(1.1)

Guaranteed minimum pension equalisation

The High Court's October 2018 ruling that UK pension schemes must equalise Guaranteed Minimum Pensions (GMP) to ensure equal treatment of male and female scheme members provided welcome clarity to the expected calculation of historic GMP charges. The judgement applied to GMP accrued between 17 May 1990 and 5 April 1997 and has resulted in an increase in the Group's estimated scheme liabilities of £0.5m. As the Group does not recognise defined benefit pension surpluses on balance sheet, the effect of the GMP charge has not impacted the Group's total comprehensive income for the year, as the GMP charge reduces a net surplus position that has already been derecognised from the Balance Sheet in previous years.

20 Other assets

	GROUP		SOCIETY	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Receivable from subsidiary undertakings	**-**	-	**1.1**	3.3
Prepayments and accrued income	**12.8**	9.7	**12.0**	11.7
Other	**5.3**	3.0	**2.0**	0.5
	18.1	12.7	**15.1**	15.5

21 Due to Members

	GROUP and SOCIETY	
	2019 £m	2018 £m
Held by individuals	**3,400.7**	2,713.5
Other shares	**0.2**	0.2
	3,400.9	2,713.7

Repayable from the date of the Balance Sheets in the ordinary course of business as follows:

Accrued interest	**16.2**	12.9
On demand	**1,445.8**	1,351.2
In not more than three months	**1,396.8**	936.7
In more than three months but not more than one year	**227.5**	178.1
In more than one year but not more than five years	**312.7**	234.1
In more than five years	**1.9**	0.7
	3,400.9	2,713.7

22 Due to other customers

	GROUP		SOCIETY	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Amounts owed to subsidiary undertakings	**-**	-	**-**	1.1
Other	**189.8**	142.6	**189.8**	142.6
	189.8	142.6	**189.8**	143.7

Repayable from the date of the Balance Sheet in the ordinary course of business as follows:

Accrued interest	**0.9**	0.7	**0.9**	0.7
On demand	**5.1**	2.8	**5.1**	2.8
In not more than three months	**75.0**	53.4	**75.0**	53.4
In more than three months but not more than one year	**101.8**	85.7	**101.8**	86.8
In more than one year but not more than five years	**7.0**	-	**7.0**	-
	189.8	142.6	**189.8**	143.7

23 Deposits from banks

Repayable from the date of the Balance Sheets in the ordinary course of business as follows:

	GROUP and SOCIETY	
	2019 £m	2018 £m
Accrued interest	**0.7**	0.8
In not more than three months	**43.7**	53.5
In more than three months but not more than one year	**84.2**	44.5
In more than one year but not more than five years	**261.0**	311.0
	389.6	409.8

24 Other liabilities

	GROUP		SOCIETY	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Amounts payable to subsidiary undertakings	**-**	-	**4.2**	5.9
Obligations under finance leases	**7.9**	0.9	**-**	0.9
Other creditors	**1.5**	2.0	**0.9**	1.2
Accruals and deferred income	**8.7**	8.9	**15.2**	7.5
	18.1	11.8	**20.3**	15.5

Obligations under finance leases fall due as follows:

Within one year	**0.9**	0.1	**0.9**	0.1
In one to five years	**3.1**	0.8	**3.1**	0.8
In more than five years	**1.9**	0.8	**1.9**	0.8
	5.9	0.9	**5.9**	0.9

These liabilities are secured by charges over the assets to which they relate.

25 Provisions for liabilities and charges

Group and Society

	FSCS Levy £m	**Other Provisions £m**	**Total £m**
Opening Provision at 1 January 2019	**0.1**	**0.8**	**0.9**
New Provisions for the year	**-**	**0.6**	**0.6**
Released Provisions during the year	**-**	**(0.4)**	**(0.4)**
Amounts utilised / transferred during the year	**(0.1)**	**(0.2)**	**(0.3)**
Closing Provision at 31 December 2019	**-**	**0.8**	**0.8**

GROUP and SOCIETY

	FSCS Levy £m	Other Provisions £m	Total £m
Opening Provision at 1 January 2018	0.3	1.4	1.7
Released Provisions during the year	(0.1)	-	(0.1)
Amounts utilised during the year	(0.1)	(0.6)	(0.7)
Closing Provision at 31 December 2018	0.1	0.8	0.9

Provision for Financial Services Compensation Scheme Levy
At 31 December 2019 the Society no longer holds a provision for the FSCS levy.

Other provisions
Other provisions include an estimate of the costs of potential consumer redress.

Notes to the Accounts for the year ended 31 December 2019

26 Subordinated liabilities

	GROUP and SOCIETY	
	2019 £m	2018 £m
3.849% fixed rate subordinated notes 2019	**-**	25.0
	-	25.0

On a winding up, the subordinated notes would rank behind the claims against the Society of all depositors, creditors and investing Members (other than holders of deferred shares i.e. permanent interest bearing shares) of the Society.

The notes were repayable, at the Society's option, with the prior consent of the Regulators, only on the payment of a penalty, on any interest date within five years of the maturity date.

27 Subscribed capital

	GROUP and SOCIETY	
	2019 £m	2018 £m
12.625% permanent interest bearing shares	**10.0**	10.0
10.750% permanent interest bearing shares	**10.0**	10.0
	20.0	20.0

The 12.625% and 10.750% subscribed capital issues were issued for an indeterminate period and are only repayable in the event of the winding up of the Society.

28 Guarantees, contingent liabilities and commitments

(i) Until 11 June 1996, under Section 22 of the Building Societies Act 1986, the Society had an obligation to discharge the liabilities of its subsidiary undertakings insofar as they were unable to discharge the liabilities out of their own assets. Subsequently, the Society has voluntarily agreed to provide continued support to all of its subsidiary undertakings, insofar as any liabilities are not covered by legislation.

(ii) Commitments
The Society has no capital commitments for the acquisition of property, plant, and equipment at 31 December 2019.

	GROUP and SOCIETY	
	2019 £m	2018 £m
Irrevocable undrawn committed loan facilities	**215.8**	131.1
Payments under non-cancellable operating lease agreements		
Total minimum lease payments:		
Within one year	**0.9**	0.8
In one to five years	**3.1**	2.5
Over five years	**1.9**	1.2
	5.9	4.5

29 Note to the Cash Flow Statements

	GROUP 2019 £m	GROUP 2018 £m	SOCIETY 2019 £m	SOCIETY 2018 £m
Reconciliation of profit before taxation to net cash inflow from operating activities				
Profit before taxation	**14.7**	13.3	**11.6**	13.2
Depreciation and amortisation	**4.2**	2.9	**2.3**	1.2
Interest on subordinated liabilities	**0.8**	0.8	**0.8**	0.8
Interest on subscribed capital	**2.3**	3.5	**2.3**	3.5
Increase / (decrease) in derivative financial instruments	**11.0**	(30.5)	**11.0**	(30.5)
(Increase) / decrease in other financial liabilities at fair value through profit or loss	**(11.1)**	29.1	**(11.1)**	29.1
Changes in retirement benefit obligations	**0.3**	0.3	**0.3**	0.3
Other non-cash movements	**(15.2)**	0.1	**(16.1)**	0.6
Net cash inflow before changes in operating assets and liabilities	**7.0**	19.5	**1.1**	18.2
Increase in loans and advances to customers	**(515.9)**	(66.1)	**(516.4)**	(67.6)
(Increase) / decrease in cash collateral pledged	**(19.4)**	25.7	**(19.4)**	25.7
Increase / (decrease) in shares	**687.2**	(74.8)	**687.2**	(74.8)
Increase in amounts due to other customers and deposits from banks	**27.0**	48.8	**25.9**	39.6
Decrease in debt securities in issue	**-**	(1.0)	**-**	(1.0)
(Increase) / decrease in other assets, prepayments and accrued income	**(5.4)**	(0.8)	**0.4**	0.4
Increase / (decrease) in other liabilities	**6.3**	(1.9)	**4.8**	(1.1)
Net cash inflow / (outflow) from operating activities	**186.8**	(50.6)	**183.6**	(60.6)
Cash and cash equivalents				
Cash and balances with the Bank of England	**215.7**	152.9	**215.7**	152.9
Loans and advances to banks repayable on demand	**10.7**	10.1	**-**	0.1
At 31 December	**226.4**	163.0	**215.7**	153.0

Cash and cash equivalents comprise cash in hand, balances with the Bank of England, loans and advances to banks available on demand or with original maturities of three months or less and investment securities with a maturity period of three months or less i.e. highly liquid assets readily convertible into cash.

IAS 7 "statement of cashflows" requires enhanced disclosures around changes in liabilities arising from financing activities arising from cash flows and non cash changes.

Changes of liabilities arising from financing liabilities in the year were as follows:

		Non-cash changes		Cash Flows			
	Balance sheet 31 December 2018	**Day 1 adjustment***	**Accrued interest/lease charge**	**Interest payment flows**	**Capital repayment flows**	**Other****	**Balance sheet 31 December 2019**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Subordinated liabilities	**25.0**	**-**	**1.0**	**(1.0)**	**25.0**	**-**	**-**
Subscribed capital (PIBS)	**20.4**	**-**	**0.9**	**(1.3)**	**-**	**-**	**20.0**
Finance lease arrangements	**0.9**	**6.4**	**0.2**	**(0.9)**	**(0.9)**	**1.3**	**7.9**

		Non-cash changes		Cash Flows			
	Balance sheet 31 December 2017	Day 1 adjustment*	Accrued interest/ lease charge	Interest payment flows	Capital repayment flows	Other	Balance sheet 31 December 2018
	£m	£m	£m	£m	£m	£m	£m
Subordinated liabilities	25.0	-	1.0	(1.0)	-	-	25.0
Subscribed capital (PIBS)	31.0	-	3.5	(4.1)	(10.0)	-	20.4
Finance lease arrangements	1.0	-	-	-	(0.1)	-	0.9

Opening and closing balance sheet positions include applicable accrued interest. The Group's financing liabilities are held on balance sheet at their amortised cost under IAS 39 and are denominated in Sterling. Accordingly, the accounting value of the Group's financing liabilities has not been impacted by changes in fair value or foreign exchange rates during the year to 31 December 2019.

*Day 1 adjustment relates to finance lease arrangements on the recognition of IFRS16 lease liability on balance sheet.

**This relates to new leases entered into in 2019.

30 Related parties

The Group is controlled by Newcastle Building Society which is registered in England and Wales and operates in the United Kingdom. Further details of subsidiary undertakings are disclosed in Note 15 to these Accounts. The Directors are considered to be the only key management personnel as defined by IAS 24.

Transactions with Directors and their close family members

Directors and their close family members have entered into the following transactions with Newcastle Building Society in the normal course of business.

Loans outstanding to Directors and their close family members

	2019 £000	2018 £000
At 31 December	**-**	281

These loans were made on normal commercial terms and a register of them is available for inspection at the Principal Office for a period of 15 days up to and including the Annual General Meeting.

Deposits and investments held by Directors and their close family members

	2019 £000	2018 £000
At 31 December	**446**	403

Amounts deposited by Directors and members of their close families earn interest on the same terms and conditions applicable to other customers.

The Society receives managed IT & property services, and business support services from Newcastle Strategic Solutions Limited, a wholly owned subsidiaries of the Society. Historically the IT and property services were provided by Newcastle System Management Limited, however the trade of this subsidiary was subsumed into Newcastle Strategic Solutions within the financial year. The Society provides financial and administrative services to Newcastle Strategic Solutions Limited.

During the year, the following transactions were carried out by the Society with related parties:

(a) Sales of financial and administrative services

	2019 £000	2018 £000
Newcastle Systems Management Limited	**630**	1,102
Newcastle Strategic Solutions Limited	**7,698**	8,382

Sales of services are negotiated with related parties on commercial terms.

(b) Purchases of services:

	2019 £000	2018 £000
Managed IT and Property Services		
Newcastle Systems Management Limited	**2,955**	6,613
Business Support Services		
Newcastle Strategic Solutions Limited	**4,388**	3,113
Property Rental		
Newcastle Portland House Limited	**66**	66

Purchased services are negotiated with related parties on commercial terms.

30 Related parties Continued

At 31 December 2019 the following unsecured balances remained outstanding with related parties:

(c) Outstanding balances:

	Amounts owed to Society		Amounts owed by Society	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Newcastle Systems Management Limited	**-**	755	**-**	369
Newcastle Strategic Solutions Limited	**1,066**	2,524	**392**	1,704
Newcastle Financial Advisers Limited	**-**	-	**3**	882
Newcastle Portland House Limited	**19**	19	**2,891**	2,908
Newcastle Mortgage Loans (Jersey) Limited	**16**	16	**-**	-

At 31 December 2019 the following borrowings and cash deposits remained outstanding with related parties:

(d) Borrowings/ cash deposits:

	Amounts borrowed from Society		Amounts deposited with Society	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Newcastle Systems Management Limited	**23,833**	23,522	**-**	679
Newcastle Strategic Solutions Limited	**5,169**	4,531	**-**	421
Newcastle Mortgage Loans (Jersey) Limited	**1,836**	2,386	**-**	-

	Interest paid to Society		Interest paid by Society	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Newcastle Systems Management Limited	**805**	1,156	**3**	6
Newcastle Strategic Solutions Limited	**737**	305	**1**	9
Newcastle Mortgage Loans (Jersey) Limited	**131**	179	**-**	-

(e) Lease relationships:

Newcastle Strategic Solutions Limited lease office space in the Group's head office from the Society under contractual leases. At 31 December 2019, these were considered to be operating leases.

In the next financial year the Society expects to receive £188,000 from the subsidiary in respect of currently agreed leases from the subsidiaries.

31 Financial instruments

These disclosures are given on a Group basis, as the risks of the organisation are managed on a Group basis. The Society basis is not considered to be materially different from the Group basis for any of the disclosures in this note.

Categories of financial instruments

The accounting policies note, Note 1 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the balance sheet by the class of financial instrument to which they are assigned and by the measurement basis. Throughout this note, the following measurement basis acronyms are used: fair value through other comprehensive income (FVOCI), fair value through profit or loss (FVTPL).

		Amortised Cost	FVOCI	FVTPL	Total
Group as at 31 December 2019	**Note**	**£m**	**£m**	**£m**	**£m**
Cash in hand and balances with the Bank of England*		215.7	-	-	215.7
Loans and advances to banks	10	230.5	-	-	230.5
Debt securities	11	-	416.3	-	416.3
Derivative financial instruments	31	-	-	0.1	0.1
Fair value adjustments for hedged risk	13	-	-	186.6	186.6
Loans and advances to customers	12	3,295.1	-	-	3,295.1
Other assets (of which financial)	20	-	-	-	-
Total financial assets		**3,741.3**	**416.3**	**186.7**	**4,344.3**
Financial liabilities					
Due to Members - shares	21	3,400.9	-	-	3,400.9
Fair value adjustments for hedged risk	13	-	-	-	-
Due to other customers	18	189.8	-	-	189.8
Deposits from banks	23	389.6	-	-	389.6
Derivative financial instruments	31	-	-	185.9	185.9
Subordinated liabilities	26	-	-	-	-
Subscribed capital	27	20.0	-	-	20.0
Other liabilities (of which financial)	24	-	-	-	-
Total financial liabilities		**4,000.3**	**-**	**185.9**	**4,186.2**

*Cash in hand includes £10.7m in cash held by the Society's subsidiary entities.

All of the Group's FVTPL financial assets and liabilities are mandatorily measured at fair value under IFRS 9. The Group has not elected to hold at FVTPL any financial assets or liabilities that could otherwise have been held at amortised cost or at FVOCI.

Cash in hand and balances with the Bank of England

Cash held for liquidity and operational purposes earning interest income.

Loans and advances to banks

Cash lent to financial institutions to generate an interest income return and cash collateral placed with derivative counterparties to be repaid to the Society in future periods.

Debt securities

Assets comprising covered bonds, residential mortgage backed securities, and government gilts. Investments made to utilise liquid cash reserves to generate interest income.

Derivative financial instruments

Financial instruments whose value is derived from an underlying asset, index or reference rate it is linked to. The Group does not operate a derivative financial instruments trading book. Exposures in the treasury portfolio are held for liquidity purposes or in the case of fair value exposures on derivatives, for hedging purposes.

31 Financial instruments Continued

Fair value adjustments for hedged risk
Adjustments to reflect the fair value of financial instruments that are designated as hedged items as part of the Group's interest rate risk hedging activities.

Loans and advances to customers
Cash lent to individual Members of the Society, corporates and housing associations.

Due to Members – shares
Cash deposits made by customers held by the Society.

Due to other customers
Cash deposits made by non-Members of the Society.

Deposits from banks
Deposits made by financial institutions with the Society.

Subordinated liabilities
Loan notes issued by the Society incurring fixed annual interest expense.

Subscribed capital
Permanent Interest Bearing Shares issued by the Society, with further details given in Note 27.

		Amortised Cost	FVOCI for sale	FVTPL	Total
Group as at 31 December 2018	Note	£m	£m	£m	£m
Cash in hand and balances with the Bank of England		147.0	-	5.9	152.9
Loans and advances to banks	10	10.2	-	200.3	210.5
Debt securities	11	-	329.0	-	329.0
Derivative financial instruments	31	-	-	3.5	3.5
Fair value adjustments for hedged risk	13	-	-	175.9	175.9
Loans and advances to customers	12	2,772.2	-	-	2,772.2
Other assets (of which financial)	20	6.9	-	-	6.9
Total financial assets		**2,936.3**	**329.0**	**385.6**	**3,650.9**
Financial liabilities					
Due to Members - shares	21	2,713.7	-	-	2,713.7
Fair value adjustments for hedged risk	13	-	-	0.4	0.4
Due to other customers	22	142.6	-	-	142.6
Deposits from banks	23	409.8	-	-	409.8
Derivative financial instruments	31	-	-	178.3	178.3
Subordinated liabilities	26	25.0	-	-	25.0
Subscribed capital	27	20.0	-	-	20.0
Other liabilities (of which financial)	24	9.9	-	-	9.9
Total financial liabilities		**3,321.0**	**-**	**178.7**	**3,499.7**

The Group has not reclassified any financial assets during the year. The Group's IFRS 9 transitional disclosures are available in the Newcastle Building Society Annual Report and Accounts 2018 and the Newcastle Building Society Announcement for the year ended 31st December 2019, both available online at https://www.newcastle.co.uk/about-us/media-centre/financial-results/.

Fair value of financial assets and liabilities
Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The Group has financial assets and liabilities for which there is a practical right to set off the recognised amounts, and which are settled net in practise.

However, the netting arrangements do not result in an offset of balance sheet assets and liabilities for accounting purposes as the right to set off is not unconditional in all circumstances.

Under IAS 32: Financial Instruments: Presentation, there are no financial assets or liabilities which are offset with the net amount presented on the balance sheet.

Under IFRS 7, the Group must disclose the effect of its netting arrangements, including the effects of potential rights of set off associated with its recognised financial assets and liabilities.

31 Financial instruments Continued

Group as at 31 December 2019

	Gross and net amount presented in the statement of financial position	Offsetting financial collateral (received*)/ pledged not meeting the offsetting criteria of IAS 32	Net collateralised position
Financial assets	**£m**	**£m**	**£m**
Interest rate swaps	0.1	(0.1)	-
Financial liabilities			
Interest rate swaps	(185.9)	185.9	-

Group as at 31 December 2018

	Gross and net amount presented in the statement of financial position	Offsetting financial collateral (received*)/ pledged not meeting the offsetting criteria of IAS 32	Net collateralised position
Financial assets	£m	£m	£m
Interest rate swaps	3.5	(3.5)	-
Financial liabilities			
Interest rate swaps	(178.3)	178.3	-

*Offsetting collateral is pledged and received in line with underlying Credit Support Annexes (CSA) with the Group's financial counterparties. The Group posts and receives cash collateral on a daily basis to minimise its own and counterparty exposures to mark-to-market positions. Collateral posted is measured against counterparty mark-to-market values and may not reflect the Society's internal valuation of its financial instruments.

The Society has entered into International Swaps and Derivatives Association (ISDA) Master agreements with financial counterparties in line with standard industry practice. Netting agreements contained within are not considered sufficient alone to satisfy the offsetting criteria of IAS 32. The netting agreements are intended to protect the Society against fair value loss in the unlikely future event of counterparty default.

The Society has continued to make use of the London Clearing House (LCH) through 2019, minimising its exposure to non-LCH counterparties. The protected manner of LCH collateral placements mitigates counterparty credit risk with respect to collateral that would otherwise be pledged to non-centralised derivative counterparties.

Financial collateral of (£29.2m) has been placed with an LCH counterparty with respect to 'initial margin': an amount calculated by central counterparties to protect against potential future exposures that could arise from valuation changes. This is in addition to a typical 'variation margin', covering the LCH's accounting exposure to the Society as at 31 December 2019. The Society's collateral pledged against initial margin requirements is included in the collateral column above, contributing to the net over collateralisation vs. accounting exposure of £31.7m.

Where the Society holds multiple financial assets and liabilities with a single counterparty, and a Master netting agreement is in effect, the net fair value exposure for each counterparty is calculated. Net exposures placed with counterparties are consolidated into the financial assets disclosure above, net exposures received from counterparties are similarly consolidated into the financial liabilities.

Collateral
In the ordinary course of business, the Group may from time to time access market-wide facilities provided by central banks secured against non-cash collateral.

Cash collateral has been posted and received in line with Credit Support Annexes with the Group's financial counterparties, as detailed above. Cash collateral received is the legal property of the Group with no obligation to return. Similarly, cash collateral pledged is no longer under the legal ownership or control of the Group.

The fair value of collateral pledged and received is as set out below:

	GROUP and SOCIETY	
	2019 £m	2018 £m
Cash collateral received under CSA agreements	**-**	-
Other financial assets collateral pledged under repurchase agreements	**586.4**	611.5
Cash collateral paid under CSA agreements	**219.7**	200.3

As at 31 December 2019 an immediate 100bp uplift in the zero-coupon 3-month yield curve would produce collateral inflows of **£69.1m** (2018: £77.1m).

Cash collateral is held to mitigate exposures to counterparties with postings updated daily to reflect mark-to-market exposures across the Society's derivative transactions.

31 Financial instruments Continued

Fair value

During 2019 the Society crystallised gains/losses of **£0.4m** through sale of FVOCI debt securities held on balance sheet. The Society does not trade in financial instruments but is required to demonstrate the liquidity of its debt security holdings for regulatory purposes on a periodic basis.

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group's or Society's balance sheets at their fair value. These assets and liabilities are held at values reflecting their intended use. In all cases, this is via collection of contractual amounts due and not through disposal. This is deemed to also reflect their highest and best use. If the Society's intended use of an asset or liability changes the accounting adopted for the item is revisited for reclassification. The carrying values below reflect the Group's maximum exposure to counterparty credit risk at 31 December 2019.

Group

			Carrying value		Fair value	
	Note	Level*	**2019 £m**	2018 £m	**2019 £m**	2018 £m
Financial assets						
Cash and balances with the Bank of England		3	**215.7**	152.9	**215.7**	152.9
Loans and advances to banks	10	3	**230.5**	10.2	**230.5**	10.2
Loans and advances to customers	12	3	**3,295.1**	2,772.2	**3,475.7**	2,928.1
Other assets (of which financial)	20	3	**-**	6.9	**-**	6.9
Financial liabilities						
Due to Members - shares	21	3	**3,400.9**	2,713.7	**3,423.3**	2,709.8
Due to other customers	22	3	**189.8**	142.6	**193.3**	142.5
Deposits due to other banks	23	3	**389.6**	409.8	**390.0**	409.8
Subordinated liabilities	26	1	**-**	25.0	**-**	25.3
Subscribed capital	27	1	**20.0**	20.0	**34.2**	34.3
Other liabilities (of which financial)	24	3	**6.9**	9.9	**6.9**	9.9

*Level defined below. The Group does not trade in financial instruments. Against level three assets there is no expectation that a deferred gain or loss on initial recognition will be recognised in future periods: the transaction price at inception is considered to reflect an appropriate day one fair value. For short term receivables and payables within other assets and other liabilities, the carrying value of amounts due and owed is considered to approximate the fair value of the amounts due and owed. IFRS 9 based impairment allowances against other assets is not material.

Loans and advances to banks
The fair value of floating rate and overnight deposits is their carrying amount. The fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

Loans and advances to customers
Loans and advances to customers are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

Due to Members - shares
The fair value of shares represents the discounted amount of estimated future cash flows paid to shareholders.

Deposits due to other banks
The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

Subordinated liabilities
The fair value of subordinated liabilities is calculated based on discounted cash flows reflecting the contractual liabilities.

Subscribed capital
The fair value of subscribed capital is calculated based on discounted cash flows reflecting the contractual liabilities.

31 Financial instruments Continued

Fair value measurement

The following table summarises the fair value measurement basis used for assets and liabilities held on the balance sheet at fair value:

	Level	**2019 £m**	2018 £m
Financial assets			
Debt securities at FVOCI	1	**416.4**	329.0
Derivative financial instruments	2	**0.1**	3.5
Fair value adjustments for hedged risk on underlying instruments	2	**186.6**	175.9
Financial liabilities			
Derivative financial instruments	2	**185.9**	178.3
Fair value adjustments for hedged risk on underlying instruments	2	**-**	0.4

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 price) 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).

These definitions have been taken from March 2009 amendment to IFRS 13 'Improving Disclosures: Financial Instruments'.

The Society uses modelling software to measure fair value movements on its hedging instruments and hedged items on a portfolio (macro) basis. Industry anticipated interest rate movements are factored into the calculations to give an expected fair value of the derivative portfolio.

Hedge Accounting

The Group is exposed to interest rate risk across its fixed interest rate financial assets and liabilities.

The Society's core business is to provide competitive mortgage and savings products to its Members. Deposits by Members fund the Society's mortgage lending, with the Society paying an interest charge in return for deposited funds and borrowers pay to the Society an interest income in return for the funds they have borrowed.

Mortgage contracts attracting a fixed rate of interest are typically the most popular of the Society's mortgage offerings, with a fixed rate usually agreed for a term of two to five years. By contrast, much of the Society's deposits are made under short term agreements, with deposits often repayable by the Society 'on demand' at the direction of the depositor. This introduces 'interest rate risk' to the Society's business as when 'market-wide' interest rates move, the return received on mortgage assets can be slower to respond (due to longer term fixed contracts) than the return paid on Member deposits which can be repriced more quickly. As a result, and on a macro scale, the interest rates paid for short term funding and deposits can be considered to be 'variable' rather than fixed. This introduces an 'interest rate risk' miss-match between fixed rate mortgage lending and variable rate mortgage funding.

To address this risk, the Society enters into interest rate swap agreements with external counterparties. These contracts protect against interest rate risk by 'swapping' a portion of the Society's fixed interest rate exposure to a variable rate: the Society agrees to pay a fixed rate to a financial counterparty for a period of time in exchange for receipt of a variable interest rate against a notional balance. Practically, this acts to match the interest rate 'type' across large values of mortgages and deposits.

The Society enters into interest rate swaps that are expected to effectively address interest rate risk across either identified and 'closed book' portfolios of mortgage assets (non-macro), or to address the interest rate risk profile expected to be reflected by the Society's balance sheet but against non-specific assets that may change over time (macro). By design, the Society's hedges are expected to be economically effective, with notional nominals, durations and rates on interest rate swaps agreed only where they are expected to be a good fit to the same characteristics of the underlying assets that are to be hedged. The Society typically hedges particular interest rate components of its mortgage assets, and not the assets as a whole: in line with the Group's interest rate risk tolerances and policies. Tailoring the component of an asset that is to be hedged and entering into swap contracts with well-matched key terms to the asset components being hedged is expected to produce 'simple' hedge ratios: whereby the entirety of a swap is hedged against the entirety of a designated hedging instrument portfolio.

Interest rate swaps are derivative financial instruments (see Note 1 for further detail) and are held on balance sheet at their fair value. To align the accounting for derivatives with their risk mitigation activities, the Society formally designates its interest rate swaps as 'hedging instruments' and applies the hedge accounting requirements of IFRS 9 (for non-macro portfolios) and IAS 39 (for macro portfolios) accordingly. This allows, where the Society's hedges are effectively acting to mitigate interest rate risk as intended, for the change in fair value on amortised cost mortgages and deposits that would otherwise not be reflected in financial statements, to be included on balance sheet as fair value adjustments for hedged risk. These fair value movements are expected to offset fair value movements on the Society's derivative contracts: with the Society's Income Statements insulated from the impact of derivative value movements as a result.

Where effective, fair value hedges accounting for interest rate risk ensures that the Society's accounting results are not adversely impacted by its risk mitigation activities. Hedge ineffectiveness can still arise from early asset repayments, imperfectly matched key terms, differences in the timing of cash flows of hedged items and hedging instruments, different interest rate curves applied to discount the hedged items and hedging instruments and the effect of changes in counterparties' credit risk on the fair values of hedging instruments.

31 Financial instruments Continued

The maturity profile of the Society's hedging instruments used in fair value hedge relationships is as follows:

As at 31 December 2019	Up to 3 months	Between 3 months and 12 months	Between 1 year and 5 years	Over 5 years
Total				
Nominal Amounts £m	140.0	425.6	436.3	126.9
Average fixed interest rate	0.75%	1.06%	1.64%	2.88%
Fair Value Assets	-	-	-	-
Fair Value Liabilities	-	(0.9)	(14.0)	(170.9)
Macro				
Nominal Amounts £m	40.0	417.5	344.5	17.5
Average fixed interest rate	0.88%	0.98%	0.95%	0.66%
Fair Value Assets	-	-	-	-
Fair Value Liabilities	-	(0.6)	(2.7)	-
Micro				
Nominal Amounts £m	100.0	8.1	91.8	109.4
Average fixed interest rate	0.70%	4.99%	4.23%	3.23%
Fair Value Assets	-	-	-	-
Fair Value Liabilities	-	(0.3)	(11.3)	(170.9)

Swap assets and liabilities are held at their fair value on balance sheet as 'derivative financial instruments'.

Fair value movements attributable to hedged interest rate risk on hedged items are held on balance sheet under the heading 'fair value adjustments for hedged risk'.

31 Financial instruments Continued

Hedge Ineffectiveness

	2019 £m
Gains / (losses) on non-macro hedging instruments	
Interest rate swaps	0.5
Gains / (losses) on non-macro hedged items	
Mortgage assets (loans and advances to customers)	1.0
Gains / (losses) on macro hedging instruments	
Interest rate swaps	(9.8)
Gains / (losses) on macro hedged items	
Mortgage assets (loans and advances to customers)	8.9

Hedging gains and losses are recognised in the income statement as 'gains less losses on financial instruments and hedge accounting'
During 2019, fair value gains on hedging instruments of (£11.1m) were offset by fair value losses on hedged items of £11.6m with the net gain of £0.5m.

Credit Risk

Credit risk is the risk that a customer or counterparty is unable to honour their repayment of obligations as they fall due. The Group Risk Committee, as detailed in the Risk Management Report, maintain oversight of the Credit Risk Committee. The Committee is involved in the monitoring of the credit risk within the Group's assets. With IFRS 9 introducing forward looking requirements to model credit risk across long term horizons, a Model Risk Committee also operates charged with oversight of the Group's IFRS 9 models and assessment and approval of its key model inputs. Through 2019 the Model Risk Committee met quarterly, coinciding with key dates in the Society's reporting calendar.

Credit risk mainly arises from commercial and consumer loans and advances and loan commitments arising from such lending activities but also arises from the Group's investment in debt securities and exposure to third party (financial and non-financial) debtors. The Society ensures that credit risk is mitigated by only investing in investment grade debt securities and by having strict lending criteria to ensure that mortgage lending is within the Society's risk appetite.

The Group's policy with respect to accounting for impairment of financial assets is given in Note 1. Practical application of this policy is achieved as follows:

Under IFRS 9, the Group conducts a forward looking assessment of impairment. Expected credit losses are recognised across applicable financial assets based on whether there has been a significant increase in credit risk since the asset's origination. Throughout this note, assets with no significant increase in credit risk since origination will be denoted as 'stage 1 assets', assets which have suffered a significant increase in credit risk but have not defaulted will be denoted as 'stage 2 assets' and assets that have defaulted are denoted as 'stage 3 assets'.

When assessing movement in credit risk it is the change in the risk of default occurring that is key, not the change in the amount of any expected credit loss.

Assets are assessed on an individual basis with a forward looking assessment undertaken to support the recognition 'now' of future potential losses. While losses are provided for, assets are only formally written off when the Society no longer holds any expectation of subsequent receipt, typically at the conclusion of a negotiation or sale.

Implementation and ongoing administration of high quality IFRS 9 impairment models requires significant management experience and judgement, both in assessing historic performance trends and factors and in projecting these into uncertain future economic environments. External professional modelling assistance has been coupled with the Society's extensive internal expertise to facilitate a robust and compliant implementation. Best practice guidance issued by consolidated professional audit and accountancy firms, IFRS implementation guidance, and banking centric governance and modelling guidance from European and domestic authorities form the foundation of the Society's IFRS 9 impairment response.

31 Financial instruments Continued

Significant increase in credit risk since origination

The Society considers financial assets that are more than one month overdue to have significantly increased in credit risk since origination across all financial asset classes. More specifically:

The Society assesses the increase in credit risk on residential and new buy to let mortgages as follows:

At the application stage, a prospective borrower's credit risk is assessed. The Society does not lend to high risk customers but will lend to 'prime customers' who can fall under a range of 'application scores'- based on a wide variety of factors including affordability, credit history, committed monthly spend, etc. A borrower's application score gives a quantified assessment of borrower risk- a 'risk score'.

On a quarterly basis, the Group receives borrower credit scores from Experian, an industry leader in the provisioning of consolidated credit scoring information. This data is mapped internally to a new borrower risk score– allowing continuous assessment of the movement in borrower risk since origination.

Where a borrower's risk score is suitably consistent between origination and the reporting date, a borrower is categorised as a 'stage 1' borrower.

Where a borrower's risk score increases past pre-defined internal thresholds, but a borrower has not otherwise 'defaulted', the borrower is categorised as a 'stage 2' borrower. A borrower who has fallen into >1 month's arrears is automatically considered to be a stage 2 borrower.

A borrower who has defaulted, (assessed against a range of internal qualitative and quantitative criteria) is categorised as a 'stage 3' borrower. A borrower who has fallen into >3 month's arrears is automatically considered to be a stage 3 borrower.

The Society assesses the increase in credit risk on commercial legacy and other legacy mortgages as follows:

Specialist internal departments assess the risk of loss against the Group's legacy mortgage books on a case by case basis. Across the Society's historically highest risk exposures, commercial real estate, this includes the annual completion of tailored risk grade scorecard designed to encompass the key characteristics contributing to underlying risk.

Each of the scorecard risks are weighted to provide a final 'weighted risk score' for the loan, which categorises the loan in terms of likelihood of failure in a moderate or severe recessionary scenario. The risks that carry the highest weightings relate to tenant failure and serviceability.

Exposures receiving the highest overall risk scores are placed onto the Society's 'borrower watchlists' prompting enhanced and more frequent internal scrutiny.

All payments due are monitored on a real-time basis. In the event of a late payment the position is reviewed immediately and appropriate action taken. The facility is then closely monitored.

The Society assesses the increase in credit risk on housing association mortgages as follows:

HAs are monitored and managed by the Commercial Lending Department with a range of management information used to assess the Society's ongoing exposure (which while of extremely high credit quality remains of significant size). An open dialogue is maintained with borrowers with the Society appraised of their status, financial results and position, and numerous other financial and risk metrics. Quarterly management information is also reviewed including business plans. Lending is contingent on compliance with a number of financial commitments and covenants with the Society actively monitoring for potential breach of contractual positions.

Whilst the Society has never experienced any arrears or suffered losses, because of the scale and nature of long term exposures borrowers' credit risk is measured through a bespoke risk grade scorecard which charts financial performance, covenant compliance, asset cover, stock location/demand and regulatory feedback.

Housing associations are historically a nil loss, nil default sector and are widely considered to be Government backed in the case of financial stress. The strength of a 'nil-default sector' should not be understated: housing association exposures have proven to be of the lowest credit risk throughout a volatile and extended recession period. The Society has no internal history of loss to draw on with respect to housing association exposures and cannot supplement its own data with loss data of its peers.

The combined effect of a well collateralised set of exposures, in an environment where the demand for housing is only increasing, with no history of default on the part of any borrower and a sincere expectation that any theoretical default would be addressed by the jurisdictional Government leads to a conclusion that no material impairment of housing association exposures is plausibly expected.

The Society assesses the increase in credit risk on debt securities as follows:

The Society monitors the external credit ratings applied to its debt security investments on a daily basis.

The Society's debt security holdings are all of 'investment grade' or higher. The Society has therefore assessed that the credit risk on its debt security exposures has not increased significantly since initial recognition.

The Society's treasury risk department runs very severe annual stressed scenarios over the Society's residential mortgage backed securities (RMBS). The Society's policy to allow only investment grade and senior secured exposures leaves the Society highly insensitive to stressed scenarios as the 'waterfall structure' of RMBS payments ensures continued Society receipt of contractual cash flows even through significantly stressed scenarios.

The Society's covered bond exposures are similarly resilient: the Society is only exposed to regulated UK covered bonds with the regulations providing for the full segregation of covered bond asset pools from the bond issuer. The regulations introduce numerous investor protections including mandatory over-collateralisation, an extensive initial application process and regular regulatory stress testing and supervisory monitoring.

31 Financial instruments Continued

The Society assesses the increase in credit risk on other financial assets as follows:

The company has elected to take advantage of IFRS 9's practical expedient when assessing the accounting impairment applied to its trade receivables. Lifetime expected credit losses are therefore provided against all trade receivables. A provisions matrix approach, where provisions against receivables are calculated as an increasing percentage of the receivable balance, rising as receivables fall further overdue, has been adopted.

Assessment of the appropriate provision percentages has been made in line with the company's historic trade receivable recovery. Where appropriate, forward looking views to recovery are also be incorporated.

Modifications

The Society grants forbearance to commercial borrowers in the form of extending the loan term on maturity, capitalising arrears as part of a wider exercise to get a borrower back on track with a revised debt repayment plan, and adjusting the interest rate to aid serviceability particularly where a fixed rate has expired. Generally the Society expects commercial investment loans to be repaid on maturity given the stated strategy of winding down the portfolio but will grant forbearance when this is also in the best interests of the Society e.g. providing the borrower with a little more time to sell the security property following a tenant renewal.

The Society occasionally grants forbearance to other borrowers (in similar forms to commercial) where this is expected to improve the ultimate recovery on loans advanced.

The requirement to grant forbearance is considered an objective indicator that an asset has suffered a significant increase in credit risk since origination. As such, while forbearance may mitigate a selection of the Society's other indications of default, the granting of forbearance will not result in a preferential staging (Stage 1 or 2) being applied to any forborne asset. While benefiting from any revised terms that forbearance may bring, an asset is not able to move to a lower staging. Only once forbearance has been lifted can an asset qualify for a reduced staging with the Society operating a 6 month 'curing' policy: deferring the reduction in staging until a 6 month period has passed in which no other indicators of default or heightened credit risk have presented themselves.

Impairment calculation

The Society's impairment methodology applied to legacy mortgages, debt securities and other financial assets is as described above. For the Society's core residential mortgage books, the following methodology applies:

The Society calculates, for each mortgage exposure, a forward view as to how likely that mortgage is to default at some point over its expected life. The probability that a mortgage will default is not 'point in time'- the Society has to calculate a continuous and forward looking assessment of the probability of default as IFRS 9's base expectation is that 'lifetime' expected credit losses will be provided for (or 12 month expected losses for stage 1 assets).

Lifetime expected credit losses are calculated by the Society as the discrete losses that would likely be incurred (considering mortgage exposure vs. the expected sale value of the mortgaged property) if a mortgage defaulted on any of a large range of future dates. Each discrete provision needs to be assigned a probability of default weighting in order to calculate one overall 'lifetime' expected credit loss. As such, a continuous forward view to the probability of default must be calculated.

31 Financial instruments Continued

Key impairment model inputs, assumptions and estimation techniques

The Society calculates its probability of default (PD) as follows:
- The Society has undertaken a detailed assessment of more than 12 years of its internal credit risk data to determine the core factors that lead to borrower default.
- Default indicators identified included granting of forbearance, evidence of mortgage fraud, borrowers falling into > 3 months arrears, borrower insolvency or bankruptcy and voluntary repossession of property. These are used in the staging assessment above to assist in the classification of borrowers as stage 1, stage 2 or stage 3.
- The Society's assessment also considered 'wider' patterns of default, analysing historic borrower defaults by their maturity (how long a mortgage had been held by the Society), vintage (during which original time period the Society lent to a borrower) and considering 'exogenous' (external factors including the interest rate environment, unemployment rates, UK (nominal) GDP, House Price Index, etc.) factors in play at the time of default.
- The exogenous, maturity and vintage (EMV) factors are used to derive point in time and forward looking probability of default curves: projecting historical information about defaults suffered under known 'EMV conditions' forward in combination with the Society forward views on the wider macroeconomic environment (as this will influence the forward view on how exogenous factors may develop over time). In combination, these curves form the Society's forward looking probability of default curve, as calculated under the 'EMV' model.

The Society calculates its exposure at default (EAD) as follows:
- The Group projects mortgage balances forward to give an estimate of each borrower's mortgage balance over time. This factors in forecast interest additions and expected borrower payments alongside an estimate of the value of each borrower's property collateral throughout a long term forecast. An adjustment is made to uplift the Group's exposure to borrowers to simulate a typical borrower default of 3 missed monthly payments plus typical fees associated with arrears.
- The output is a per-mortgage forward projection of mortgage balances.

The Society calculates its expected loss given default (LGD) as follows:
- The Group calculates a per-mortgage 'loss given default'(LGD), an estimate of the proportion of each mortgage loan exposure that is believed to be at risk if the borrower defaults on their obligation to repay the outstanding capital and interest and the property is subsequently possessed and sold.
- LGD is calculated as the probability of possession given the default of a borrower (PPD) which estimates the likelihood of possession following default multiplied by the expected shortfall on each mortgage: an estimation of the difference between the exposure at default (as discussed above) and the sale price of the property, net of relevant sales costs.

Provisions: PD * EAD * LGD

The Group then calculates a final provision for each mortgage: the probability of default multiplied by the amount the Group expects to lose in the event of a default. As discussed above, this is not 'static' or a 'point in time' loss: the Group calculates PD, EAD and LGD across a continuous forward planning horizon. The final provision number is not a singular PD*EAD*LGD, it reflects the discounted overall expected loss that could be incurred over the life of each mortgage: a weighted average of multiple possible future loss events.

Multiple economic scenarios

IFRS 9 expects more than one scenario to be considered when calculating expected credit losses. The Society applies this principle by assessing the provisions required under three separate macroeconomic forecasts. These macroeconomic forecasts feed into the exogenous component of the Society's EMV models.

The Society runs:
- Base scenario: calculated with reference to the Bank of England's quarterly forecasts, and in line with budgets;
- Upside scenario: a positively stressed variant to the base scenario; and
- Downside scenario: a negatively stressed variant to the base scenario.
- Severe downside scenario: a severely negatively stressed variant to the base scenario.

The Society's final expected credit losses are the losses calculated under each discrete scenario multiplied by a 'likelihood factor': currently set to 60% for the base scenario, 10% for the upside, 29% for the downside scenarios, and 1% for the severe downside.

Key macroeconomic information

The Society considers the following to be the key macroeconomic and forward view inputs to its impairment models:
- Bank of England base rate
- Society standard variable rate
- UK nominal gross domestic product
- UK unemployment rate
- UK household income growth rate
- UK house price index

The Society's assessments as to which variables are key has not changed during 2019. Quarterly updates to the variables themselves to reflect the most recent market information have been reflected in the Society's impairment results.

31 Financial instruments Continued

Quantitative impairment impact

Reconciliation table	Loss allowance at 1 January 2019	Increases due to origination and acquisition	Decreases due to derecognition	Changes due to change in credit risk (net)	Transition between stages	Loss allowance at 31 December 2019
	£000	£000	£000	£000	£000	£000
Prime residential						
Stage 1	47.2	50.4	(5.7)	147.2	(136.2)	102.9
Stage 2	186.8	203.0	(13.0)	84.9	(25.7)	436.0
Stage 3	935.4	73.5	(10.6)	(84.6)	161.9	1,075.6
Total	**1,169.4**	**326.9**	**(29.3)**	**147.5**	**-**	**1,614.5**
Buy to Let						
Stage 1	1.2	3.8	(0.1)	8.9	(6.8)	7.0
Stage 2	4.1	10.4	-	2.9	6.8	24.2
Stage 3	-	8.6	-	-	-	8.6
Total	**5.3**	**22.8**	**(0.1)**	**11.8**	**-**	**39.8**
Commercial						
Stage 1	1,325.0	-	-	(1.100.0)	-	215.0
Stage 2	-	-	-	-	-	-
Stage 3	8,105.0	-	(7,100.0)	516.2	-	1521.2
Total	**9,430.0**	**-**	**(7,100.0)**	**(583.8)**	**-**	**1,736.2**
Housing Association						
Stage 1	-	-	-	-	-	-
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
Total	**-**	**-**	**-**	**-**	**-**	**-**
Serviced Apartments						
Stage 1	-	-	-	-	-	-
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
Total	**-**	**-**	**-**	**-**	**-**	**-**
Policy Loans						
Stage 1	-	-	-	-	-	-
Stage 2	0.1	-	(0.1)	-	-	-
Stage 3	320.4	-	(320.4)	-	-	-
Total	**320.5**	**-**	**(320.5)**	**-**	**-**	**-**
Total						
Stage 1	**1,373.4**	**54.2**	**(5.8)**	**(353.9)**	**(143.0)**	**924.9**
Stage 2	**191.0**	**213.4**	**(13.1)**	**87.8**	**(18.9)**	**460.2**
Stage 3	**9,360.8**	**82.1**	**(7,431.0)**	**(168.4)**	**161.9**	**2,005.4**
Total	**10,925.2**	**349.7**	**(7,449.9)**	**(434.5)**	**-**	**3,390.5**

31 Financial instruments Continued

Quantitative impairment impact

Reconciliation table	Gross exposure at 1 January 2019	Increases due to origination and acquisition	Decreases due to derecognition	Changes due to change in credit risk (net)	Transition between stages	Gross exposure at 31 December 2019
	£m	£m	£m	£m	£m	£m
Prime residential						
Stage 1	1,669.1	689.8	(244.4)	(58.7)	25.2	2,081.0
Stage 2	186.4	110.6	(19.6)	(5.0)	(31.2)	241.2
Stage 3	11.7	0.6	(1.2)	(0.3)	6.0	16.8
Total	**1,867.2**	**801.0**	**(265.2)**	**(64.0)**	**-**	**2,339.0**
Buy to Let						
Stage 1	213.1	96.4	(13.1)	(0.6)	(0.3)	295.5
Stage 2	13.6	9.5	(0.2)	-	0.3	23.2
Stage 3	-	0.2	-	-	-	0.2
Total	**226.7**	**106.1**	**(13.3)**	**(0.6)**	**-**	**318.9**
Commercial						
Stage 1	26.9	-	(22.9)	22.0	-	26.0
Stage 2	0.1	-	-	-	-	0.1
Stage 3	11.8	-	(0.1)	(7.8)	-	3.9
Total	**38.8**	**-**	**(23.0)**	**14.2**	**-**	**30.0**
Housing Association						
Stage 1	424.7	-	(22.9)	(5.2)	-	396.6
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
Total	**424.7**	**-**	**(22.9)**	**(5.2)**	**-**	**396.6**
Serviced Apartments						
Stage 1	19.6	-	(0.8)	(0.6)	-	18.2
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
Total	**19.6**	**-**	**(0.8)**	**(0.6)**	**-**	**18.2**
Policy Loans						
Stage 1	3.0	-	-	(0.4)	-	2.6
Stage 2	-	-	-	-	-	-
Stage 3	0.3	-	-	(0.3)	-	-
Total	**3.3**	**-**	**-**	**(0.7)**	**-**	**2.6**
Total						
Stage 1	**2,356.4**	**786.2**	**(304.1)**	**(43.5)**	**24.9**	**2,820.1**
Stage 2	**200.1**	**120.1**	**(19.8)**	**(5.0)**	**(30.9)**	**264.5**
Stage 3	**23.8**	**0.8**	**(1.3)**	**(8.4)**	**6.0**	**20.9**
Total	**2,580.3**	**907.1**	**(325.2)**	**(56.9)**	**-**	**3,105.4**

The gross carrying values above reflect the Group's maximum exposure to credit risk as at 31 December 2019 without taking into account any collateral held or provisions made against expected loss.

The Society did not purchase or originate any financial assets that were considered to be credit impaired during 2019.

There has been no material movement in loss allowances held against other financial assets during 2019. Debt securities held remain of very high credit quality at 31 December 2019 and the Group is not exposed to any significant value or volume of overdue trade receivables.

No collateral is held against the Group's debt security or other financial asset exposures.

Notes to the Accounts for the year ended 31 December 2019

31 Financial instruments Continued

Sensitivity

The Group's mortgage provisions reflect probability weighted scenarios run across its mortgage books and are sensitive to the probabilities applied accordingly. Provisions are most sensitive to increases in the downside scenario probability:

	Actual 2019								
Upside	10%	10%	**10%**	10%	**10%**	10%	**10%**	10%	**20%**
Base	60%	80%	**70%**	60%	**50%**	40%	**55%**	50%	**50%**
Negative	29.0%	10%	**20%**	30%	**40%**	50%	**34%**	39%	**25%**
Stress	1.0%	0%	**0%**	0%	**0%**	0%	**1%**	1%	**5%**
Provision, £000's	**£819**	**£470**	**£611**	**£756**	**£901**	**£1,046**	**£892**	**£964**	**£1,066**
Increase/(decrease) in Provision, £000	**£0**	**(£349)**	**(£208)**	**(£63)**	**£82**	**£227**	**£73**	**£145**	**£247**

The Group's mortgage lending is all secured with a first charge registered against the collateral property. While not in scope of IFRS 9, this includes the Group's equity release mortgages. The average loan to value of the Group's loan portfolios at 31 December 2019 is 61.1% (2018: 62.0%) as detailed in the Strategic Report. Quarterly regional Halifax House Price Index data is used to monitor the value of residential collateral. The contractual capacity to recover defaulted mortgage contracts through the sale of property collateral acts significantly to reduce the Group's risk of loss.

The credit quality of the Group's residential loans is considered to be excellent with the loans continuing to perform and arrears being below industry averages. At 31 December 2019 there were 18 loans in 12 months arrears or more with balances of £1.4m (2018: 18 loans totalling £1.1m).

The Group's non-impaired commercial loan assets are also considered to be of a good credit quality.

Further specifics by type of mortgage lending are as follows:

Prime residential mortgage book

The Prime residential mortgage book consists of traditional residential loans. No sub-prime or self-certification lending has been undertaken. The below analysis includes equity release mortgage lending that is not within the scope of IFRS 9 driven credit risk disclosures provided in the tables above.

Loan to value (indexed)	2019 £m	2019 %	2018 £m	2018 %
<70%	**1,611.9**	**64.1**	1,341.0	65.6
70% - <80%	**348.1**	**13.9**	282.5	13.8
80% - <90%	**289.9**	**11.5**	231.1	11.3
>90%	**262.7**	**10.5**	190.7	9.3
	2,512.6	**100.0**	2,045.3	100.0

The table below provides further information by payment due status:

	2019 £m	2019 %	2018 £m	2018 %
Neither past due nor impaired	**2,491.7**	**99.2**	2,030.2	99.3
Past due up to 3 months but not impaired	**13.0**	**0.5**	10.8	0.5
Impaired and past due 3 to 6 months	**4.8**	**0.2**	2.0	0.1
Impaired and past due over 6 months	**2.3**	**0.1**	2.2	0.1
In possession	**0.8**	**-**	0.1	-
	2,512.6	**100.0**	2,045.3	100.0

Against past due and possession cases, **£46.1m** (2018 £36.7m) collateral is held.

No loans that would be past due or impaired have had their terms renegotiated.

The Society granted forbearance against 30 residential loans in 2019 in the form of reduced payments or payment breaks. With no alteration made to the contractual rates of interest and balances totalling £3.2m at 31 December 2019 no modification gain or loss is recorded as a result of short-term forbearance granted. Provisions of £32,000 are held against residential mortgages that were granted forbearance during the year.

31 Financial instruments Continued

Retail Buy to Let Mortgage book

The Retail BTL mortgage book consists of buy-to-let to individuals <£1m.

Loan to value (indexed)	2019 £m	2019 %	2018 £m	2018 %
<70%	**192.3**	**65.2**	121.3	60.5
70% - <80%	**100.5**	**34.0**	77.1	38.4
80% - <90%	**1.0**	**0.3**	0.4	0.2
>90%	**1.6**	**0.5**	1.9	0.9
	295.4	**100.0**	200.7	100.0

The table below provides further information by payment due status:

	2019 £m	2019 %	2018 £m	2018 %
Neither past due nor impaired	**293.5**	**99.4**	199.4	99.2
Past due up to 3 months but not impaired	**1.3**	**0.4**	0.9	0.5
Not past due but impaired	**-**	**-**	-	-
Impaired and past due up to 3 months	**-**	**-**	-	-
Impaired and past due up to 3 to 6 months	**-**	**-**	-	-
Impaired and past due over 6 months	**0.4**	**0.1**	0.3	0.2
LPA receivership	**-**	**-**	-	-
In possession	**0.2**	**0.1**	0.1	0.1
	295.4	**100.0**	200.7	100.0

Specialist residential mortgage book

The Specialist residential mortgage book consists of buy-to-let to individuals >£1m and corporates, and residential investment loans.

Loan to value (indexed)	2019 £m	2019 %	2018 £m	2018 %
<70%	**23.2**	**62.3**	37.3	77.4
70% - <80%	**10.6**	**28.5**	10.7	22.2
80% - <90%	**0.2**	**0.5**	0.2	0.4
>90%	**3.2**	**8.7**	-	-
	37.2	**100.0**	48.2	100.0

The table below provides further information by payment due status:

	2019 £m	2019 %	2018 £m	2018 %
Neither past due nor impaired	**29.0**	**77.9**	42.6	88.3
Past due up to 3 months but not impaired	**-**	**-**	-	-
Not past due but impaired	**-**	**-**	-	-
Impaired and past due up to 3 months	**-**	**-**	-	-
Impaired and past due up to 3 to 6 months	**5.0**	**13.4**	5.6	11.7
Impaired and past due over 6 months	**-**	**-**	-	-
LPA receivership	**3.2**	**8.7**	-	-
In possession	**-**	**-**	-	-
	37.2	**100.0**	48.2	100.0

Against past due and possession cases, **£12.9m** (2018 £11.3m) collateral is held.

31 Financial instruments Continued

Commercial lending book

The commercial lending book comprises:

Group	2019 £m	2019 %	2018 £m	2018 %
Loans secured on Commercial Property	**30.0**	**6.7**	38.8	8.0
Loans secured on Serviced Apartments	**18.2**	**4.1**	19.6	4.1
Loans to Housing Associations	**396.6**	**89.2**	424.7	87.9
	444.8	**100.0**	483.1	100.0

Loans secured on commercial property Loan to value (unindexed)	2019 £m	2019 %	2018 £m	2018 %
<70%	**15.3**	**51.0**	15.9	41.0
70% - <80%	**1.7**	**5.7**	1.8	4.6
80% - <90%	**-**	**-**	-	-
>90%	**13.0**	**43.3**	21.1	54.4
	30.0	**100.0**	38.8	100.0

Loans secured on serviced apartments Loan to value (unindexed)	2019 £m	2019 %	2018 £m	2018 %
<70%	**2.8**	**15.5**	3.0	15.3
70% - <80%	**10.1**	**55.4**	10.4	53.2
80% - <90%	**5.3**	**29.1**	6.2	31.5
>90%	**-**	**-**	-	-
	18.2	**100.0**	19.6	100.0

The table below provides further information by payment due status:

	2019 £m	2019 %	2018 £m	2018 %
Neither past due nor impaired	**26.2**	**87.2**	27.0	69.7
Past due up to 3 months but not impaired	**-**	**-**	-	-
Not past due but impaired	**3.8**	**12.8**	11.8	30.3
Impaired and past due up to 3 months	**-**	**-**	-	-
Impaired and past due 3 to 6 months	**-**	**-**	-	-
Impaired and past due over 6 months	**-**	**-**	-	-
LPA receivership	**-**	**-**	-	-
In possession	**-**	**-**	-	-
	30.0	**100.0**	38.8	100.0

31 Financial instruments Continued

At 31 December 2019, the Society had no commercial investment loans in arrears of 3 months or more (2018 none).

The Society had no commercial loans in possession or subject to LPA receivership at the end of 2019 (2018 none).

The approach of appointing an LPA receiver for impaired loans of this type has produced acceptable outcomes in the past few years and the Society expects to continue to adopt this approach should any further similar situations arise.

The Society grants forbearance to commercial borrowers in the form of extending the loan term on maturity, capitalising arrears as part of a wider exercise to get a borrower back on track with a revised debt repayment plan, and adjusting the interest rate to aid serviceability particularly where a fixed rate has expired. Generally the Society expects commercial investment loans to be repaid on maturity given the stated strategy of winding down the portfolio but will grant forbearance when this is also in the best interests of the Society e.g. providing the borrower with a little more time to sell the security property following a tenant renewal.

In the year ended 31 December 2019 the Society had granted forbearance to 3 in the financial year, however had repaid by the year end.

Loans secured on commercial property are diversified by industry type and an analysis is shown below:

	2019 £m	**2019 %**	2018 £m	2018 %
Retail	**16.8**	**56.0**	17.6	45.4
Office	**1.7**	**5.7**	9.4	24.2
Industrial	**8.2**	**27.3**	8.5	21.9
Hotel/Leisure	**2.7**	**9.0**	2.8	7.2
Student Accommodation	**-**	**-**	-	-
Serviced Apartments	**-**	**-**	-	-
Other	**0.6**	**2.0**	0.5	1.3
	30.0	**100.0**	38.8	100.0

Group and Society Loans to Housing Associations Loan to value (unindexed)	**2019 yr-end £m**	**2019 yr-end %**	2018 yr-end £m	2018 yr-end %
<70%	**158.3**	**39.9**	215	50.6
70% - <80%	**131.2**	**33.1**	132.5	31.2
80% - <90%	**107.1**	**27.0**	77.2	18.2
>90%	**-**	**-**	-	-
	396.6	**100.0**	424.7	100.0

Loans to Housing Associations are secured on residential property.
No Housing Association loans are past due or impaired.

31 Financial instruments Continued

Risk exposures by credit grade

Across the Society's prime residential and new buy to let mortgage exposures (i.e the Group's non-closed mortgage books) provisions may be disaggregated by detailed probability of default ranges as follows:

Lifetime probability of default	**Exposure**			**Provision**			**Provision Coverage**		
	Stage 1	**Stage 2**	**Stage 3**	**Stage 1**	**Stage 2**	**Stage 3**	**Stage 1**	**Stage 2**	**Stage 3**
%	£m	£m	£m	£000	£000	£000	%	%	%
0% - 1%	118.7	0.1	-	(0.1)	-	-	0.1	-	-
1% - 2%	1,030.9	0.8	-	(21.5)	(0.1)	-	2.1	6.9	-
2% - 3%	811.3	-	-	(36.5)	-	-	4.5	-	-
3% - 4%	125.7	-	-	(7.8)	-	-	6.2	-	-
4% - 5%	205.1	-	-	(19.2)	-	-	9.4	-	-
5% - 6%	3.8	-	-	-	-	-	0.1	-	-
6% - 7%	2.9	-	-	(0.4)	-	-	12.7	-	-
7% - 8%	2.1	1.1	-	-	-	-	0.4	3.7	-
8% - 9%	1.2	3.9	-	-	(0.3)	-	2.3	8.3	-
9% - 10%	2.1	8.6	-	(0.2)	(2.1)	-	10.1	24.8	-
10% - 100%	72.7	249.9	16.6	(29.9)	(477.7)	(223.9)	41.1	191.2	1,345.3
Total	**2,376.7**	**264.3**	**16.6**	**(115.7)**	**(480.2)**	**(223.9)**	**4.9**	**181.7**	**1,345.3**

Lifetime probability of default indicates the percentage change that a loan will trigger any of the stage 3 indicators, as detailed above, over the life of the loan and does not alone indicate a likeliness that the default will result in any significant loss to the Group.

The comparatively small provisions coverage reflects the capacity for property collateral to effectively mitigate the Society's ultimate exposure to loss.

Provisions against other financial assets are not considered to be sufficiently material at £0.1m to warrant further detailed analysis.

Provisions against commercial and legacy Buy to Let mortgages are not presented by risk grade: legacy exposures, as detailed above, are assessed for impairment on an individual basis by specialist internal risk teams.

Interest rate risk

Interest rate risk is the exposure of the Group's net interest income to movement in interest rates. This is managed using a combination of limits set by the Board and by the use of derivative instruments. The sensitivity to interest rate movements is measured using dynamic stress tests for a series of parallel rate shifts over various time periods.

At 31 December 2019	**+2% £m**	**-2% £m**
Next 12 months	4.1	(0.5)
Next 2 years	4.6	0.2
Next 3 years	8.9	(0.3)

An immediate 2% upwards movement in interest rates would increase members' interest by **£0.6m** (2018: £0.2m)

Interest rate risk in the pension schemes

Sensitivity is disclosed in the pensions note.

Currency risk

The Group has no exposure to currency risk.

Equity risk

The Group has no material direct exposure to equity risk. The fair value amounts are approximately equal and offsetting so there is no material charge or credit in the accounts.

Annual Business Statement

for the year ended 31 December 2019

1 Statutory percentages

	2019 %	Statutory %
Lending limit	**2.1**	25.00
Funding limit	**14.56**	50.00

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997. Lending limit is calculated excluding all IAS 39 adjustments for derivatives and fair values.

The lending limit measures the proportion of business assets not in the form of loans secured on residential property.

Business assets are the total assets of the Group plus allowances for losses on loans and advances less liquid assets, investment properties and property, plant, and equipment as shown in the Group balance sheet.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals.

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 fully secured on residential property and are funded substantially by its Members.

2 Other percentages

As a percentage of shares and borrowings:	2019 %	2018 %
Gross capital	**5.67**	7.37
Free capital	**4.51**	6.20
Liquid assets	**21.67**	21.20
Result for the year as a percentage of mean total assets	**0.28**	0.29
Management expenses as a percentage of mean total assets	**1.45**	1.33

The above percentages have been prepared from the Annual Accounts.

Gross capital represents the aggregate of the general reserve, available for sale reserve, subordinated liabilities and subscribed capital.

Free capital represents gross capital less property, plant and equipment, investment property and non-current assets held for sale.

Liquid assets are as shown in the Group Balance Sheets but exclude liquid assets pledged under repo agreements and includes collateral.

Shares and borrowings represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Management expenses represent the aggregate of administrative expenses and depreciation.

Mean total assets are the average of the 2019 and 2018 total assets.

Annual Business Statement

for the year ended 31 December 2019 (Continued)

Directors at 31 December 2019

	Date of Birth	Date of Appointment	Business Occupation
GA Bennett MA	**10.02.61**	**24.04.19**	**Non Executive Director**
	Other Directorships: Newcastle Portland House Limited; MAM Properties Limited.		
BP Glover LLB, ACIB	**03.07.60**	**11.08.17**	**Company Director**
	Other Directorships: Cygnet Properties and Leisure PLC; Recognise Financial Services Limited.		
AS Haigh BSc	**26.01.63**	**27.01.14**	**Building Society Chief Executive Officer**
	Other Directorships: Community Foundation serving Tyne & Wear and Northumberland; North East England Chamber of Commerce.		
K Ingham	**20.02.65**	**04.09.14**	**Vice President Operations**
	Other Directorships: Newcastle Strategic Solutions Limited; Vice President Operations (Europe Middle East and Africa at Expedia Inc.).		
A Laverack BA **(Business name: Anne Shiels)**	**08.06.61**	**17.07.17**	**Company Director**
	Other Directorships: Anne Shiels Consulting Limited.		
S Miller BSc, ACIB	**16.10.70**	**16.01.18**	**Building Society Customer Director**
	Other Directorships: Newcastle Financial Advisers Limited.		
PJ Moorhouse FCCA	**18.01.53**	**31.10.11**	**Non Executive Director**
	Other Directorships: Newcastle Strategic Solutions Limited; Newcastle Systems Management Limited.		
J Morris BA, FCA	**13.09.56**	**31.10.11**	**Non Executive Director**
	Other Directorships: None.		
DA Samper BA, CA	**21.12.74**	**20.12.18**	**Building Society Chief Financial Officer**
	Other Directorships: None.		
MR Thompson BA, FCA	**11.10.61**	**29.01.19**	**Non Executive Director**
	Other Directorships: Newcastle United Foundation; Tyne and Wear Building Preservation Trust Limited.		
IW Ward FCIB	**04.05.49**	**09.07.13**	**Non Executive Director**
	Other Directorships: Newcastle Financial Advisers Limited; Newcastle Systems Management Limited; Branston Consultancy Limited; OneSavings Bank PLC; Charter Court Financial Services Group PLC; Charter Court Financial Services Limited; Exact Mortgage Experts Limited; Broadlands Finance Limited; Charter Mortgages Limited.		

Documents may be served on any of the Directors c/o Addleshaw Goddard LLP, One St Peter's Square, Manchester M2 3DE. The Executive Directors have service contracts which can be terminated at any time by the Society on six months' notice. The Executive Directors' service contracts were entered into on the dates of their appointment, excepting A S Haigh who was appointed to the role of Chief Executive on 1 May 2015, having previously held the role of Chief Operating Officer. There are no contracts for Non-Executive Directors and no compensatory terms for loss of office.

Country-by-Country Reporting

The reporting obligations set out in Article 89 of the European Union's Capital Requirements Directive IV (CRD IV) have been implemented in the UK by the Capital Requirements (Country-by-Country Reporting) Regulations.

Newcastle Building Society is the biggest building society in the North East and the ninth largest in the UK with assets of c£4.4 billion.

As a mutual organisation, the Society's primary focus is its Members and it aims to provide mortgage, savings and insurance products supported by excellent customer service. Additionally, the Society offers financial advice, as an appointed representative of Openwork, through Newcastle Financial Advisers Limited. Outsourcing of financial services and Information Technology services are provided through Newcastle Strategic Solutions Limited.

The consolidated financial statements of the Newcastle Building Society Group include the audited results of the Society and its subsidiary undertakings. The consolidated entities, their principal activities and countries of incorporation, are detailed in Note 15 to the Annual Report and Accounts.

Basis of preparation

a) Country

All of the consolidated entities were incorporated in the United Kingdom, with the exception of Newcastle Mortgage Loans (Jersey) Limited, which is incorporated and operates with no employees in Jersey.

b) Total operating income and profit before tax

Total operating income and profit before tax are compiled from the Newcastle Building Society Group consolidated financial statements for the year ended 31 December 2019, which are prepared in accordance with International Financial Reporting Standards ("IFRS"). Total operating income represents the sum of the Group's net interest income, other income, other charges and gains less losses on financial instruments and hedge accounting. Group total operating income was **£74.9m** (2018: £64.5m), the proportion not arising from UK-based activity is not considered material for the purposes of this disclosure.

c) Corporation tax paid

Corporation tax paid represents the net cash taxes paid to the tax authority, HMRC during 2019. Corporation tax paid is reported on a cash basis and will normally differ from the tax expense recorded for accounts purposes due to:

- Timing differences in the accrual of tax charge and the payment of tax charge. The Group makes quarterly payments on account to HMRC. Payments are made in July, October, January and April. As the Group's accounting year runs from January to December, payments made in any financial year will not align with tax due in that financial year.
- The Society brought forward into 2019 tax losses from previous years that were used to extinguish a portion of its taxable profits in 2019 and will be similarly used in future years.
- Other differences between when income and expenses are accounted for under IFRSs and when they become taxable.

During 2019 the Group paid **£1.3m** in corporation tax.

d) Full-time equivalent employees ("FTEs")

The average number of Group full time equivalent employees was **1039.0** (2018: 969.5) all of which were employed in the UK.

e) Group profit before tax

Group profit before tax was **£14.7m** (2018: £13.3m) with a tax charge of **£3.3m** (2018: £2.5m). The profit before tax and the tax charged relates to UK-based activity and the UK tax jurisdiction.

Independent auditors' report to the Directors of Newcastle Building Society

Report on the audit of the country-by-country information

Opinion

In our opinion, Newcastle Building Society's country-by-country information for the year ended 31 December 2019 has been properly prepared, in all material respects, in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

We have audited the country-by-country information for the year ended 31 December 2019 in the Country-by-Country Report.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the country-by-country information section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Society in accordance with the ethical requirements that are relevant to our audit of the country-by-country information in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Emphasis of matter - Basis of preparation

In forming our opinion on the country-by-country information, which is not modified, we draw attention to the schedule, which describes the basis of preparation. The country-by-country information is prepared for the directors for the purpose of complying with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013. The country-by-country information has therefore been prepared in accordance with a special purpose framework and, as a result, the country-by-country information may not be suitable for another purpose.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the country-by-country information is not appropriate; or
- the directors have not disclosed in the country-by-country information any identified material uncertainties that may cast significant doubt about the Society's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the country-by-country information is authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Society's ability to continue as a going concern.

Responsibilities for the country-by-country information and the audit

Responsibilities of the directors for the country-by-country information

The directors are responsible for the preparation of the country-by-country information in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013 as explained in the basis of preparation statement to the country-by-country information, and for determining that the basis of preparation and accounting policies are acceptable in the circumstances. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of country-by-country information that is free from material misstatement, whether due to fraud or error.

In preparing the country-by-country information, the directors are responsible for assessing the Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Society or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the country-by-country information

It is our responsibility to report on whether the country-by-country information has been properly prepared in accordance with the relevant requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

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

A further description of our responsibilities for the audit of the country-by-country information is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinion, has been prepared for and only for the Society's directors in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

The engagement partner responsible for this audit is Catrin Thomas.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Newcastle upon Tyne
25 February 2020

Customer testimonial

"It's some years since I moved my savings account to the Newcastle Building Society in Ponteland and I certainly appreciate the convenience of a local branch where the staff are always pleasant and helpful."

Gordon

Ponteland customer

Glossary

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears - A customer is in arrears when they are behind in their mortgage payments. A customer is 3 months in arrears when they have missed the equivalent of 3 mortgage payments.

Administrative expenses - Expenses incurred in running the day to day activities of the Society including staff, property, marketing and technology costs.

Basel II - The second of the Basel Accords, issued by the Basel Committee on Banking supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the PRA Handbook.

Basel III - The third of the Basel Accords, issued by the Basel Committee on Banking supervision, which are a long-term package of changes that will strengthen regulatory requirements for capital and liquidity.

Buy to Let (BTL) - A mortgage designed to support customers purchasing an investment property to let out.

Capital Requirements Directive (CRD IV) - The EU legislative package covering prudential rules for banks, building societies and investment firms. CRD IV is made up of the Capital Requirements Directive and Capital Requirements Regulations, it is designed to implement the Basel III Accord across the EU.

Commercial lending / mortgage - Loans secured on commercial property.

Common Equity Tier 1 capital - Defined by the PRA as general reserves or qualifying capital instruments which for the Society is the accumulation of retained profits.

Common Equity Tier 1 ratio - Common Equity Tier 1 capital as a percentage of risk weighted assets.

Contractual maturity - The final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal and interest is due to be paid.

Covered bonds - Debt securities backed by a portfolio of mortgages that is segregated from the issuer's other on-balance sheet assets solely for the benefit of the holders of the covered bonds.

Credit risk - The risk that a customer or counterparty is unable to honour their repayment obligations as they fall due.

Debt securities - Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding central banks.

Derivative financial instruments - A derivative financial instrument is a type of financial instrument (or an agreement between two parties) that has a value based on the underlying asset, index or reference rate it is linked to. The Group uses derivative financial instruments to hedge its exposures to interest rate risk.

Effective interest rate method (EIR) - The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period.

Fair value - Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial Conduct Authority (FCA) - FCA regulates the conduct of financial firms providing services to consumers and maintains the integrity of the UK's financial markets.

Financial Services Compensation Scheme (FSCS) - The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the PRA is obliged to pay an annual levy, which goes towards running costs and compensation payments.

Forbearance - A term generally applied to arrangements which are provided to support mortgage customers experiencing financial difficulties. An example of this would be a temporary reduction in mortgage payments.

Free capital - Represents gross capital less property, plant and equipment and investment property.

Funding limit - Measures the proportion of shares and borrowings not in the form of shares held by individuals.

Gilts - These are bonds issued by certain national governments. The Group only classifies debt securities issued by the Bank of England as Gilts.

Gross capital - The aggregate of general reserve, available-for-sale reserve, subscribed capital and subordinated liabilities.

Impaired loans - Loans where an event has occurred which indicates the Group does not expect to collect all the contractual cash flows due, or expects to collect them later than they are contractually due.

Individual Capital Guidance (ICG) - Guidance from the PRA on the minimum level of capital that must be held.

Individual Liquidity Guidance (ILG) - Guidance from the PRA on the minimum quantity of a firm's liquidity resources and the firm's funding profile.

Individually / collectively assessed - Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be incurred.

Interest rate risk - The risk that the value of the Society's net assets or net interest income falls as a result of a change in interest rates.

Internal Capital Adequacy Assessment Process (ICAAP) - The Group's own assessment of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios.

Internal Liquidity Adequacy Assessment Process (ILAAP) - The Group's internal assessment of the liquidity levels needed to meet its regulatory liquidity requirements.

Legacy mortgage portfolios - Mortgage loan books where the Group has ceased new lending and is winding down exposures.

Lending limit - Measures the proportion of business assets not in the form of loans fully secured on residential property.

Leverage ratio - A Basel III ratio which measures Tier 1 capital against total on and off balance sheet assets.

Liquid assets - The total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.

Liquidity Coverage Ratio (LCR) - A Basel III measure of the amount of highly-liquid assets against cash outflows over a 30 day period.

Liquidity risk - The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash inflows and outflows.

Loan-to-value ratio (LTV) - A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates UK residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis) to reflect changes in house prices.

Loans and advances to banks - Treasury investments purchased with banking institutions.

Management expenses - Management expenses represent administrative expense and depreciation. The management expense ratio is management expenses expressed as a percentage of mean total assets.

Market risk - The risk that movements in market risk factors, including re-pricing of assets and liabilities and the imperfect matching of interest rates between different asset and liability types, may adversely impact the Society.

Mean total assets - Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.

Member - A person who has a qualifying share investment or a mortgage loan with the Society.

Net interest income - The difference between interest received on assets and interest paid on liabilities.

Non-Executive Director - A Member of the Society's Board who does not form part of the executive management team. He or she is not an employee of the Society.

Operational risk - The risk of loss arising from inadequate or failed internal processes, people and systems or from external events.

Other lending - Loans and advances secured on traded endowment policies.

Past due - Loans on which payments are overdue including those on which partial payments are being made.

Permanent Interest Bearing Shares (PIBS) - Unsecured, deferred shares that are a form of capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing Members of Newcastle Building Society.

Prime - Prime mortgages are those granted to the most credit worthy category of residential borrowers.

Prudential Regulation Authority (PRA) - Part of the Bank of England and responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms

Renegotiated loans - Loans are classed as renegotiated with the customer's consent, when their terms have changed during the year. Loans and advances are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower.

Repo - Short to medium-term funding agreements which allow a borrower to sell a financial asset, such as Government bonds, as security for cash. As part of the agreement the borrower agrees to repurchase the security at a later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future), it is a reverse repurchase agreement or reverse repo.

Residential mortgage backed securities (RMBS) - Asset backed securities that represent interests in residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).

Residential loans - Residential loans are secured against residential property.

Risk appetite - The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's Members whilst achieving business objectives.

Risk-weighted assets (RWA) - The value of assets, after adjustment under Basel II rules, to reflect the degree of risk they represent. The Society measures RWA using the standardised approach.

Shares - Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.

Shares and borrowings - The total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest.

Solutions - A subsidiary of the Society that offers business to business services through people, process and innovative application of technology. Services include complete systems for smaller societies and white-labelled savings management for a range of banks and building societies.

Solvency ratio - The ratio of total capital to total risk weighted assets.

Subordinated debt / liabilities - A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing Members (other than holders of PIBS).

Tier 1 capital - Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital comprises general reserves from retained profits. Other regulatory adjustments may be made for the purposes of capital adequacy. Under the grandfathering rules of Basel III qualifying capital instruments such as PIBS can be included in other Tier 1 capital (i.e. not Common Equity Tier 1) transferring to Tier 2 over the grandfathering period.

Tier 2 capital - Comprises the Group's qualifying subordinated debt and collective impairment allowance (for exposures treated on a Basel II standardised basis).

Wholesale funding - The total of deposits from banks, amounts owed to other customers and debt securities in issue.

Branch and Financial Advice Centre Directory

Alnwick - 28 Bondgate Within, NE66 1TD	**Tel: (01665) 603 344**
Ashington - 10 Station Road, NE63 9UJ	**Tel: (01670) 815 919**
Barnard Castle - 25 Market Place, DL12 8NE	**Tel: (01833) 600 100**
Berwick Upon Tweed - 12 Hide Hill, TD15 1AB	**Tel: (01289) 306 417**
Bishop Auckland - 15 Newgate Street, DL14 7HG	**Tel: (01388) 433 001**
Carlisle - 65 English Street, CA3 8JU	**Tel: (01228) 524 518**
Chester-Le-Street - 42 Front Street, DH3 3BG	**Tel: (0191) 388 5266**
Consett - 19/21 Middle Street, DH8 5QP	**Tel: (01207) 502 636**
Cramlington - 34/35 Craster Court, NE23 6UT	**Tel: (01670) 735 813**
Darlington - 7/8 Horsemarket, DL1 5PW	**Tel: (01325) 383 656**
Durham - 73/75 Saddler Street, DH1 3NP	**Tel: (0191) 384 3182**
Gateshead - 12 Ellison Walk, Trinity Square, NE8 1BF	**Tel: (0191) 477 2547**
Gosforth - 105/107 High Street, NE3 1HA	**Tel: (0191) 285 5965**
Hawes - Hawes Community Office, Market Place, DL8 3RA	**Tel: (01969) 600 333**
Hartlepool - 133/135 York Road, TS26 9DR	**Tel: (01429) 233 014**
Hexham - 1-2 Beaumont Street, NE46 3LZ	**Tel: (01434) 605 106**
Middlesbrough - 38 Linthorpe Road, TS1 1RD	**Tel: (01642) 243 617**
Morpeth - 14 Market Place, NE61 1HG	**Tel: (01670) 514 702**
Newcastle - 136 Northumberland Street, NE1 7DQ	**Tel: (0191) 261 4940**
Newcastle - Portland House, New Bridge Street, NE1 8AL	**Tel: (0191) 232 0505**
North Shields - 76 Bedford Street, NE29 0LD	**Tel: (0191) 259 5286**
Penrith - 12 Market Square, CA11 7BX	**Tel: (01768) 862 888**
Ponteland - 23 Broadway, Darras Hall, NE20 9PW	**Tel: (01661) 821 828**
South Shields - Unit 3-5 Denmark Centre, NE33 2LR	**Tel: (0191) 454 0407**
Stokesley - 36 High Street, TS9 5DQ	**Tel: (01642) 711 742**
Sunderland - 14 Waterloo Place, SR1 3HT	**Tel: (0191) 565 0464**
West Denton - 22 Denton Park Centre, NE5 2RA	**Tel: (0191) 267 5038**
Whickham - 28 Front Street, NE16 4DT	**Tel: (0191) 488 1766**
Whitley Bay - 303 Whitley Road, NE26 2HU	**Tel: (0191) 252 0642**
Wooler - The Cheviot Centre, NE71 6BL	**Tel: (01668) 260 360**
Yarm Library - 41 The High Street, TS15 9BH	**Tel: (01642) 785 985**