Newcastle Building Society

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Connecting communities in the North East with a better Financial Future.

Newcastle Building Society
Annual Report & Accounts 2018

Cover photo: Spanish City, part of the rejuvenation of Whitley Bay in North Tyneside; one of many great locations in the North East region.

Newcastle Building Society

Contents

3	2018 Performance Highlights
4	Chairman's Statement
6	Chief Executive's Review
10	Strategic Report
16	Community Support
18	Our Directors
20	Directors' Report
21	Statement of Directors' Responsibilities
22	Report of the Directors on Corporate Governance
27	Audit Committee Report
30	Remuneration Committee Report
35	Risk Management Report
39	Independent Auditors' Report
44	Income Statements
45	Statements of Comprehensive Income
46	Balance Sheets
48	Statements of Movements in Members' Interests
49	Cash Flow Statements
50	Notes to the Accounts
96	IFRS 9 Transitional Disclosures
100	Annual Business Statement
102	Country-by-Country Reporting
103	Auditors' Report
104	Glossary
106	Branch and Financial Advice Centre Directory

2018 Performance Highlights

£183m invested by new savers

14,518 new savers across the UK

98% overall customer satisfaction

Gross residential lending £520m

285 self-build mortgages

1,169 first-time buyers

1,102 employees

63 charities awarded community fund grants totalling £178,902

4,590 volunteering hours donated by colleagues

24 industry awards

£13.3m profit before tax

Common Equity Tier 1 Capital 15.7%

Chairman's Statement

2018 has seen good progress for the Society. We have focused on our Purpose - Connecting Communities in the North East with a Better Financial Future – which has driven performance, shaped change and challenged us to be even better for the benefit of our members, customers and our communities.

Phil Moorhouse, Chairman

Brexit uncertainty has undoubtedly had an impact on housing market confidence, with an increasing number of potential home buyers citing concerns about future falls in house prices as a barrier to purchase. A no less influential issue continuing to affect the market remains that of affordability. In some regions property prices present considerable challenges to getting onto the housing ladder and as such owning a home remains out of reach for some.

Mortgage market growth remains weak, although home re-mortgaging continues to be an area of growth.

Households have benefited from relatively strong wage growth but consumer spending is weaker and households have been borrowing less. Savers may take some comfort from the fact that fixed savings rates have been generally rising since the start of the year, although they remain relatively low. Bank base rates continue at historically low levels.

Looking forward, the rate of inflation is predicted to remain low and forecasts for growth in the UK economy remain modest, but positive.

Despite the headwinds of Brexit, increasing competition in the mortgage market, and ongoing regulatory developments, a wholehearted commitment across our Society to delivering our Purpose has driven another year of robust growth and strong performance, alongside an increase in our membership.

There are a few areas I would like to highlight of which I am particularly proud.

Our commitment to our customers

Our multi-million pound branch improvement and refurbishment programme, which is well underway, reaffirms our commitment to being on your high street and continuing to offer a convenient, friendly face-to-face branch service.

This year we aim to complete the transformation to a network of modern, digitally enabled, people first branches we can be proud of that sit right at the heart of our communities.

Our commitment to remaining on the high street against a backdrop of continuing announcements of branch closures by banks and other financial institutions has prompted many new customers in towns and cities across the North East to join us.

Building lasting authentic relationships through our branch network is supported by our subsidiary, Newcastle Financial Advisers Limited, which has been providing accessible financial advice on the high street for the past 16 years. This service is valued highly by customers across the North East, with our in-branch Pension Clinics also proving very popular.

Meeting up with our Members is a pleasure and 2018 saw numerous opportunities to spend time and enjoy some valuable conversations. Our pre Annual General Meeting Member Events took place at Alnwick Castle in Northumberland and Preston Park in Stockton, followed by our Annual General Meeting at St James Park in Newcastle. Every year, a growing number of Members are taking the time to come along to meet and hear about the Society's progress.

It is incredibly heartening to know that you are personally invested in your Society and in what we are trying to achieve, with, and for communities across the North East.

Our financial performance is inextricably linked with our strategic Purpose and in 2018 we delivered our highest growth in income in recent years, with increasing operating profits year on year, strong capital ratios and liquidity. Further details are set out in the Chief Executive's Review.

Our aim is to maintain a strong balance sheet and sustainable future for the Society, which in turn contributes to and enables our ambitions to create a regional building society that delivers significant benefits across the North East.

Subsidiary company growth and success

Our award winning subsidiary, Newcastle Strategic Solutions Limited, which provides fully integrated savings technology and services platforms for a range of UK financial institutions, challenger banks and global household brand names, retained its market leading position, despite an increasingly competitive marketplace. Alongside our technology solutions subsidiary, Newcastle Systems Management Limited, it is creating numerous job opportunities and is already a significant employer in the region. We continue to invest in systems and processes to meet threats to data and IT services.

Our communities

Helping our communities make positive changes is a core pillar of our Purpose.

In 2018 our colleagues were out and about as part of our volunteering programme, sharing their skills, making connections and supporting others in a range of situations. From food banks to farms for children and families living with autism – it is really uplifting to see the difference our colleagues have been making across the North East.

Volunteering is just one feature of our community engagement. Our commitment to the High Street, the support offered to local charities by the Newcastle Building Society Community Fund at the Community Foundation, our ongoing partnership with Dementia Friends and The Prince's Trust and our financial education programme all help in making a positive difference to communities here in the region.

Our board

During 2018 we continued to strengthen our Board, with the arrival of David Samper who took up the reins as our Chief Financial Officer in December from Sainsbury's Bank, with responsibility for our Finance, Treasury and Legal departments. We also welcomed Mick Thompson in January 2019 who joined us as a Non-Executive Director and member of our Audit Committee having been a Senior Partner at KPMG for nine years. Details on David and Mick are included in the 'Our Directors' page of this report. Finally, Adam Bennett will be joining the Board following this year's Annual General Meeting and will be a member of the Group Risk Committee.

Richard Bottomley left the Board after four years' service as Chairman of the Audit Committee. David Buffham, the Society's Deputy Chairman and Senior Independent Director, will be standing down in the first half of 2019 after nine years' service. We would like to thank both for their contributions over the years, and to wish them all the best.

We were pleased to welcome Stuart Lynn as a Non-Executive Director of our subsidiaries Newcastle Systems Management Limited and Newcastle Strategic Solutions Limited. Stuart brings a wealth of experience as a business leader in technology, from his time in the National Health Service and The Sage Group PLC.

Summary

As the North East's largest building society we are committed to delivering our Purpose for the benefit of our region.

I am confident that with our strong Purpose and strategy we will continue to meet the challenges of 2019 and beyond, and will further realise the potential of a dynamic, regionally focused building society such as ours.

I would like to say a big thank you to our colleagues and to our customers who continue to support us in this ambition.

Phil Moorhouse
Chairman
26 February 2019

Chief Executive's Review

I am very pleased to report that 2018 was a year of continued positive progress for the Society, with growth in residential lending, more new savers resulting in an increase in Members and increased levels of financial advice business.

Andrew Haigh, Chief Executive

This progress is underpinned with a robust financial performance, including increased operating profit, strong capital and liquidity ratios and very low levels of arrears.

At the heart of Newcastle Building Society lies our Purpose, which states that we 'connect communities in the North East with a better financial future' and leads us to put our customers and the communities we serve foremost in our plans and ambitions for the future.

In what proved to be a very busy and productive year for the Society, we achieved a number of positive outcomes in delivering our Purpose and making a genuine difference for the communities we serve. Just some of the highlights from the year include:

- The launch of our new branch concept for Durham, Gosforth and Carlisle branches as part of our multi-million pound branch refurbishment programme;
- Our continued support for the Newcastle Building Society Community Fund at the Community Foundation, which has enabled the launch of Building Improvement Grants, designed to help maintain and improve community buildings in the region, with the first £50,000 grant awarded to Springfield Community Association;
- The Newcastle Building Society Community Fund was also pleased to announce a four-year partnership, committing donations of more than £100,000 to The Prince's Trust, supporting programmes which seek to invest in young talent and improve employability in the region. The Prince's Trust also provides significant leadership development opportunities for colleagues across the Society;
- Our ongoing commitment to Dementia Friends, which has to date involved over 1,500 colleagues, customers and staff from the local high street in receiving awareness training from the Society's Dementia Friend champion; and
- By no means least welcoming new colleagues to the Society in particular those who have joined us as part of our early talent community.

Building authentic and lasting customer relationships

We were pleased to see our customer satisfaction score improve from 96% to 98% in 2018.

Helping people own their homes is a key pillar of our Purpose and is at the heart of our building society. Our gross lending for 2018 exceeded £520m, slightly reduced from £535m in 2017, in a fiercely competitive market. Our prime net lending was over £160m leading to an overall increase in our residential mortgage book. Despite the broader UK economic challenges, we supported over 1,100 first time buyers in their quest to own their own home.

Our Self Employed mortgage volumes have doubled and we have also introduced 'Help to Buy' and 'Buy to Let' mortgages for this growing self-employed market reflecting the continuing change in employment trends.

Once again it was great to be recognised in a number of industry awards. For the second year in a row we have been awarded 'What Mortgage's' Best Regional Building Society. We were also named Best Self Build Lender by 'Build IT' and we were also recognised by the Legal and General Mortgage Club Awards as best smaller lender for 2018. When combined with service quality awards received by clients of our Newcastle Strategic Solutions Limited subsidiary, we were involved in winning 24 industry awards in 2018.

As well as helping customers own their home, we also believe that it is important that we encourage people to save and help them plan their finances.

Despite the backdrop of extensive bank branch closures across our region, our commitment to being present in the towns and cities across the North East remains firm.

We recognise the power of communities and the role of the high street as a focus for community life. That is why we are improving the branch experience we provide to our customers, as part of a wider investment programme, delivering modern, bright and open spaces, with private meeting areas, friendly and knowledgeable colleagues, and a financial adviser in every branch.

Our latest new branch format was launched in 2018 in Durham, Gosforth and Carlisle and we continue with our programme to update all of our branch network by the end of 2019.

Our savings accounts offer some of the best buy savings rates on the high street and during 2018 we were featured in national press best buy tables.

We added to our savings portfolio a new regular saver product and a one or two year fixed rate bond. We also increased the rate on the current issue of The Newcastle Community Saver easy access account.

In the second half of the year we introduced our Newcastle Cash Lifetime ISA, which enables customers to save for a deposit for their first home or for their retirement, attracting a 25% UK Government bonus on amounts saved each tax year.

Our growing range of savings accounts has been well received and I am delighted that as a result, 2018 saw an increase in the number of Members of the Society. We have offered our new Members a warm welcome to Newcastle Building Society, committing that we will remain on the high street now and in the future.

Our financial advice subsidiary, Newcastle Financial Advisers Limited, gives customers financial advice regardless of how much they have to invest. Newcastle Financial Advisers Limited has a significant and growing level of funds under management for people in the region.

Our Pension Clinics were very successful, offering free 30 minute chats with a financial adviser to help people get answers to their pension questions and see what they may need to do next.

Newcastle Financial Advisers Limited increased income and profits in 2018 and scores highly for customer satisfaction.

Helping our colleagues realise their potential

Our colleagues are the driving force of our Society and in return we aim to be a great place for them to work, where they can realise their potential. It is also important to us as a significant employer, that where appropriate, we continue to grow the employment opportunities we offer across the region, so we were pleased to add 68 new jobs in 2018.

Our Human Resources team are central to how we work to develop the region's talent and potential and it was great to see their work recognised by the North East HR&D CIPD Awards in June when they won the award for Excellence in Resourcing & Talent Management.

We have made a significant investment in our new leadership programmes for senior managers, and continue to build our early talent programme as we build our contribution to nurturing regional talent which can come from all walks of life and irrespective of background and personal circumstances.

Our early talent programme has been running for a number of years for graduate recruitment and undergraduate placement, but has been further developed to include apprenticeships. Our growing apprenticeship opportunities are across a range of business areas, with all apprenticeships attracting a Living Wage salary (paying above the Government recommended wage), a structured learning programme with both a nationally recognised qualification and a career at the end. Our partnership with The Prince's Trust also plays a key role in our developing talent and supporting employability in the region.

An important part of our customer offering is the provision of face-to-face financial advice. We understand that this service is highly valued by our customers and we are one of the few financial services companies still offering financial advice on the high street.

Fundamental to this is our financial adviser colleagues and our commitment to growing the financial adviser talent of the future. Our bespoke training programme between Openwork and Newcastle Financial Advisers Limited provides opportunities for growth and development and colleague applications are invited from across the business. The programme leads to a professional status and a role as a qualified financial adviser. We are delighted that two more graduates from the programme have recently taken up full time financial adviser positions in the branch network after completing their professional training.

In 2018 we improved employer pension contributions for more than half our colleagues to help them build a bigger pension pot, and following a review of pay and grading, more than a third of our colleagues have enjoyed a salary uplift over and above the cost of living increase also provided. We are proud to be a Real Living Wage employer, which goes further than the Government's national minimum wage.

Connecting with our communities

Our branches continue to play a key role in their local communities. Where possible, we are introducing community spaces into our refurbished branches which are available to community groups and have already been used in a host of different ways. We have also tried to be sympathetic to local tradition when we have restored older buildings – for example the restoration work on the iconic Durham Teapot that sits above our Durham branch, undertaken by the City of Durham Trust and the stained glass windows and chandeliers in our new location in Carlisle have both preserved features which are valued by local residents. We consider it a privilege to support those in our towns and cities who are actively working to improve the potential, history and culture of our region.

We donated £797,000 or 6% of our pre-tax profits to charity during 2018. We have continued to build the Newcastle Building Society Community Fund at the Community Foundation, through donations made by the Society in proportion to balances held in our Community Saver accounts and our colleague fundraising activities.

Chief Executive's **Review** Continued

The Community Fund is building a legacy for future Members, with increasing capacity to make grants which support local charities and community groups. Our grant programme is expanding year on year and now includes larger grants of up to £50,000 to support community building improvements. In addition, a total of £179,000 was awarded in 63 smaller grants during 2018.

We have a long-standing relationship with the Sir Bobby Robson Foundation. The Newcastle Building Society Community Fund at the Community Foundation is continuing that relationship with an ongoing and significant level of funding support for at least the next five years. The combined contributions of the Society and The Newcastle Building Society Community Fund have just passed the £2.8m mark in cumulative donations to this worthy cause, which funds leading cancer research, diagnosis and treatment for people across our region.

There are around 35,000 people living with dementia in the North East, a statistic that is expected to increase. We have committed to ensuring that every colleague will become a Dementia Friend and have also been offering Dementia Friends sessions to customers in our branches, and extended an open invitation for others on the high street to join us. I am proud that we have over 1,500 Dementia Friends who received training and learnt about improving the lives of those living with dementia in our region.

Our colleagues have continued to embrace our volunteering programme in 2018, more than doubling their volunteering contribution this year with 55% of colleagues volunteering. They have spent over 4,750 hours in the community supporting 137 groups and local charities.

Helping our clients and partners succeed

Newcastle Strategic Solutions Limited and Newcastle Systems Management Limited, two of the Society's subsidiaries received ISO 27001 Certification for their Information Security Management System. Meeting this international standard benchmark evidences our ongoing investment in having the right controls to respond to the threats to data and IT service provision. We were also pleased to renew our Cyber Essentials Plus accreditation during the year.

Newcastle Strategic Solutions continues to be the UK's leading provider of outsourced savings management services and were delighted to see strong growth in scale of savings balances under administration throughout 2018 and a number of clients win industry awards for the quality of service provided to their customers.

Financial performance

It is only possible for the Society to thrive and continue to serve the region if our underlying business model is sustainable in the long term and our financial performance is robust. Profitability is one of the key financial performance measures.

Profit before tax improved to £13.3m for the year ended 31 December 2018 compared to £13.1m for 2017. Our 2017 profit before tax was positively impacted by a one-off credit of over £2m relating to the purchase of our Cobalt office and it is pleasing to report that in 2018 we saw that one-off credit replaced by an overall improvement in Operating Profit before provisions and exceptional items, which increased by £2.6m to £14.7m.

Overall growth in income of £6.6m, was offset by an increase in costs of £3.9m associated with the significant ongoing investment into the business, including our branch refurbishment programme and pay and grading project. The cost to income ratio improved from 79% to 77%. Net interest margin improved from 0.79% to 0.92% reflecting increased income.

Mortgage impairment charges have increased, from £0.2m to £1.5m, the majority of which reflects a small number of legacy non-performing commercial loans.

Provisions for liabilities and charges decreased by £1.1m from £1.0 debit to £0.1m credit. The credit relates to the reduction in the provisions required for the Financial Services Compensation Scheme levy and consumer redress.

The Group's capital ratios remain robust with Common Equity Tier 1 ratio improving from 15.3% to 15.7% and Tier 1 capital ratio reducing slightly from 16.6% to 16.3%. The Group's overall capital ratio (Solvency ratio) also reduced to 17.7% compared to 18.9% at the end of 2017. Both reductions were as a result of a planned repayment of one of the Group's Permanent Interest Bearing Shares during 2018. The leverage ratio (on a transitional basis) was 5.4%.

Despite the weak growth in the mortgage market during 2018 and strong competition, as noted above, our gross residential mortgage lending was £520m and net residential lending was £160m. The percentage of mortgage loans in arrears of 3 months or more, across our whole mortgage portfolio based on the number of loans, reduced again from 0.34% to 0.30%; lower than the industry average. Possession cases also continued at very low levels reflecting the excellent credit quality of the Society's residential lending.

The Group's liquidity, excluding encumbered assets, ended the year as 14.6%, compared to 17.0% in 2017. This had been actively managed down over the second half of the year to improve efficiency but remains well within in our planned operating guidelines and above our minimum operating requirements.

The Society's liquidity coverage ratio was 179% against a regulatory minimum required level of 100%. This significant headroom reflects the quality of the Society's liquidity with the majority of it invested in AAA/AA rated assets, in the UK.

Summary

2018 has been a significant year of change and progress for Newcastle Building Society. We have seen our highest growth in income compared to recent years with increasing profitability year on year and our Member base has started to grow again. We have seen good levels of lending and are particular pleased to be able to support new homeowners in taking their first steps onto the property ladder.

Our connection to our communities is even more evident and embedded in the day to day operations of the Society. Our contributions to the Newcastle Building Society Community Fund at the Community Foundation are both enabling a positive impact to be made immediately through community grants and building a legacy for future generations as the fund continues to grow. Finally, our Newcastle Strategic Solutions Limited and Newcastle Systems Management Limited subsidiaries continue to offer market leading services and make a positive contribution to our financial performance.

Whilst economic uncertainties continue from Brexit and other global issues, we passionately believe in our Purpose of

"Connecting Communities in the North East with a better Financial Future."

and continue to invest in our business, colleagues and communities to build a strong regional brand that is recognised for making a genuine difference for the communities we serve.

We have no doubt that the year ahead will bring many unique challenges but we believe we are well placed to address them and continue in our long-term aspiration to live out our Purpose and make a genuine, positive contribution in supporting our Members by helping them save, plan their finances and own their home, and in our support for their communities across the region.

Andrew Haigh
Chief Executive
26 February 2019

Strategic Report

The Directors present their Strategic Report on the Group for the year ended 31 December 2018.

Purpose and Strategy

Newcastle Building Society is the largest building society based in the North East of England with assets of c£3.7 billion.

2018 has been a year of very good progress with the Society continuing to follow a strategy which has seen improvement in areas of our services and financial strength. We are reporting increased profits, strong capital ratios, a robust liquidity position and low levels of arrears.

The Society's purpose is "Connecting Communities in the North East with a better Financial Future." We set out our Purpose at the start of 2017 and this has continued to influence and direct our actions throughout 2018.

At the heart of our Purpose lies our understanding of what it means to be "The North East's Building Society". Five pillars underpin the purpose, with these pillars further supported by the Society values and behaviours.

Our Purpose

Connecting Communities in the North East with a better **Financial Future.**

What do we mean by "Connecting"?

We recognise that connecting with customers in a meaningful way is the foundation of building a lasting and authentic relationship with them; whether it is through face- to-face advice or contact in a branch; digital content on the website or social media; or through a seminar or customer event.

What do we mean by "Communities"?

A mutual is a community of members coming together to achieve a common goal and we recognise just how powerful that sense of common purpose can be. Our communities include; physical and digital communities around the branch; digital communities facing a shared problem or goal; communities represented in generations of families; colleague communities; and charities we have helped or worked with.

What do we mean by "North East"?

Although we operate across the UK supported by broker, digital and telephone channels, it is in the North East that we aim to make a real difference and build a truly differentiated brand presence. This is where we go beyond the product experience, in our role as employer and supporter of communities, and providing a face to face friendly welcome in our branches where we can build relationships over generations.

The five pillars of our Purpose

- 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 Behaviours

- Focusing on customers
- Engaging others
- Seeing the bigger picture
- Driving performance
- Developing effective teams
- Innovating and improving

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.

Newcastle Strategic Solutions Limited, our savings management outsourcing subsidiary, is a business to business supplier which plays a key role in the Society's financial model. The Solutions business provides multi-channel savings management services for banks, building societies and other financial institutions.

Newcastle Systems Management Limited, our IT subsidiary, serves all elements of the Group and also extends those services to business to business clients. In both cases we continue to develop the quality and efficiency of our capability – underpinning the Group with excellent IT services and securing our market position as the leading provider of outsourced savings management services. Both subsidiaries operate on a commercial basis, to make a profit, and the profits from these businesses generate capital enabling the Society to invest in the services it provides and grow our lending.

Financial Performance

The Chief Executive's review details the Society's performance and success throughout 2018 and should be read in conjunction with this report. The Strategic Report outlines the financial performance of the Society over 2018.

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

Customers	2018	2017
Customer satisfaction	98%	96%
Colleagues		
Colleague turnover	11.3%	11.4%
Financial - Profitability		
Operating Profit	£14.7m	£12.1m
Net interest margin	0.92%	0.79%
Cost to income ratio	77%	79%
Financial - Balance Sheet		
Common Equity Tier 1 ratio	15.7%	15.3%
Leverage ratio	5.4%	5.2%
Liquidity coverage ratio	179%	180%
Gross lending	£520m	£535m

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 a overall satisfaction score of 98% in 2018, an increase on the score for last year, which was 96%. 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) within the Society's financial advice subsidiary, Newcastle Financial Advisers Limited (NFAL), was a fantastic 71 (52 in 2017), a testament to the quality and value our financial advice team are delivering to our customers.

In 2019 we are introducing a new voice of the customer programme which will provide daily, real-time feedback from our customers helping us to continue to develop and improve the experience we deliver.

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 staff 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. The valued views of colleagues are regularly gathered through engagement surveys, focus groups and interactive corporate updates delivered by the Chief Executive and senior management team.

The Society listens very carefully to this feedback, which is used to shape aspects of how we improve as an employer. The Society is also committed to promoting a common understanding of the more specific drivers of its financial performance. Bi-annual update sessions, typically coinciding with the Society's half-year and year-end results, are delivered by senior management to explain the Society's position and direction with emphasis given to key financial and economic influences.

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 on page 16 and 17.

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 2018 Corporate Bonus Scheme will pay all eligible colleagues an amount based on their annual assessment rating, for 2018.

Strategic Report (continued)

The majority of staff received a 4% bonus with a small portion (13%) receiving an enhanced bonus payment, 3% 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 and in 2018 a pay award of 2.5% was given.

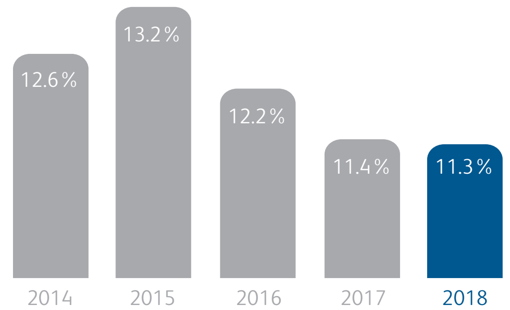
The Society operates an Equal Opportunities Policy. It is the intention of the Society that no applicant or employee receives less favourable treatment on the grounds of disability, sex, transgender status, sexual orientation, marital status, civil partnership status, race, ethnic origin, colour, age, 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 2018 are as follows:

	Female		Male	
	2018	**2017**	**2018**	**2017**
Directors	19%	23%	81%	77%
Senior Managers	40%	33%	60%	67%
Managers	40%	40%	60%	60%
Employees	68%	67%	32%	33%
Overall	**61%**	**60%**	**39%**	**40%**

Colleague turnover is as an important reflection of the success of our colleague agenda. The Group colleague turnover rate improved slightly to 11.3% in 2018 from 11.4% in 2017.

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. During 2018 the Society introduced mental health first aiders and health and wellbeing advocates across the Society as part of a new initiative emphasising 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.

Group Income Statement	**2018 £m**	**2017 £m**
Net interest income	34.2	29.1
Other income and charges	30.3	28.8
Total operating income	**64.5**	**57.9**
Administrative Expenses	(46.9)	(43.0)
Depreciation	(2.9)	(2.8)
Operating profit before impairments, provisions and exceptional items	**14.7**	**12.1**
Impairment charges	(1.5)	(0.2)
Provision for liabilities and charges	0.1	(1.0)
Exceptional gain on purchase of Cobalt Offices	-	2.2
Profit for the year before taxation	**13.3**	**13.1**

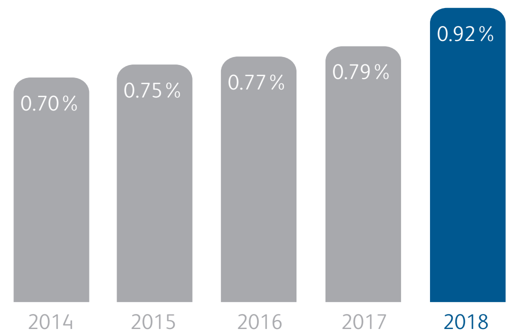
Profit for the year before taxation increased slightly to £13.3m in 2018 from £13.1m in 2017. Excluding the one-off credit in the prior year, profit before tax increased by £2.4m (22%) during 2018. Operating profit before impairments, provisions and exceptional items improved by 21% to £14.7m in 2018 (2017: £12.1m). Total operating income was up by 11%, whilst due to the ongoing investment into the business costs also increased by 9%. Operating profit before impairments, provisions and exceptional items 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 2018 was £5.3m (2017: £5.5m).

Net Interest Margin

Net interest income increased by £5.1m to £34.2m reflecting increased mortgage lending and the impact of rises in LIBOR coupled with the ongoing benefit of reduced funding costs from participation in the Bank of England's Term Funding Scheme. Our net interest margin improved to 0.92% (2017: 0.79%).

Net Interest Margin



Net interest margin is a relative measure of the Group's net interest income (as disclosed in the Income Statements on page 44) – 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 £1.5m to £30.3m in 2018 from £28.8m in 2017. Income from Newcastle Strategic Solutions Limited, our Savings Management outsourcing business continues to grow as balances under management rise. Income from Newcastle Financial Advisers Limited (NFAL), our financial advice subsidiary was up £0.3m compared to the period ended 2017. The divisional performance of the Member and Solutions businesses are shown in Note 9.

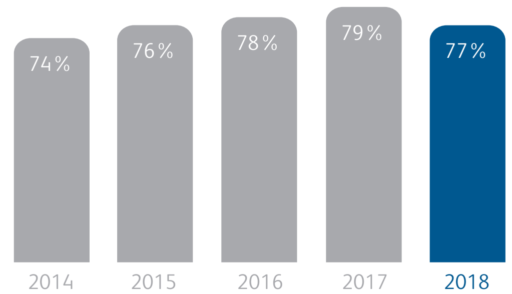
Administrative Expenses and Depreciation

Administrative expenses increased by 9.1% or £3.9m from £43.0m to £46.9m in 2018, with depreciation expense increasing from £2.8m to £2.9m. Overall management expenses (the sum of administrative expenditure and depreciation) increased to £49.8m from £45.8m reflecting significant levels of investment in colleagues and the branch network during the year.

The increase in overall management expenses reflects the investment in our colleagues through our pay and grading project, which has seen the Society increase pension provision and benchmark the level of salary it offers. We have also created new posts which are supporting the Society's growth. We continued our long term capital investment in our branch network and information technology. Our branch refurbishment program will continue until early 2019. Information technology is a cornerstone of any business and investment ensures our technology platform is at a leading level to provide security of data and enhanced resilience.

The Board considers the cost to income ratio to be an important measure of financial progress against internal targets and the return achieved on investment in the business. The cost to income ratio improved by 2% from 79% in 2017 to 77% in 2018. 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 on page 44) divided by total operating income, as similarly presented. Management assess the ratio as a measure of operating efficiency.

Cost to Income Ratio



Impairment charges

The impairment charge for loans and advances to customers has increased to £1.5m in 2018 from £0.2m in 2017. The majority of which reflects a small number of legacy non-performing commercial loans. The Society has been successful in its strategy of winding down the commercial portfolio and reducing risk with the commercial balances, net of impairment provisions amounting to less than £30m representing 1.1% 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 26. The 2018 credit of £0.1m recognised in the Income Statement compares to a charge of £1.0m for the prior year, a decrease of £1.1m.

Taxation

The Group shows an effective corporation tax rate of 19% in 2018. During 2018, new provisions of the Finance Act came into force that limit the annual amount of tax relief that financial institutions can claim through the offset of taxable losses from previous years against current year profits. The tax charge therefore reflects both tax payable against 2018's profitable operations and the reduction in the deferred tax asset carried on the balance sheet as taxable losses from previous years are used to extinguish the eligible part of the current year corporation tax charge. In addition there was a net £0.1m 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	**2018 £m**	**2017 £m**
Assets		
Liquid assets	692.4	789.8
Derivative financial instruments	3.5	4.9
Loans and advances to customers	2,772.2	2,707.3
Fair value adjustments for hedged risk	175.9	206.2
Property, plant and equipment	38.8	38.8
Other assets	15.0	15.1
Total Assets	**3,697.8**	**3,762.1**
Liabilities		
Shares	2,713.7	2,788.5
Fair value adjustments for hedged risk	0.4	1.6
Deposits and debt securities	552.4	504.6
Derivative financial instruments	178.3	210.2
Other liabilities	12.9	15.4
Subordinated liabilities	25.0	25.0
Subscribed capital	20.0	30.0
Reserves	195.1	186.8
Total Liabilities	**3,697.8**	**3,762.1**

Strategic Report (continued)

Liquid Assets

The Society has continued to maintain a level of high quality liquid assets throughout 2018. 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	2018 %	2017 %
Cash in hand and balances with the Bank of England	31.1	32.3
Gilts	14.5	15.0
Residential mortgage backed securities	28.4	27.9
Covered bonds	23.9	24.5
Other	2.1	0.3
	100.0	**100.0**

As mentioned above 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. As planned the Society managed liquidity to lower levels over the year.

The statutory liquidity percentage (liquid assets as a percentage of Shares, Deposits and Liabilities) reported at 31 December 2018 was 21.2% compared to 23.9% in 2017.

Excluding encumbered collateral balances liquidity was 14.6% compared to 17.0% 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 2018 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 2018. Loans and advances to customers increased by £66m overall in 2018 as shown in the table below.

Loan Portfolios	2018 £m	2017 £m
Prime Residential	2,045	1,933
Retail BTL <£1m	201	153
Specialist Residential	48	58
Housing Associations	425	498
Commercial	39	47
Other	26	29
	2,784	2,718
Provisions	(12)	(11)
	2,772	**2,707**
	2018 %	**2017 %**
Average LTV %	62.0	59.3

The £66m increase in gross mortgage balances before provisions includes a £94m managed reduction in legacy books and a £160m increase in our core residential lending including £48m of net lending on buy to let properties to individuals. 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 32.

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	
	2018 %	2017 %	**2018 %**	2017 %
Residential	0.29	0.33	0.44	0.24
Other	1.36	1.12	0.69	0.45
Total	**0.30**	**0.34**	**0.36**	**0.19**

The overall level of mortgage arrears is below UK Finance reported averages. Overall by number of loans arrears are down by 4bp to 0.30%, however by balance we have seen an increase of 17bp to 0.36%. 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 Retail Credit Committee with the levels of concessions granted not considered to be material for the size of the overall book.

The Society grants forbearance to commercial borrowers on a case by case basis however the size of the remaining book and low levels of arrears mean little forbearance was granted in 2018. Note 32 contains further details of commercial forbearance cases.

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 2018 the Society had 1 possession property in relation to owner occupied loans, 2 buy to let possession properties and there was 1 exposure being managed by a Law of Property Act receiver.

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 decreased by £75m during 2018 to £2.7bn. Wholesale funding, including drawdown on Bank of England Funding Schemes, increased during the year by £50m. This increase in wholesale balances has resulted in the percentage of wholesale balances to total share and deposit liabilities increasing from 15.4% in 2017 to 16.91% in 2018. The Group's mortgage loans remain wholly funded by retail savings balances.

Capital

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

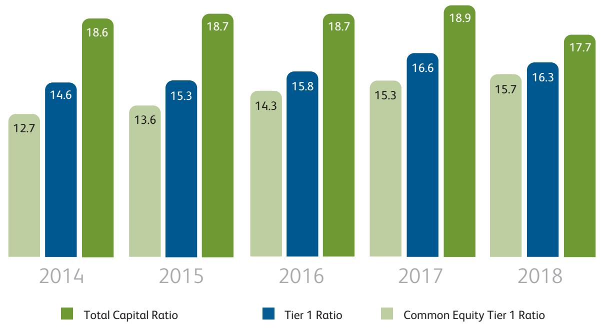
Capital	2018 £m	2017 £m
Tier 1 Capital		
Common Equity Tier 1 Capital	191.8	182.5
Additional Tier 1	8.0	15.0
	199.8	197.5
Tier 2 Capital		
Tier 2 Capital	16.6	24.5
Collective Impairment Allowance	0.6	3.2
	17.2	27.7
Total Capital	217.0	225.2
Risk Weighted Assets		
Liquid Assets	46.1	45.5
Loans and Advances to Customers	1,019.9	995.8
Other Assets	53.2	51.6
Off Balance Sheet	16.2	18.2
Operational Risk	88.9	81.9
	1,224.3	1,193.0
Capital Ratios	**%**	**%**
Common Equity Tier 1 Ratio	15.7	15.3
Tier 1 Ratio	16.3	16.6
Total Capital Ratio	17.7	18.9
Leverage Ratio	5.4	5.2

The Group complied with Individual Capital Guidance plus capital buffers, as notified by the Prudential Regulation Authority, throughout 2018. The total capital ratio was 17.7% (2017: 18.9%); 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 16.3% and 15.7%, respectively in 2018.

The Group repaid £10.0m of its Permanent Interest Bearing Shares (PIBS) during 2018. The PIBS were issued to investors in 2008 and formed part of the Group's regulatory capital.

Repayment of these PIBS demonstrates the Society's success in its long-term commitment to de-risk its Balance Sheet and improve its profitability.

Capital Ratios



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 2018 the figure was 5.4% (2017: 5.2%). This is, and has remained throughout 2018, well in excess of the proposed 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 2018 was £153.2m. Further details on the Group's capital position including the transitional impact of Basel III is given in the Pillar III disclosures to be published on the Society's website at the same time as these accounts.

Principal Risks and Uncertainties

The principal risks and uncertainties faced by the Group are set out in the Risk Management Report on pages 35 to 38.

Outlook

The economic, political and competitive backdrop remains uncertain and we expect in 2019 that the competitive environment for both savings and lending will be ever more challenging. While there remains significant uncertainty on the horizon the Society will focus on what it does best; providing great products and services to our customers and Members, connecting them to a better financial future.

On behalf of the Board
David Samper
Chief Financial Officer
26 February 2019

Community Support

Newcastle Building Society Community Fund
at the Community Foundation

Supporting our communities is core to what we do. From colleague fundraising and enabling grants to local projects and charities, to volunteering for causes across the North East.

In 2018 total charitable giving was £797,000 that's equivalent to 6 % of our pre-tax profit. Support from the Newcastle Building Society Community Fund increased with £178,902 given in the form of 63 community grants. Here are some of the local causes that have been supported over the year.

Building on the success of community grants, the Newcastle Building Society Community Fund introduced Building Improvement Grants in 2018. This grant programme provides larger amounts of up to £50,000 for community groups or charities in the region who need to make improvements to their community buildings. This might include: construction, expansion, renovation or replacement of an existing facility or facilities.

Members can nominate local community groups, causes and charities across the North East for grants of up to £3,000.

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

Nominated by Ian GT Miller, The Bay Foodbank received a grant of £3,000 which has enabled them to provide food for breakfast and lunch clubs at a local school. The Bay Foodbank is based in North Shields and was founded in February 2012 with the aim to provide emergency food provision to individuals or families experiencing a financial crisis.

Brandon Boxing

Brandon Boxing Club was established in 2013 by Alex Oliver BEM. The aim of the club is to provide support and encouragement to people in the East-Durham area. The club received a grant of £795 to purchase new boxing equipment. Alex of Brandon Boxing, who is well known in his local community for working with young people and helping to keep them off the streets helped us open our Durham branch at the beginning of 2018.

Silver Fox Motorcyclists

Silver Fox Motorcyclists group, based in Berwick used a grant of £1,125 to offer first aid training to approximately 25 group members. The group take part in a motorbike ride of up to 200 miles every week. The importance of riders having some first aid knowledge was brought to light in 2017 after one of the group was involved in a head on collision during a ride. While the rider was recovering in hospital, an introductory course was organised for members.

Charitable giving

Throughout 2018 we continued our commitment to the Sir Bobby Robson Foundation, with a further £97,000 donated by the Society and the Newcastle Building Society Community Fund. We also increased our charitable giving via our Newcastle Building Society Community Fund, giving away over £170,000 in grants.

Changing Lives

Changing Lives supports over 17,500 vulnerable people a year, changing their lives for the better. A national charity which began and is based in the North East, the charity received a grant of £1,645 to help revamp their community kitchen at Ridley Villas. The renovation enables families to cook, eat together and share stories. The charity provides opportunities for people to come together to tackle isolation.

Building Improvement Grants

Springfield Community Association was our first Building Improvement Grant recipient and received a grant of £49,110. They are a volunteer led charity based in Forest Hall, established using money raised by the local community. Springfield will be using the grant to transform their community space through a number of refurbishments. The grant will help provide a brand-new accessible community facility with many social and economic benefits for existing and new service-users and partners.

Colleague Fund Raising

Colleague raised money by holding various themed "FunD Days" throughout 2018. Ranging from fitness to summer to Halloween themes colleagues had fun and also raised over £20,000 for the Newcastle Building Society Community Fund, Macmillan Cancer Support and Children in Need.

REFUSE Cafe

The Property Services team helped to transform a local Chester-Le-Street café, REFUSE. The café were struggling to find tradesmen to carry out the joinery work when the team stepped in to help transform the space.

Volunteering

Throughout 2018 our colleague volunteering contribution more than doubled with 55 % of colleagues delivering over 4,750 hours to help 137 groups and local charities across the North East.

Our 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, with more than 30 years' business experience and over 20 years in the mutual sector. He has held leadership roles as both an Executive and a Non-Executive Director. 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 gained his strong customer focus through his early career in marketing and customer service roles with British Airways, Barclays and National & Provincial Building Society. An advocate of mutuality, he was previously Chairman of Mutuo, an independent organisation that promotes the development of new and existing mutuals to Government. Andrew is a Board member of the Community Foundation Tyne & Wear and Northumberland and Vice 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 held senior roles across a number of multinational organisations in the UK and abroad, including RBS, Ulster Bank, and most recently 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.

Patrick Ferguson
Strategy, Planning & Risk Director

Patrick joined the Society's Board in February 2014; before this he was the Society's Group Risk Executive for almost four years.

He has extensive experience in risk management, including conduct risk and regulatory compliance, in addition to financial reporting, planning, and budgeting. He has 19 years' experience in the building society sector and has held the posts of Finance Director, General Manager, Finance and Head of Strategy and Planning. He qualified as a chartered accountant with PricewaterhouseCoopers LLP.

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 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.

John Morris
Non-Executive Director

John is a Fellow of the Institute of Chartered Accountants and brings to the Society a significant amount of experience of both the banking and building society sectors.

He 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 a member of the Society's Group Risk Committee, Nominations Committee, Chairman of the Remuneration Committee and Interim Chairman of the Audit 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.

He is a non-executive director of the Charter Court Financial Services Group PLC and its subsidiaries (which include Charter Savings Bank), where he chairs both the Remuneration and Stakeholder Committees. He is also a member of the Risk and Audit Committees. Ian 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 the Newcastle Systems Management Limited and Newcastle Financial Advisers Limited Boards. He is also a member of the Society's Group Risk Committee.

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 and a Director of Newcastle Systems Management Limited. 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 38 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 within the consumer sector and is extremely people and customer focused.

She is currently Senior Operations Director for Europe, Middle East and Africa at Expedia Inc. after moving from Virgin Media in 2017. She has previously held roles in other organisations as Customer Service Director, Head of Service and HR Director. Karen started her career with 18 years in Financial Services at the Co-operative Bank. She is a Director of Newcastle Strategic Solutions Limited and a member of the Society's Remuneration Committee. Karen also plays an active role within the North East Chamber of Commerce and is a member of techUK.

David Buffham
Deputy Chairman and Senior Independent Director

David is the Society's Deputy Chairman and Senior Independent Director. He has spent most of his career at the Bank of England.

He held a wide variety of banking and other roles, including the post of Bank of England Agent for the North East. There he was responsible for reporting to the Bank's Monetary Policy Committee on the region's economy and explaining policy to key stakeholders in the North East. He brings this knowledge and experience to the fore as a member of the Society's Group Risk Committee, Nominations Committee and Remuneration Committee. He is a Director of both Newcastle Strategic Solutions Limited and Newcastle Systems Management Limited. He is an experienced Non-Executive Director and is a Director of Zytronic PLC, William Leech (Investments) Limited and The William Leech Foundation Limited.

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 Fast Moving Consumer Goods.

Most recently she held Executive roles at Hallmark Cards and Lloyds Banking Group/HBOS. She is also an adviser to the education sector, with a passion for creating closer links between business, education and community. As a fully qualified and sought after Executive Coach with her own consulting business, Anne works with Chief Executives and Senior Level Leaders. Anne is a member of the Society's Audit Committee and has recently become a member of Remuneration Committee.

Bryce Glover
Non-Executive Director

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

The majority of Bryce's career has focused on corporate and commercial banking. He was Managing Director of Commercial Banking at Alliance and Leicester and Santander, before joining Nationwide Building Society in 2009 as director heading its Commercial Division, where he managed a £22bn commercial lending portfolio and the Society's business savings accounts. He was Nationwide's Corporate Affairs Director from 2014 to December 2016. He is a Director of Recognise Financial Services Limited. Bryce is Chairman of the Society's Group Risk Committee.

Mick Thompson
Non-Executive Director

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, engineering, 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. Mick is a member of the Society's Audit Committee.

Directors' Report

The Directors present their Annual Report and Accounts and Annual Business Statement for the year ended 31 December 2018, 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 32 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 5 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 on page 35 of these Annual Report and Accounts.

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 32 sets out the metrics associated with the key risks including sensitivity analysis and exposure levels.

Mortgage arrears
As at 31 December 2018 there were 18 cases (2017: 16) where payments were 12 months or more in arrears. The capital balances of these loans were £1.1m (2017: £0.9m). The total amount of arrears on these loans was £0.2m (2017: £0.1m).

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.

Through the Newcastle Community Saver a total of £777,000 was donated to charitable causes, including the Newcastle Building Society Community Foundation and the Sir Bobby Robson Foundation.

Our colleagues undertook a variety of fundraising activities during 2018 in aid of the Newcastle Building Society Community Fund, Children in Need and McMillan Cancer Support raising in excess of £20,000 for important causes.

Throughout 2018, colleagues volunteered 4,500 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 2018, can be found in the Community Support Round-up on pages 16 and 17.

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 suppliers' payment terms which may be set at shorter timescales. At 31 December 2018, the number of creditor days was 17 (2017: 25 days).

Directors
As at 31 December 2018, the members of the Board, who have served at any time during the year and continue to act as Directors, are as follows:

David Buffham, Patrick Ferguson*, Bryce Glover, Andrew Haigh*, Karen Ingham, Anne Laverack (business name: Anne Shiels), Phil Moorhouse, John Morris, Stuart Miller* (joined the Board on 16 January 2018), David Samper* (joined the Board on 20 December 2018) and Ian Ward.

Angela Russell resigned from the Board on 25 April 2018 and Richard Bottomley resigned from the Board on 24 September 2018.

At the Annual General Meeting (AGM), to be held on 24 April 2019, all of the Directors will offer themselves up for either election or re-election.

Mick Thompson was appointed as a Non-Executive Director after the year-end on 29 January 2019. He will offer himself for election at the AGM.

David Buffham will be standing down as a Director in the first half of 2019 after nine years' service.

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 on page 30 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 on pages 18 and 19 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 on pages 22 to 26.

Statement of Directors' Responsibilities

The following statement, which should be read in conjunction with the statement of auditors' responsibilities on page 42, 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 Act; 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
Chairman
26 February 2019

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. The UK Corporate Governance Code (the Code), issued by the Financial Reporting Council (FRC) in April 2016 is addressed to publicly quoted companies, however, 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 17th June 2016, and, therefore, the Society has regard to this Code within the 2018 Annual Report and Accounts.

Notwithstanding what has been stated above, the FRC issued a revised Code in July 2018, which will be applicable to the Society with regard to the 2019 Annual Report and 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 main changes to the previous Code includes the responsibility for a board to have appropriate workforce policies and practices, which reinforce a healthy culture. To address this point, the Society intends to set up a "Colleague Forum", chaired by an Executive Director. 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.

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 appro ach taken by the Society and how the Board considers it has demonstrated application of the principles of the 2016 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 on pages 18 and 19. 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 on page 23.

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 David Buffham was appointed Deputy Chairman on 26th April 2017, having previously been appointed Senior Independent Director on 1st January 2016. 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 comprised of eight Non-Executive Directors and four 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 June 2018. 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 every three years; 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) and are subject to annual review.

Board Changes and Elections/Re-elections

It is recognised that changes need to be made to the Board from time to time. In 2018, Angela Russell and Richard Bottomley resigned from the Board, Stuart Miller was appointed as Customer Director, and David Samper was appointed as Chief Financial Officer. In January 2019, Mick Thompson was appointed as a Non Executive Director.

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

One aspect of the Code provides that all directors of FTSE 350 companies should be subject to annual election by shareholders, and therefore, in accordance with best practice on corporate governance 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 on pages 18 and 19.

Management Information

The Chairman is responsible for ensuring that the Directors receive accurate, timely and clear information. Board members receive meeting packs each month except in August and December when there are no Board meetings. They also receive Management Information each month by way of email. A rolling Board agenda is tabled at each meeting to ensure that all key areas are covered appropriately during the year. Sufficient time is set aside 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 November 2018, which was entirely separate to the UK Corporate Governance Code's requirement for an externally facilitated review of a board's effectiveness to take place every three years (which was last carried out in 2016). The internal review was based on feedback from Directors, together with an assessment made against the first two principles of Leadership and Effectiveness set out within 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 Chairman of each Committee reports to the Board at a subsequent meeting on matters discussed at each Committee meeting.

Similar to the Board, each Committee has carried 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 the effectiveness review for each Committee is summarised and presented to the Board for review. All concluded satisfactorily.

Information concerning attendances at the meetings is detailed on page 26. Terms of Reference for the Audit Committee, Group Risk Committee, Remuneration Committee and NomCo are included on the Society's website (http://www.newcastle.co.uk) and are subject to annual review.

Audit Committee

Details of the Audit Committee are contained in the Audit Committee Report on page 27. Through the work of the Audit Committee and the Internal Audit Services department during 2018, 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 on page 30.

Group Risk Committee

Details of the Group Risk Committee are contained in the Risk Management Report on page 35.

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 2019.

The main objectives of NomCo are summarised as follows:-

- To oversee the structure of the Board, Board Committees and Subsidiary Companies;
- 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), David Buffham, John Morris and Anne Shiels. NomCo operates to a rolling agenda to ensure it discharges its full responsibilities. It normally meets a minimum of twice a year and in 2018 it met on two 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 2018 the Society utilised the services of independent recruitment specialists, Odgers Berndston, Warren Partners, and NRG Ltd 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 and Role Descriptions, and Terms of Engagement for Non-Executive Directors, to ensure that all Directors fully understand and comply with their role and the responsibilities of being a Director of the Society.

Report of the Directors on Corporate Governance (continued)

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 three female directors on the Board last year until Angela Russell resigned in April, following which there were two (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

It has been agreed previously by the Board that all Directors, as appropriate, should be required to seek election or re-election at each AGM, the forthcoming one to be held on 24th April 2019.

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 will 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 at each meeting as part of the standard agenda.

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 criteria 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 chairman should, on appointment, meet the independence criteria, but thereafter the test of independence is not appropriate in relation to the chairman). The last review of the independence of Non-Executive Directors was carried out by NomCo in January 2019, where it was confirmed that the independence requirements in terms of character and judgement were met; this was subsequently agreed by the Board in January 2019.

One of the Non-Executive Directors, Ian Ward, is a director of a number of companies within the Charter Court Financial Services Group PLC, including Charter Savings Bank. 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 David Buffham.

During 2018, 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.

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 Chairman), David Buffham, Karen Ingham, Ron McCormick, Stuart Lynn, Phil Grand (Managing Director NSSL) and Andrew Ward (Finance Director NSSL).

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 sufficient that their confidentiality, integrity and availability is 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 December 2018 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 Chairman), Phil Moorhouse, David Buffham, Stuart Lynn, Steve Watchman (Managing Director NSML) and Andrew Ward (Finance Director NSML).

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

- To oversee the strategic direction of Information Technology, Property Management and associated services and to ensure this is consistent with the Society's agreed Strategic Plan for ongoing development and improvement of these propositions;
- To review the performance of NSML in terms of financial results including profitability, risk management and customer outcomes;
- To monitor developments in the area of cyber risk mitigation to ensure the Group and Society are protected and resilience is enhanced on an ongoing basis;
- To ensure that appropriate mechanisms are in place to inform the Society's Board about the performance of NSML and any key issues identified;
- To ensure that NSML complies with all relevant legislation including the General Data Protection Regulation and associated data protection legislation, and the appropriate regulations relating to NSML activities;
- To establish and review a risk appetite statement for NSML, and to review, at least annually, the position of NSML against that risk appetite statement;
- To ensure that an annual review of service resilience is conducted;
- To approve the NSML budget on an annual basis (prior to inclusion in the Group budget which is approved by the Society's Board);
- To approve the NSML statutory accounts;
- To consider and act upon the findings of any external/internal audits or reviews and make suitable recommendations as appropriate;
- To ensure that information assets are protected sufficient that their confidentiality, integrity and availability is 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 NSML Board is undertaken on an annual basis. The last review was undertaken in January 2019 where it was concluded the NSML Board was effective.

Newcastle Financial Advisers Limited (NFAL)

NFAL Board Members are:

Ian Ward (NFAL Chairman), 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 also uses external consultants to provide challenge and advice to the Board. At least once a year directors from Openwork Limited 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 November 2018 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 Annual General Meeting (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. We supplement our AGM event with at least two other annual Member engagement events held in the North and South of our region to enable more of our Members to interact with our Executive team, with our colleagues, and to receive an update on our progress.

Understanding what Members think about our products and service is also extremely important. This year we introduced our Voice of the Customer survey tool, designed to enable Members to provide us with their feedback, quickly and easily, when they transact with us in branch, via phone, or on our website. This tool will provide us with visibility and live data on our customer satisfaction scores across all our channels. Members are also encouraged to join our customer panel and we consult with this group on a range of topics.

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.

Branch re-launches, which mark the completion of refurbishment or relocation of branches as part of our current multi-million pound network improvement programme, are always well attended by our Members and the local community. Hosted by our Chief Executive, and also attended by members of the Board, they provide a valuable insight into our Members' views and opinions.

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.

These events provide an excellent opportunity not only to speak to our Members but also to interact and listen to their views. Periodically we also hold 'Meet the Chief Executive' events for Members which provide an opportunity for Senior Management, including members of the Board, to engage with and listen to customer feedback. We also keep in touch with Members via our Priority Register Service.

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 that this financial support for our heartland communities will continue to grow in scope and scale.

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.

Report of the Directors on Corporate Governance (continued)

Our Dementia Friends Champion has delivered dementia awareness sessions to more than 1,500 individuals 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 on pages 16 and 17.

Board and Board Committee Membership Attendance Record

The table below sets out the number of meetings attended by Directors during 2018 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
Phil Moorhouse	10 (10)	-	-	-	2 (2)	6 (6)	6 (6)	4 (5)*
David Buffham	9 (10)	-	5 (6)	3 (4)	2 (2)	5 (6)	6 (6)	-
Patrick Ferguson	10 (10)	-	-	-	-	-	-	-
Bryce Glover	9 (10)	-	6 (6)	-	-	-	-	-
Andrew Haigh	10 (10)	-	-	-	-	-	-	-
Karen Ingham	8 (10)	-	-	4 (4)	-	5 (6)	-	-
Stuart Miller	10 (10)	-	-	-	-	-	-	4 (4)
John Morris	10 (10)	4 (4)	6 (6)	4 (4)	2 (2)	-	-	-
David Samper	0 (0)	-	-	-	-	-	-	-
Anne Shiels	10 (10)	4 (4)	-	4 (4)	1 (1)	-	-	-
Ian Ward	10 (10)	-	5 (6)	-	-	-	6 (6)	5 (5)
Angela Russell	4 (4)	-	-	-	-	-	-	1 (1)
Richard Bottomley	7 (8)	3 (3)	-	-	-	-	-	-

*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
26 February 2019

Audit Committee Report

Audit Committee

Members of Audit Committee at 31 December 2018 were:
John Morris (Committee Chair), and Anne Shiels. The Committee express their thanks to Richard Bottomley for his hard work and dedication to the Audit Committee prior to his retirement in September 2018. Mick Thompson was appointed to the Committee on 29 January 2019.

The Audit Committee's extensive experience and qualifications are detailed on pages 18 and 19 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. 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 Chairman.

Directors' remuneration, including for members of the Audit Committee, is detailed within the Remuneration Committee Report on page 31 of the Annual Report and Accounts. The Report on Corporate Governance on pages 22 to 26 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 2018 review on 26 November 2018.

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, Finance Director, Strategy, Planning and Risk Director, 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 page 26 of the Annual Report and Accounts.

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 Audit Committee's remit and any issues arising from audits, including matters required to be discussed by relevant law or regulations. The Chairman 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 through:

- 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 Finance Director 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 Auditor's findings and recommendations.

The main areas of financial reporting significance considered by the Audit Committee in 2018 were as follows:

- **IFRS 9 (Financial Instruments) and IFRS 7 (Financial Instrument Disclosures):** The Group has applied the accounting requirements of IFRS 9 since 1 January 2018 and published its transitional IFRS 9 disclosures in its interim 2018 report. The Group's first full year-end IFRS 9 disclosures are included in the 2018 Annual Report and Accounts, including extensive IFRS 7 enhancements reflecting more robust reporting requirements introduced by IFRS 9. The Audit Committee has reviewed the Group's disclosures and concluded satisfactorily on the disclosures made.

- **IFRS 9 provisioning:** This is inherently an area of accounting estimate and judgement. The Society's commercial loan impairment provisions are agreed by the Society's Provisioning Committee (under IFRS 9 methodology) and then reported to the Audit Committee. The Audit Committee reviews the level of provisioning through detailed discussion with management on the key judgements and estimates made including triggers for and methodology behind impairment calculations. The impact of forbearance in the mortgage portfolios has been considered and appropriate disclosures made in the financial statements. The Committee is satisfied with the assumptions adopted and models used to calculate provisions over the residential and commercial mortgage books.

  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 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 2018 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.
- **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 Finance Director. 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. IAS39 macro hedging remains an area of consideration.
- **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 2018 financial year the Audit Committee recommended to the Board that approval be given to the audited Annual Report and Accounts and Summary Financial Statements as at 31 December 2018.

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 on pages 35 to 38 of the Annual Report and Accounts.

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. Specific areas of focus in 2018 included reviewing the controls in operation for; lending, savings, information technology and cyber security, treasury, finance, risk management, 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 Strategy, Planning and Risk Director, 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 2018. The Internal Audit department are subject to an independent and objective external assessment at least every five years.

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 2018 the External Auditors were engaged to provide non-statutory audit data 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 Chairman 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

The next formal external audit tender process will be conducted in advance of the 2021 audit cycle. Mandatory rotation of the audit's senior partner, Gary Shaw (the partner since 2015), applies at the end of the 2018 audit with PwC able to conduct the Group's audit under a different lead partner until conclusion of the 2020 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.

During 2019, in line with recommendation made by the Financial Reporting Council's UK Corporate Governance Code, responsibility for oversight of the Group's whistle blowing practices will transition to the Group Board.

On behalf of the Board
John Morris
Chairman of the Audit Committee
26 February 2019

Remuneration Committee Report

Introduction

This report details the Society's approach to pay for the period 1 January to 31 December 2018. 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 effective from 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 for the delivery of 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;
- 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 senior managers to continue to run the Society successfully. The Remuneration Policy, therefore, focuses on rewarding our Executives in line with the achievement of our goals set out in the Strategic Plan and Corporate Key Performance Indicators whilst continuing to provide 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 2018. The effectiveness of the committee is also reviewed on an annual basis and was last reviewed, and found effective, on 27th November 2018.

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 David Buffham, 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 4 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 financial year and approving the level of Corporate Bonus to be paid based on achievement of the Corporate Key Performance Indicators;
- Considering the disclosure requirements for the Remuneration Report including Pillar 3 disclosures; and
- Considering proposals for the introduction of a new Executive Bonus Scheme effective from January 2019, details of which are provided in section iii) 'Directors' Remuneration Policy' shown on Page 32.

ii) Report on Remuneration

The total remuneration received by Executive Directors is shown on page 31. The information has been audited and shows remuneration for the years ended 31 December 2017 and 31 December 2018 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 on page 100 of the Annual Report and Accounts. None of the current Executive Directors retained any remuneration as a result of their non-Society positions.

Chief Executive Remuneration

The Chief Executive is the Society's most highly paid employee and no employee earns more than any Executive Director. A 2.5% pay rise was received by all staff, including Mr A Haigh, in April 2018. Mr Haigh's total salary increased by 4.4% reflecting the full year impact of a salary increase awarded in 2017.

Calculation of Annual Bonus

Throughout 2018, the Society operated a Corporate Bonus Scheme that applied to everyone across the Society.

In agreeing the level of corporate bonus for the year the Committee considers the Group's delivery of the Corporate Key Performance Indicators (KPIs) which include group profit, capital and liquidity targets, quality measures around service, complaints and customer satisfaction, and targets for savings and mortgage business. Further information on KPI performance can be found on page 11 of 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 Director determining where they fall into the agreed range.

Bonuses are paid as a percentage of basic salary. A corporate bonus of 4% of basic salary has been awarded to Executive Directors in relation to 2018.

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)	Pension contributions to defined contribution scheme (Notes 2,3,4 & 5)	Total contractual benefits
		£000	£000	£000	£000	£000
Executive Directors						
AS Haigh - Note 2	**2018**	**306**	**41**	**9**	**-**	**356**
	2017	293	40	9	-	342
P Ferguson	**2018**	**150**	**10**	**5**	**14**	**179**
	2017	139	10	4	13	166
S Miller - Note 4 (Appointed 16 January 2018)	**2018**	**147**	**18**	**5**	**5**	**175**
	2017	-	-	-	-	-
D Samper (Appointed 20 December 2018)	**2018**	**6**	**-**	**-**	**-**	**6**
	2017	-	-	-	-	-
AM Russell - Note 3 (Retired 25 April 2018)	**2018**	**64**	**14**	**-**	**-**	**78**
	2017	191	26	6	2	225
D Thompson (Resigned 24 April 2017)	**2018**	**-**	**-**	**-**	**-**	**-**
	2017	53	10	-	4	67
Total for Executive Directors	**2018**	**673**	**83**	**19**	**19**	**794**
	2017	676	86	19	19	800
Non-Executive Directors						
PJ Moorhouse	**2018**	**69**	**-**	**-**	**-**	**69**
	2017	68	-	-	-	68
DJ Buffham	**2018**	**56**	**-**	**-**	**-**	**56**
	2017	54	-	-	-	54
J Morris	**2018**	**53**	**2**	**-**	**-**	**55**
	2017	50	2	-	-	52
IW Ward	**2018**	**52**	**1**	**-**	**-**	**53**
	2017	47	1	-	-	48
BP Glover (Appointed 11 August 2017)	**2018**	**39**	**4**	**-**	**-**	**43**
	2017	15	1	-	-	16
A Laverack (Appointed 17 July 2017)	**2018**	**40**	**1**	**-**	**-**	**41**
(Business name: Anne Shiels)	2017	18	-	-	-	18
K Ingham	**2018**	**40**	**-**	**-**	**-**	**40**
	2017	39	-	-	-	39
RJ Bottomley OBE (Retired 24 September 2018)	**2018**	**32**	**2**	**-**	**-**	**34**
	2017	41	2	-	-	43
RJ McCormick (Retired 26 April 2017)	**2018**	**-**	**-**	**-**	**-**	**-**
	2017	17	1	-	-	18
Total for Non-Executive Directors	**2018**	**381**	**10**	**-**	**-**	**391**
	2017	349	7	-	-	356
Total for all Directors	**2018**	**1,054**	**93**	**19**	**19**	**1,185**
	2017	1,025	93	19	19	1,156

Notes:

1. During 2017 and 2018 the Society's Executive Directors participated in the Group's annual Corporate Bonus Scheme.
2. Mr AS Haigh has elected to take his pension contribution amounting to £27,506 as a cash payment. He is liable for his own tax and national insurance contributions on this payment.
3. Mrs AM Russell elected to take her pensions contribution amounting to £5,759 as a cash payment. She is liable for her own tax and national insurance contributions on this payment.
4. Mr S Miller has elected to take part of his pension contribution amounting to £8,072 as a cash payment. He is liable for his own tax and national insurance contributions on this payment.
5. None of the Society's Directors participate in the Group's defined benefit pensions scheme.

Remuneration Committee Report (continued)

iii) Directors' Remuneration Policy

This section sets out the Director's Remuneration policy that will apply 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 Director's 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 is to ensure that the Society can continue to attract, retain and motivate senior managers in an increasingly competitive market place. The Executive Bonus Scheme will apply to the Society's Executive Directors and other members of the Executive Committee.

The absence of an Executive Bonus Scheme has placed the Society at a disadvantage when recruiting to senior roles, making it difficult to attract the appropriate calibre of skills and experience to support the delivery of the increased level of ambition within our strategic plan.

The development of the new Executive Bonus Scheme was underpinned by a robust benchmarking process with support from an external remuneration specialist.

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 will be 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 performance.

As the introduction of the Executive Bonus Scheme constitutes a material change to our Remuneration Policy, members will be invited to make an advisory vote on the Policy at the 2019 AGM.

The Corporate Bonus Scheme will remain in place for other colleagues, however it is our intention to review that Scheme during 2019 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 at: "Newcastle Building Society" c/o Addleshaw Goddard LLP (Ref. GAB), Milton Gate, 60 Chiswell Street, London, EC1Y 4AG.

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 employees 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. All employees were subject to the Group's Pay and Grading Review and Job Evaluation Policy during 2017.

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. In 2014, the Society voluntarily elected to adopt some of the changes to remuneration reporting that apply to UK listed companies and one of the factors that the Committee took into consideration was the opportunity to give Members a chance to vote on the Society's Remuneration Policy.

The Society's Remuneration Report and Policy was last voted on in April 2018. Member approval was given to the 31 December 2017 Directors' Remuneration Report (90.48% approval with 14,298 votes for, 1,504 against and 300 withheld). Member approval was given similarly to the Directors' Remuneration Policy (89.83% approval with 14,175 votes for, 1,605 against and 323 withheld).

At the 2019 AGM there will be separate votes on the Remuneration Report (sections (i) and (ii) above) and Remuneration Policy (section (iii) above), which will both be on an advisory basis. We will take the views of our Members seriously, as expressed through the advisory votes, and will consider the results carefully to determine what action, if any, is appropriate.

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 car 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.

Remuneration Committee Report (continued)

Summary of the Remuneration of Code Staff

A summary of the remuneration of Code Staff during 2018 and the business areas in which they operate is shown below.

Category	Typical Functions	Year	Number in Category During the Year	Fixed Remuneration £000	Variable Remuneration (Note 1) £000	Total Remuneration £000
Executive Directors	CEO, Finance Director & Deputy CEO, Strategy, Planning & Risk Director, Customer Director	**2018**	**4**	**775**	**19**	**794**
		2017	4	781	19	800
Other Executives	HR Director, Managing Director NSML, Managing Director NSSL, Chief Financial Officer (Note 2).	**2018**	**4**	**484**	**9**	**493**
		2017	3	290	9	299
Control Functions	Compliance, Underwriting, Internal Audit, Customer Outcomes, Treasury, Balance Sheet Management.	**2018**	**7**	**436**	**16**	**452**
		2017	7	476	14	490
Total		**2018**	**15**	**1,695**	**44**	**1,739**
		2017	14	1,547	42	1,589

Notes:

Note 1: Variable remuneration reflects participation in the Group's annual Corporate Bonus Scheme.

Note 2: David Samper joined the Society in November 2018 and was appointed to the Board as the Group's Chief Financial Officer on 20 December 2018. Prior to his Board appointment David was considered to be part of the Group's Code Staff with his remuneration included within the other directors sub category above. This category also includes remuneration paid to the Society's Interim Finance Director during 2018.

John Morris
Chairman of the Remuneration Committee
26 February 2019

Risk Management Report

Overview

The Society's risk management framework is designed to enable the Society to proactively identify and manage risks to support the achievement of the Society's objectives.

It includes monitoring and controlling the significant risks to which the Society is exposed to ensure the security and resilience of the Society. 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.

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 an independent Group Risk department that is responsible for ensuring that appropriate risk management is applied. This includes the provision of reports on risks, and risk management for the GRC and its sub-committees. The Strategy, Planning and Risk Director provides formal updates on risk management to the Board, in relation to the Group, at least quarterly.

Risk Framework

The Society and Group risk management framework operates under the "three lines of defence" principle. The first line of defence is within departments, business units and subsidiaries where Executives, managers and staff have responsibility for risk management and ensuring adequate controls are in place to mitigate risk. The second line of defence is provided by the GRC and supporting sub-committees together with oversight of the first line by the Group Risk department. The third line of defence is provided by Internal Audit and the Audit Committee, which are responsible for reviewing the effectiveness of the first and second lines of defence.

The risk framework includes the use of Board approved risk appetite statements covering profitability in a stressed scenario, capital, liquidity, operational risk, credit risk, interest rate risk, the fair treatment of customers and conduct risk, and IT risk. They set out key limits and escalation triggers. The risk appetite statements, together with the risk position, are reported to the Board quarterly, and formally approved annually.

The risk framework makes use of stress testing and scenario testing. Stress tests consider the potential outcomes for portfolios and for the Society in the event of stressed scenarios incorporating, for example, falling house prices and rising unemployment. Scenario tests consider the outcome in the event of a particular risk or event occurring, and are used to help evaluate the controls, and assess the adequacy of the Society's incident management and business continuity plans.

Group Risk Committee

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

Members of the GRC in 2018, all of whom were Non-Executive Directors, were Bryce Glover (Committee Chairman), David Buffham, 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 2018 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 GRC is supported by five Executive committees, as follows:

The Retail Credit Committee (RCC) is responsible for credit risk across the Group arising from the retail mortgage portfolio including lending policy, underwriting, limit setting and monitoring, forbearance, possessions, affordability, scorecard effectiveness and efficiency, and residential stress testing. During 2018 RCC met monthly.

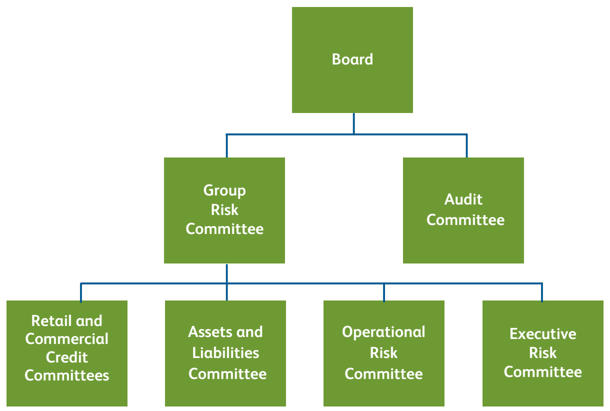
The Commercial Credit Committee (CCC) is responsible for credit risk across the Group's non-retail mortgage portfolio including loan strategy, limit monitoring, risk indicators and stress factors, annual reviews and breach reports, loan renegotiations, monitoring risk trends on the portfolio, and stress testing. During 2018 CCC met quarterly.

The Operational Risk Committee (ORC) is responsible for operational risks arising across the Group, including operational risk policy, risk event trends, actions on significant risk events, project risks, business continuity policy, and scenario testing. During 2018 ORC met monthly.

The Executive Risk Committee (ERC) is responsible for "overlap" risks i.e. risks that go across business areas, and in particular for conduct risks, and overall stress testing. It is responsible for approving compliance policy, monitoring compliance with policies, conduct risk indicators, business continuity policy, and overall stress testing. During 2018 ERC met monthly.

The Assets and Liabilities Committee (ALCO) is responsible for all aspects of treasury risk management including liquidity risk, interest rate risk, counterparty credit risk, and balance sheet management. During 2018 ALCO met monthly.

Risk Governance Structure



Risk Management Report (continued)

Risk and Impact	Mitigation	Change in Risk Profile	Commentary
Credit Risk The primary credit risks relate to residential, commercial, 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 RCC 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 2018, including BTL lending to individuals, and has a strategy to increase such lending. The Society's risk to residential lending has increased as the overall book has increased. Loans 3 months or more in arrears are at historically very low levels. 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 CCC. Higher risk loans are subject to quarterly review. In the event of a breach a report is provided to the CCC. 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 now represent less than 2.2% of the mortgage book. 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 has fallen significantly 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 that 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 is at similar levels and the proportion of liquid assets held with highly rated counterparties has been maintained.

Risk and Impact	Mitigation	Change in Risk Profile	Commentary
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 liquid assets.	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.		Overall liquidity risk is unchanged.
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 32 gives details of the derivative financial instruments held at 31 December 2018, 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. Some of our savings management clients passport their EU permissions into the UK. The UK economic outcomes will depend on Brexit, and the uncertainty may result in lower growth in the UK. This may impact the risks highlighted above.

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/ 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 £9.2m at 31 December 2018 compared to a surplus of £10.8m at the end of 2017. 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. The value of savings balances managed by the Solutions business and the level of income increased during 2018 (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 improved to 15.7% from 15.3%. Capital requirements increased in 2018 due to the increase in the Countercyclical Capital Buffer to 1%. The Group's capital plans incorporate this increased requirement.

David Buffham
Chairman of the Group Risk Committee
26 February 2019

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 financial statements and Society financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and of the Society's affairs as at 31 December 2018 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 financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the "Annual Report"), which comprise: the Group and Society Balance Sheets as at 31 December 2018; the Group and Society Income Statements and Statements of Comprehensive Income, the Group and Society Cash Flow Statements, the Group and Society Statement of Movement in Members' Interests for the year then ended; and the notes to the financial statements, 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 financial statements 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 financial statements 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 financial statements, we have provided no non-audit services to the Group or the Society in the period from 1 January 2018 to 31 December 2018.

Our audit approach

Overview

Materiality:

- Overall Group materiality: £1,240,000 (2017: £1,226,000), based on 0.5% of net assets.
- Overall Society materiality: £1,155,000 (2017: £1,240,000), based on 0.5% of net assets.

Audit Scope:

- We conducted all of our audit work from 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 performed over specific account balances and financial information in three other Group undertakings that materially contributed to Group's financial performance and/or position.

Key Audit Matters:

- Valuation of equity release portfolio (Group and Society).
- Valuation of derivatives and application of hedge accounting (Group and Society).
- Adoption of IFRS 9 (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 financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industry in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group and significant component level to respond to the risk, recognising that 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. We focused on laws and regulations that could give rise to a material misstatement in the Group and Society financial statements, including, but not limited to, Building Societies Act 1986, the Listing Rules, Pensions legislation, UK tax legislation, the Financial Conduct Authority's Client Asset Sourcebook, the Prudential Regulation Authority's regulations. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the FCA and PRA, review of correspondence with legal advisors, enquiries of management, and review of internal audit reports as they related to the financial statements. 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 financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) 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 financial statements 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.

Key audit matter

Valuation of equity release portfolio

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 £200.6m (2017: £209.9m). 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

Independent Auditors' Report to the Members of Newcastle Building Society (continued)

occurs on the death of the borrower or them 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 amount of judgement applied by the directors in valuing the equity release portfolios. For the standard equity release loans 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.

The Society also holds fixed reversion loans which are held at amortised cost based on an actuarial valuation, to establish the expected current value of the future cashflows on this portfolio. This calculation is impacted by a number of assumptions which we focussed on, including, but not limited to:

- The value of the underlying security;
- Mortality and long-term care rates;
- Early redemption rates; and
- The discount rate

How our audit addressed the key audit matter

Where the directors have relied upon HPI movements to forecast expected property values we have tested the controls which management operate to ensure that HPIs are entered and calculated correctly by the system. We have also reviewed the reasonableness of the HPI assumptions used by management, and note that management use a reasonable provisioning technique, 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 obtained the external valuation of the fixed reversion loan portfolio, and considered the key assumptions made. We have challenged management and employed the use of experts on the appropriateness of key assumptions such as the mortality rates, assumptions for long term care, and early redemptions.

We obtained the data inputs for the model and have reperformed the calculation of the model.

Following completion of the above procedures, we did not identify any issues with the assumptions on which the valuation of the equity release portfolios rely, and have identified no need for further specific provisions.

Group and Society

Key audit matter

Valuation of derivatives and application of hedge accounting

See note 1 to the annual accounts for the directors' disclosures of the related accounting policies and note 32 for detailed disclosures.

The Society's operations expose the Group to significant interest rate risk, as a result of a mismatch between fixed and floating cash inflows and outflows to and from members, from investments or to providers of funds.

The directors have sought to mitigate the risk of future movements in market interest rates affecting the Group's profitability through the use of a number of derivative financial instruments, mainly in the form of interest rate swaps. The Group has designated a number of these derivatives as accounting hedges, in accordance with accounting standards to reduce the volatility of future movements in interest rates on the amounts recorded in the income statement.

The Group has a significant number of derivative instruments and uses valuation systems, and in some instances, valuations provided by counterparties, to determine the fair value of each instrument at the balance sheet date. The Group also uses systems, and in some cases bespoke cash flow models, to assess hedge effectiveness for the accounting hedges as required by accounting standards.

We focused on this area as there are a larger number of instruments that require valuations, and these require judgement. The process of recording the valuations in the accounting records requires manual input and the criteria for achieving hedge accounting are onerous and complex, both of which increase the risk of error in application.

In particular we focused on the interest yield curves and discount rates applied in the Society's valuation systems and/or counterparty valuations; and the Society's hedge documentation and calculation spreadsheets used to calculate ineffectiveness in hedge relationships.

How our audit addressed the key audit matter

We agreed fair values derived for each derivative financial instrument by management to the values recorded in the annual accounts.

We obtained a sample of derivative contracts and undertook independent valuations for these instruments at the balance sheet date using our own models. Within our models we used externally available sources for interest yield curves and discount rates for the Society, in arriving at our own independent estimates of fair value.

We compared our independently determined fair values to those calculated by management for the same instruments (whether through the use of valuation systems or those provided by counterparties) to evaluate any differences arising. In performing this comparison we calculated tolerable thresholds for valuation differences which took into account the complexity of the instrument being valued. We noted variances outside of those tolerable thresholds. However we concluded based on the external valuation services used and the long nature in the maturity of these instruments that the total variance is reasonable and as the variance on the whole book is not significant and it would not result in material misstatement with regards to derivative instruments.

We obtained and read the Group's hedging documentation to evaluate whether this documentation was compliant with the accounting requirements for applying hedge accounting and found no issues.

We also obtained and re-performed the hedge effectiveness calculations undertaken by management in assessing the effectiveness of the Group's hedge relationships. In performing this work we also recalculated the ineffectiveness recorded in the income statement within the 'Gains less losses on financial instruments and hedge accounting" line. In performance of these procedures we noted no differences to the effectiveness as calculated by the directors and recorded in the accounts.

Key audit matter

Adoption of IFRS 9

See note 32 to the annual accounts for the directors' disclosures of the expected impact of adoption of IFRS 9 on the Group's financial statements.

IFRS 9, the new standard for accounting for financial instruments was effective from 1 January 2018. The most significant impact of the new standard is in relation to loan loss provisioning. IFRS 9 requires provisions to be made on an expected loss basis, rather than the previous incurred loss basis.

The Society is exposed to significant credit risk, particularly in the residential loan portfolios, and as a result has developed a model to forecast expected loan losses to estimate the required provision.

We focussed on this area as in our view this has been subject to a significant level of focus from management throughout the year. This is also the first year in which full disclosure of the application of IFRS 9 will be made, which gives a heightened risk.

How our audit addressed the key audit matter

We have performed a review of the management's implementation of IFRS 9. We have engaged our specialist actuarial team to review the model which has been used by management to determine the expected credit loss provision under IFRS 9. During the 2018 audit, we independently compared this and prior year model codes, understood and critically assess the changes, ensuring the model remains appropriate.

As part of our detailed work we:

- Tested key assumptions used within the model to internal and external information where appropriate.
- Assessed the sufficiency of the disclosures in the financial statements relating to significant estimates made in the IFRS 9 impairment calculation, including disclosure of sensitivities.
- Assessed the completeness and validity of management's stage allocation in the mortgage books.
- Tested the completeness and accuracy of data inputs (including LTV, credit score, arrears) for the IFRS 9 models to identify any material inconsistencies with source system data.

We found the approach taken in relation to the adoption of IFRS 9 to be appropriate and judgements made were reasonable.

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 financial statements 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.

The Solutions business has been separated out from the Society, with all new contracts being directly with the Solutions business, and existing contracts being novated across into a separate legal entity, Newcastle Strategic Solutions Limited ("NSSL"). This is due to the desire from the regulators to have distinct businesses in separate legal entities.

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 fee and commission income recorded in NFAL, leasehold land and buildings recorded in NPHL and tested revenue recognition within NSSL.

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 financial statements as a whole.

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

Group financial statements

Overall materiality	£1,240,000 (2017: £1,226,000).
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 continue to use net assets, a GAAP enshrined proxy to regulatory capital, as our benchmark.

Society financial statements

Overall materiality	£1,155,000 (2017: £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 continue to use net assets, a GAAP enshrined proxy 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 £197,000 and £492,000. 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 £62,000 (Group audit) (2017: £60,000) and £57,750 (Society audit) (2017: £60,000) 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 financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements 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 financial statements.

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 on which the United Kingdom may withdraw from the European Union, which is currently due to occur on 29 March 2019, are not clear, and it is difficult to evaluate all of the potential implications on the Society's trade, customers, suppliers and the wider economy.

Independent Auditors' Report to the Members of Newcastle Building Society (continued)

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements 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 financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report 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).

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Group and Society and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

As a result of the directors' voluntary reporting on how they have applied the UK Corporate Governance Code (the "Code"), we are required to report to you if we have anything material to add or draw attention to regarding:

- The directors' confirmation on page 20 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on page 20 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report in respect of this responsibility.

Other Code Provisions

As a result of the directors' voluntary reporting on how they have applied the Code, we are required to report to you if, in our opinion:

- The statement given by the directors, on page 20, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Society's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Society obtained in the course of performing our audit.
- The section of the Annual Report on page 20 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of this responsibility.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities, the directors are responsible for the preparation of the financial statements 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 financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and 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 financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an 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 financial statements.

A further description of our responsibilities for the audit of the financial statements 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 Chapter 3 of Part 16 of the Building Societies Act 1986 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:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Society, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the Society financial statements are not in agreement with the accounting records and returns.

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 financial statements for the year ended 31 December 1994 and subsequent financial periods. The period of total uninterrupted engagement is 25 years, covering the years ended 31 December 1994 to 31 December 2018.

Other voluntary reporting

Directors' remuneration

The Society voluntarily prepares a Directors' Remuneration Report in accordance with the provisions of the Building Societies Act 1986. The directors requested that we audit the part of the Directors' Remuneration Report specified by the Building Societies Act 1986 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 Building Societies Act 1986.

Gary Shaw (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Newcastle upon Tyne
26 February 2019

Income Statements for the year ended 31 December 2018

	Note	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Interest receivable and similar income	2	**75.2**	65.6	**76.5**	66.9
Interest payable and similar charges	3	**(41.0)**	(36.5)	**(41.0)**	(36.5)
Net interest income		**34.2**	29.1	**35.5**	30.4
Other income	4	**33.0**	31.7	**15.9**	20.5
Other charges	4	**(2.8)**	(3.0)	**(2.8)**	(3.0)
Gains less losses on financial instruments and hedge accounting		**0.1**	0.1	**0.1**	0.1
Income from shares in subsidiary undertakings (dividends)	4	**-**	-	**1.3**	1.3
Total operating income		**64.5**	57.9	**50.0**	49.3
Administrative expenses	6	**(46.9)**	(43.0)	**(34.2)**	(36.3)
Depreciation	16,17	**(2.9)**	(2.8)	**(1.2)**	(1.3)
Operating profit before impairments, provisions and exceptional items		**14.7**	12.1	**14.6**	11.7
Impairment charges on loans and advances to customers	12	**(1.5)**	(0.2)	**(1.5)**	(0.2)
Provisions for liabilities and charges	26	**0.1**	(1.0)	**0.1**	(1.0)
Exceptional gain on purchase of Cobalt Offices		**-**	2.2	**-**	2.2
Profit for the year before taxation		**13.3**	13.1	**13.2**	12.7
Taxation expense	8	**(2.5)**	(2.2)	**(2.3)**	(2.0)
Profit after taxation for the financial year		**10.8**	10.9	**10.9**	10.7

The notes on pages 50 to 95 form part of these Accounts.

Statements of Comprehensive Income for the year ended 31 December 2018

	Note	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Profit for the financial year		**10.8**	10.9	**10.9**	10.7
Other comprehensive income / (expense):					
Items that may be reclassified to income statement					
Movement on fair value through other comprehensive income/available for sale reserve		**(1.7)**	1.8	**(1.7)**	1.8
Income tax on items that may be reclassified to income statement	18	**0.3**	(0.3)	**0.3**	(0.3)
Total items that may be reclassified to income statement		**(1.4)**	1.5	**(1.4)**	1.5
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	**(1.1)**	(1.7)	**(1.1)**	(1.7)
Total items that will not be reclassified to income statement		**(1.1)**	(1.7)	**(1.1)**	(1.7)
Total comprehensive income for the financial year		**8.3**	10.7	**8.4**	10.5

The notes on pages 50 to 95 form part of these Accounts.

Balance Sheets as at 31 December 2018

	Note	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
ASSETS					
Cash and balances with the Bank of England		**152.9**	182.0	**152.9**	182.0
Loans and advances to banks	10	**210.5**	227.7	**200.4**	226.3
Debt securities	11	**329.0**	380.1	**329.0**	380.1
Derivative financial instruments	32	**3.5**	4.9	**3.5**	4.9
Loans and advances to customers	12	**2,772.2**	2,707.3	**2,769.4**	2,703.0
Fair value adjustments for hedged risk	13	**175.9**	206.2	**175.9**	206.2
Investment in subsidiary undertakings	15	**-**	-	**41.8**	42.0
Property, plant and equipment and investment properties	16,17	**38.8**	38.8	**12.5**	12.0
Deferred tax assets	18	**2.3**	3.2	**2.2**	3.3
Retirement benefit asset	19	**-**	-	**-**	-
Other assets	20	**12.7**	11.9	**15.5**	15.9
TOTAL ASSETS		**3,697.8**	3,762.1	**3,703.1**	3,775.7

The notes on pages 50 to 95 form part of these Accounts.

Balance Sheets as at 31 December 2018

	Note	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
LIABILITIES					
Due to Members	21	**2,713.7**	2,788.5	**2,713.7**	2,788.5
Fair value adjustments for hedged risk	13	**0.4**	1.6	**0.4**	1.6
Due to other customers	22	**142.6**	226.2	**143.7**	236.5
Deposits from banks	23	**409.8**	277.4	**409.8**	277.4
Debt securities in issue	24	**-**	1.0	**-**	1.0
Derivative financial instruments	32	**178.3**	210.2	**178.3**	210.2
Other liabilities	25	**12.0**	13.7	**15.7**	16.6
Provisions for liabilities and charges	26	**0.9**	1.7	**0.9**	1.7
Subordinated liabilities	27	**25.0**	25.0	**25.0**	25.0
Subscribed capital	28	**20.0**	30.0	**20.0**	30.0
Reserves		**195.1**	186.8	**195.6**	187.2
TOTAL LIABILITIES		**3,697.8**	3,762.1	**3,703.1**	3,775.7

These Accounts were approved by the Board of Directors on 26 February 2019 and signed on its behalf by:

Phil Moorhouse, Chairman
John Morris, Chairman of Audit Committee
Andrew Haigh, Chief Executive

The notes on pages 50 to 95 form part of these Accounts.

Statements of Movements in Members' Interests for the year ended 31 December 2018

GROUP	General reserve £m	Fair Value Through Other Comprehensive Income £m	Total £m
At 1 January 2018	185.0	1.8	186.8
Movement in the year	9.7	(1.4)	8.3
At 31 December 2018	**194.7**	**0.4**	**195.1**

	General reserve £m	Available for sale reserve £m	Total £m
At 1 January 2017	175.8	0.3	176.1
Movement in the year	9.2	1.5	10.7
At 31 December 2017	**185.0**	**1.8**	**186.8**

SOCIETY	General reserve £m	Fair Value Through Other Comprehensive Income £m	Total £m
At 1 January 2018	185.4	1.8	187.2
Movements in the year	9.8	(1.4)	8.4
At 31 December 2018	**195.2**	**0.4**	**195.6**

	General reserve £m	Available for sale reserve £m	Total £m
At 1 January 2017	176.4	0.3	176.7
Movements in the year	9.0	1.5	10.5
At 31 December 2017	**185.4**	**1.8**	**187.2**

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

Cash Flow Statements for the year ended 31 December 2018

	Note	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Cash (outflows) / inflows from operating activities	30	**(50.6)**	66.9	**(60.6)**	62.6
Payment into defined benefit pension scheme		**(1.5)**	(2.0)	**(1.5)**	(2.0)
Net cash (outflows) / inflows from operating activities		**(52.1)**	64.9	**(62.1)**	60.6
Cash (outflows) / inflows from investing activities					
Purchase of property, plant and equipment		**(2.9)**	(18.8)	**(1.7)**	(1.1)
Decrease / (increase) in loans to subsidiary undertakings		**-**	-	**0.2**	(13.7)
Purchase of investment securities		**(72.5)**	(185.1)	**(72.5)**	(185.1)
Sale and maturity of investment securities		**121.2**	154.9	**121.2**	154.9
Net cash inflows / (outflows) from investing activities		**45.8**	(49.0)	**47.2**	(45.0)
Cash outflows from financing activities					
Interest paid on subordinated liabilities		**(0.8)**	(2.1)	**(0.8)**	(2.1)
Interest paid on subscribed capital		**(3.5)**	(3.5)	**(3.5)**	(3.5)
Repayment of subordinated liabilities		**-**	(25.0)	**-**	(25.0)
Repayment of subscribed capital		**(10.0)**	-	**(10.0)**	-
Repayments under finance lease agreements		**-**	(0.1)	**-**	(0.1)
Net cash outflows from financing activities		**(14.3)**	(30.7)	**(14.3)**	(30.7)
Net decrease in cash		**(20.6)**	(14.8)	**(29.2)**	(15.1)
Cash and cash equivalents at start of year		**183.6**	198.4	**182.2**	197.3
Cash and cash equivalents at end of year	30	**163.0**	183.6	**153.0**	182.2

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) Regulations 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.

The Annual Accounts have been prepared under the historical cost convention except for those financial assets and hedging instruments which are required by IFRS 9 to be carried at fair value through profit and loss or at fair value through other comprehensive income. A summary of the Group's principal accounting policies is set out below:

The Group has applied its accounting policies consistently across both 2018 and 2017 unless otherwise stated 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

Interest receivable and interest payable for all interest-bearing financial instruments are recognised within 'Interest receivable and similar income' and 'Interest payable and similar charges' in the consolidated income statements, using the effective interest rate method (EIRM).

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.

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. At 31 December 2018 the insurance component of the Group Equity Release assets is wholly immaterial.

Significant Accounting Policies Continued

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 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, index risk relating to savings products (equities, house prices and inflation) 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, applicable to the Society's non-macro hedging activities, assessment is given 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.

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.

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, subordinated liabilities and Permanent Interest Bearing Shares are subsequently measured at amortised cost, using the EIRM.

Significant Accounting Policies Continued

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 2018. 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, fittings and motor vehicles:

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
Motor vehicles	- over the term of the lease
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.

Operating Leases

The Group leases a number of branch and office properties under operating leases. Lease discounts or other incentives are recognised as an integral part of the net consideration agreed for the use of a leased asset with the aggregate benefit of incentives recognised as a reduction of rental expense over the lease term, on a straight line basis.

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 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 previously 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 estimates and judgements in applying its accounting policies which affect the amounts recognised in the Annual Accounts. These estimates and 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 are:-

Accounting Estimates

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.

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 32 to the Annual Accounts.

Taxation

The Group is subject to tax in three jurisdictions and, consequently, estimates are required in determining the provision for corporation tax. As shown in Note 18 to the Annual Accounts the Group has deferred tax assets which are considered recoverable given the Society and Group plans over the planning horizon.

Significant Accounting Policies Continued

Accounting Judgements

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 32 to the Annual Accounts.

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, UKs 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 32 to the Annual Accounts.

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 2018.

IFRS 9, Financial Instruments (including amendments), superseded IAS 39 giving revised classification and measurement, impairment and hedge accounting requirements for financial instruments. While implementation of IFRS 9 has not significantly impacted the Group's financial results or position, it has introduced significant changes to the Group's impairment methodology and modelling. Full detail of the Group's transition from IAS 39 to IFRS 9 was given in the 2017 Annual Report and Accounts and the 2018 Half Year Results, both available on the Group's website: https://www.newcastle.co.uk/about-us/media-centre/financial-results/

IFRS 15, Revenue from contracts with customers (including amendments), superseded IAS 18, Revenue, establishing principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard moves focus from risk and rewards, to the transfer of control of a good or service at either a point in time or over time. IFRS 15's core principle is for revenue to be recognised in relation to the transfer of goods or services to customers in an amount that reflects the consideration that is expected in exchange for those goods or services. IFRS 15 has not had a significant impact on the Group's financial statements.

Amendments made to IFRS 4, Insurance contracts, IFRS 2, Share based payments, IAS 40, Investment property, IFRS 1, First-time adoption of IFRS and IAS 28, Investments in associates and joint ventures have not been consequential to the Group.

Developments not effective at 31 December 2018

There are a number of new or amended standards which become effective in 2019, and beyond, which allow for early adoption but the Society is not taking up any of those standards before their mandatory date.

IFRS 16 Leases supersedes IAS 17 Leases and sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective of the new standard is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. 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. IFRS 16 is effective for periods beginning on or after 1 January 2019. The Group has not elected to apply the standard early.

2 Interest receivable and similar income

	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
On loans and advances to customers	**89.5**	87.1	**90.9**	88.4
On debt securities				
- interest and other income	**4.1**	3.7	**4.0**	3.7
- profits net of losses on realisation	**0.3**	-	**0.3**	-
On other liquid assets				
- interest and other income	**2.5**	1.1	**2.5**	1.1
Net expense on derivatives hedging assets	**(21.2)**	(26.3)	**(21.2)**	(26.3)
	75.2	65.6	**76.5**	66.9

Interest receivable and other income includes **£4.0m** (2017: £3.6m) from fixed income securities.

3 Interest payable and similar charges

	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
On shares held by individuals	**34.8**	31.4	**34.8**	31.4
On subscribed capital	**3.5**	3.5	**3.5**	3.5
On deposits and other borrowings				
- subordinated liabilities	**0.8**	2.1	**0.8**	2.1
- to other depositors and borrowers	**3.9**	2.5	**3.9**	2.5
Net income on derivatives hedging liabilities	**(2.0)**	(3.0)	**(2.0)**	(3.0)
	41.0	36.5	**41.0**	36.5

Net income on derivatives hedging liabilities includes £0.2m from basis risk derivatives that were not formally designated in hedge relationships during 2018.

4 Other income and charges

	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Other income				
Fee and commission income	**7.0**	7.2	**2.9**	3.4
Other operating income	**26.0**	24.5	**13.0**	17.1
	33.0	31.7	**15.9**	20.5

	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Other charges				
Fee and commission expense	**2.8**	3.0	**2.8**	3.0

	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £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 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
SOLUTIONS BUSINESS				
Savings management services				
Recognised at a point in time	**-**	-	**-**	-
Recognised over time	**24.8**	22.7	**3.5**	9.3
	24.8	22.7	**3.5**	9.3
Savings management project and change services				
Recognised at a point in time	**-**	-	**-**	-
Recognised over time	**1.3**	1.2	**0.1**	0.1
	1.3	1.2	**0.1**	0.1
IT Services				
Recognised at a point in time	**-**	-	**-**	-
Recognised over time	**0.7**	1.0	**-**	-
	0.7	1.0	**-**	-
MEMBER BUSINESS				
Regulated advice services				
Recognised at a point in time	**2.3**	2.3	**-**	-
Recognised over time	**1.8**	1.5	**-**	-
	4.1	3.8	**-**	-
Third Party Services				
Recognised at a point in time	**0.7**	0.9	**0.7**	0.9
Recognised over time	**-**	-	**-**	-
	0.7	0.9	**0.7**	0.9
Total revenue from contracts with customers	**31.6**	29.6	**4.3**	10.3

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 31.

Notes to the Accounts for the year ended 31 December 2018

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 2018:

	GROUP 2018 £m	2017 £m
Aggregate amount of transaction price allocated to long-term savings management contracts	**5.3**	-
Aggregate amount of transaction price allocated to long-term savings management systems contracts	**2.7**	-
	8.0	-

As permitted under the transitional provisions in IFRS 15, the transaction price related to partially unsatisfied performance obligations as at 31 December 2017 is not disclosed.

In relation to savings management contracts, the Group expects to recognise approximately £1.8m of the unearned amount in 2019, and £3.5m thereafter. In relation to savings management systems contracts, the Group expects to recognise approximately £0.4m of the unearned amount in 2019, and £2.3m 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 2018 £m	2017 £m
Asset recognised for costs incurred to fulfil a contract	**0.1**	-
Contract liability for IT savings management systems	**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.

Notes to the Accounts for the year ended 31 December 2018

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 change 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 are provided by the Society's subsidiary, Newcastle Systems Management Limited (NSML). NSML provide 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 the actual asset balance held by a customer in the relevant month.

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. NSML 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 dependant 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 in-line 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, NSML, and NFAL, 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 2018 are not material.

6 Administrative expenses

	Note	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Staff costs	7	**33.4**	30.7	**16.7**	15.2
Rentals under operating leases for land and buildings					
- payable to third parties		**0.9**	1.1	**0.8**	1.1
- payable to subsidiary undertaking		**-**	-	**0.9**	0.7
Other administrative expenses		**12.6**	11.2	**15.8**	19.3
		46.9	43.0	**34.2**	36.3

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 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Fees payable to the Society's auditors for audit of Society and consolidated financial statements	**0.2**	0.2	**0.2**	0.2
Fees payable to the Society's auditors for other services	**-**	0.1	**-**	0.1
	0.2	0.3	**0.2**	0.3

Fees payable to the Society's auditor for the audit of consolidated financial statements includes **£19k** (2017: £18k) attributable to subsidiary companies.
Fees payable to the Society's auditors for other services includes **£25k** (2017: £55k) for other non-audit services.

7 Staff costs

	Note	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Wages and salaries		**27.8**	25.8	**13.7**	12.6
Social security costs		**2.6**	2.4	**1.2**	1.1
Pension costs for defined contribution scheme		**3.0**	2.5	**1.8**	1.5
	6	**33.4**	30.7	**16.7**	15.2

Directors' emoluments are disclosed in the Remuneration Committee Report.

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

	GROUP 2018	GROUP 2017	SOCIETY 2018	SOCIETY 2017
Full time	**829**	822	**342**	346
Part time	**219**	211	**144**	140
	1,048	1,033	**486**	486
Head Office	**856**	844	**330**	319
Branches	**192**	189	**156**	167
	1,048	1,033	**486**	486

8 Taxation expense

	Note	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Current tax					
Current year		**0.7**	-	**0.6**	-
Adjustments in respect of previous years		**0.6**	-	**0.3**	-
Total deferred tax		**1.3**	-	**0.9**	-
Deferred tax					
Current year		**1.7**	2.3	**1.8**	2.2
Adjustments in respect of prior years		**(0.5)**	(0.1)	**(0.4)**	(0.2)
Total deferred tax		**1.2**	2.2	**1.4**	2.0
Total taxation expense in the Income Statements	18	**2.5**	2.2	**2.3**	2.0

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 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Profit for the year before taxation	**13.3**	13.1	**13.2**	12.7
Profit before taxation at the standard rate of corporation tax in the UK of **19%** (2017: 19%)	**2.5**	2.5	**2.5**	2.4
Expense not deductible for tax purposes:				
Non-taxable dividend income received	**-**	-	**(0.2)**	(0.3)
Other	**(0.2)**	(0.6)	**-**	(0.5)
Expenses	**0.1**	0.4	**0.1**	0.5
Rate change	**-**	-	**-**	-
Adjustments in respect of previous years	**0.1**	(0.1)	**(0.1)**	(0.1)
Total taxation expense	**2.5**	2.2	**2.3**	2.0

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, provisions, and FSCS levy 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 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	**3,681.0**	**16.8**	**3,697.8**

Year to 31 December 2017	Member Business £m	Solutions Business £m	Total £m
Net interest receivable	29.1	-	29.1
Other income and charges	5.6	23.2	28.8
Administrative expenses	(26.4)	(16.6)	(43.0)
Depreciation	(1.7)	(1.1)	(2.8)
Operating profit before impairments, provisions and exceptional items	6.6	5.5	12.1
Impairment charges on loans and advances to customers	(0.2)	-	(0.2)
Provisions for liabilities and charges	(1.0)	-	(1.0)
Exceptional gain on purchase of Cobalt Offices	2.2	-	2.2
Profit for the year before taxation*	7.6	5.5	13.1
Taxation expense			(2.2)
Profit after taxation for the financial year			10.9
Total assets	3,745.3	16.8	3,762.1

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

10 Loans and advances to banks

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

	GROUP		SOCIETY	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Accrued interest	**0.1**	0.1	**0.1**	0.1
On demand	**10.1**	1.5	**-**	0.1
In not more than three months	**201.8**	227.6	**201.8**	227.6
Gross loans and advances to banks	**212.0**	229.2	**201.9**	227.8
Less: allowance for losses on loans and advances to banks	**(1.5)**	(1.5)	**(1.5)**	(1.5)
	210.5	227.7	**200.4**	226.3

Allowance for losses on loans and advances to banks

	GROUP and SOCIETY	
	2018 £m	2017 £m
Balance at 1 January	**1.5**	1.6
Amounts utilised during the year	**-**	(0.1)
At 31 December	**1.5**	1.5

At 31 December 2018 the Society had loans and advances to Icelandic banks totalling **£1.6m** (2017: £1.6m), against which allowance for losses of **£1.5m** (2017: £1.5m) has been made.

11 Debt securities

	GROUP and SOCIETY	
Transferable debt securities	**2018 £m**	2017 £m
Issued by public bodies - listed	**73.3**	84.8
Issued by other borrowers - unlisted	**255.7**	295.3
	329.0	380.1

These have remaining maturities as follows:		
Accrued interest	**1.0**	1.9
In not more than one year	**21.0**	43.2
In more than one year but not more than five years	**234.1**	250.7
In more than five years	**72.9**	84.3
	329.0	380.1

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		SOCIETY	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Loans fully secured on residential property	**2,723.2**	2,635.5	**2,720.4**	2,631.2
Loans fully secured on land	**57.7**	68.0	**57.7**	68.0
Other loans	**3.3**	14.6	**3.3**	14.6
Gross loans and advances	**2,784.2**	2,718.1	**2,781.4**	2,713.8
Less: allowance for losses on loans and advances	**(12.0)**	(10.8)	**(12.0)**	(10.8)
	2,772.2	2,707.3	**2,769.4**	2,703.0

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

	GROUP		SOCIETY	
	2018 £m	2017 £m	**2018 £m**	2018 £m
On demand	**5.3**	7.1	**5.3**	7.1
In not more than three months	**28.6**	40.0	**28.6**	39.9
In more than three months but not more than one year	**53.4**	62.2	**53.4**	62.1
In more than one year but not more than five years	**281.6**	258.9	**281.4**	258.6
In more than five years	**2,415.3**	2,349.9	**2,412.7**	2,346.1
Gross loans and advances	**2,784.2**	2,718.1	**2,781.4**	2,713.8
Less: allowance for losses on loans and advances	**(12.0)**	(10.8)	**(12.0)**	(10.8)
	2,772.2	2,707.3	**2,769.4**	2,703.0

Where a loan is repayable by instalment, each such instalment has been treated as a separate repayment in the maturity analysis set out overleaf. 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 2018

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 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**

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 2017	0.9	0.6	7.1	2.7	0.3	-	8.3	3.3	11.6
Charge / (credit) for the year	-	0.7	0.9	(1.4)	-	-	0.9	(0.7)	0.2
Utilised during the year	(0.7)	-	(0.3)	-	-	-	(1.0)	-	(1.0)
Balance at 31 December 2017	0.2	1.3	7.7	1.3	0.3	-	8.2	2.6	10.8

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 **£175.9m** (2017: £206.2m).

The cumulative fair value adjustment for hedged risk for liabilities for the Group and Society was **£0.4m** (2017: £1.6m).

Notes to the Accounts for the year ended 31 December 2018

14 Insurance contracts

The Group's equity release mortgage assets are accounted for as unbundled 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 2018	**200.6**	**(1.1)**	**199.5**
31 December 2017	209.9	(0.8)	209.6

The gross mortgage balances above reflect the Group's maximum exposure (pre collateral) to credit risk at 31 December. 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 £576.9m is held against the Group's equity release exposures at 31 December 2018. By their nature, equity release mortgages are not considered to hold a pre-determined maturity date.

The insurance liability of £1.1m reflects discrete provisions made against 91 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 2018	**14.0**	**0.3**	**-**
31 December 2017	13.8	0.1	-

There were no significant amounts re-credited to the income statement during 2018 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 2018 £m
Surrenders per annum	1.00	-1%	0.8
HPI growth	2.50	-1%	3.4
Discount rate	1.19	-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 £8.5m. The base variables reflect the Group's best estimates towards future positions in house prices, mortality rates and discount rates as at 31 December 2018. 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.

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.

15 Investments in subsidiary undertakings

SOCIETY

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**

Investments in subsidiary undertakings	Shares £m	Loans £m	Total £m
Cost			
At 1 January 2017	12.0	20.0	32.0
Additions	-	16.4	16.4
Repayments received	-	(2.7)	(2.7)
At 31 December 2017	**12.0**	**33.7**	**45.7**
Provisions			
At 1 January and 31 December 2017	**0.6**	**3.1**	**3.7**
Net book amount at 31 December 2017	**11.4**	**30.6**	**42.0**

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 31 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 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**

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 2017	3.1	11.3	18.6	6.2	39.2
Additions	-	9.8	2.4	0.8	13.0
Disposals	-	-	(0.3)	-	(0.3)
At 31 December 2017	**3.1**	**21.1**	**20.7**	**7.0**	**51.9**
Accumulated depreciation					
At 1 January 2017	0.5	3.8	11.1	4.6	20.0
Charge for the year	0.1	0.4	1.7	0.5	2.7
Disposals	-	-	(0.3)	-	(0.3)
At 31 December 2017	**0.6**	**4.2**	**12.5**	**5.1**	**22.4**
Net book amount at 31 December 2017	**2.5**	**16.9**	**8.2**	**1.9**	**29.5**

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 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**

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 2017	3.1	-	12.9	1.7	17.7
Additions	-	-	0.9	0.2	1.1
Disposals	-	-	(0.3)	-	(0.3)
At 31 December 2017	**3.1**	**-**	**13.5**	**1.9**	**18.5**
Accumulated depreciation					
At 1 January 2017	0.6	-	7.1	1.3	9.0
Charge for the year	0.1	-	1.0	0.2	1.3
Disposals	-	-	(0.2)	-	(0.2)
At 31 December 2017	**0.7**	**-**	**7.9**	**1.5**	**10.1**
Net book amount at 31 December 2017	**2.4**	**-**	**5.6**	**0.4**	**8.4**

Included within Equipment, fixtures, fittings and motor vehicles and leasehold land and buildings are assets under finance leases, which comprise motor vehicles and a long leasehold property that have the following net book amounts.

	GROUP and SOCIETY 2018 £m	2017 £m
Cost		
At 1 January	**0.8**	0.8
Accumulated depreciation	**(0.1)**	(0.1)
Net book amount	**0.7**	0.7

The Group leases a number of branch and office properties under operating leases in accordance with IAS 17. On transition to IFRS 16 on 1 January 2019 the Group recognised a right-of-use asset of £6.6m, and corresponding lease liability and dilapidation provision of £7.3m, in relation to these lease contracts. The difference between the two was taken as an adjustment to opening reserves at 1 January 2019 of £0.7m. 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 in the Statement of Comprehensive Income in 2019.

17 Investment Property

	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Cost				
At 1 January	**10.0**	4.2	**4.2**	4.2
Additions	**-**	5.8	**-**	-
Disposals	**-**	-	**-**	-
At 31 December	**10.0**	10.0	**4.2**	4.2
Accumulated depreciation				
At 1 January	**0.7**	0.6	**0.6**	0.6
Charge for the year	**0.2**	0.1	**-**	-
Disposals	**-**	-	**-**	-
At 31 December	**0.9**	0.7	**0.6**	0.6
Net book amount at 31 December	**9.1**	9.3	**3.6**	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 properties are occupied by both the Group and third parties. In February 2017 the Society's subsidiary, Newcastle Systems Management Limited (NSML) purchased Cobalt 21, a previously leased office property, for a purchase price of £15.6m. Approximately 3/8ths of the property is occupied by an external third party, and therefore classified as investment property by the Group.

Management consider the purchase price to reflect the fair value of the Cobalt investment property at 31 December 2018. No formal third party valuation of the Society or Group investment property holdings was undertaken during 2018 with the properties managed to facilitate continued operation from each property (via rental to third parties or otherwise) and not towards view of speculative sale.

During 2018 rental income from investment properties of **£0.6m** (2017: £0.4m) was recognised by the Group, and **£0.2m** (2017: £0.1m) 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 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
At 1 January	**3.2**	5.6	**3.3**	5.5
Income Statements expense	**(1.7)**	(2.2)	**(1.8)**	(2.0)
Other	**-**	0.1	**-**	0.1
Prior year adjustment	**0.5**	-	**0.4**	-
Credited on items taken directly through reserves	**0.3**	(0.3)	**0.3**	(0.3)
At 31 December	**2.3**	3.2	**2.2**	3.3

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

Deferred tax assets				
Other items	**(0.1)**	(0.4)	**(0.1)**	(0.4)
Trading losses	**1.4**	2.1	**1.4**	2.1
Depreciation in excess of capital allowances	**1.0**	1.5	**0.9**	1.6
	2.3	3.2	**2.2**	3.3

Deferred tax assets				
Deferred tax asset to be recovered in less than 12 months	**1.2**	0.9	**0.9**	0.9
Deferred tax asset to be recovered in more than 12 months	**1.1**	2.3	**1.3**	2.4
	2.3	3.2	**2.2**	3.3

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

Other items	**-**	(0.2)	**-**	(0.2)
Prior year adjustment	**0.5**	-	**0.4**	-
Trading losses	**(1.5)**	(2.2)	**(1.5)**	(2.2)
Depreciation in excess of capital allowances	**(0.2)**	0.2	**(0.3)**	0.4
	(1.2)	(2.2)	**(1.4)**	(2.0)

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 2018 was 18 years. (2017: 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 2016. 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 the year, the Scheme funding level hit the trigger resulting in deficit reduction contributions halving to £850,000. The Society therefore expects to pay £1.2m to the Scheme during the accounting year beginning 1 January 2019, unless a trigger is reached for employer contributions to cease or increase.

Assumptions

The assumptions and data underpinning the triennial valuation at 30 June 2016 have been fed through to the position at 31 December 2018 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	**2018**	2017
Discount rate	**2.80%**	2.45%
RPI inflation	**3.20%**	3.10%
CPI inflation	**2.20%**	2.10%
Mortality assumptions		
Mortality (post-retirement)	**SAPS 'S2'CMI 2017 [1.25%] (yob)**	SAPS 'S2'CMI 2016 [1.25%] (yob)
Other actuarial assumptions		
RPI pension increases	**3.10%**	3.05%
Pension increases in deferment	**2.20%**	2.10%
Life expectancies (in years)		
For an individual aged 62		
Male	**24.7 years**	24.8 years
Female	**26.7 years**	26.7 years
At age 62 for an individual aged 42 in 2018		
Male	**26.2 years**	26.3 years
Female	**28.3 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 defined benefit obligation is calculated using a discount rate set with reference to corporate bond yields, however the Scheme invests significantly in equities and other growth funds. These 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 defined benefit obligation is calculated using a discount rate set with reference to corporate bond yields, a decrease in corporate bond yields would increase the Scheme's defined benefit obligations. However this would be partially offset by an increase in the value of the Scheme's bond and Liability Driven Investment (LDI) holdings (see below).
- **Inflation risk:** the majority of pension increases received before and after retirement are linked to inflation, therefore higher inflation will result in a higher defined benefit obligations although the Scheme's LDI holdings hedge inflation rate changes to some extent.
- **Mortality risk:** if Scheme members live longer than expected, the Scheme's benefits will need to be paid for longer, increasing the Scheme's defined benefit obligation.

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

- **Diversification:** the Scheme's 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 their 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 the future.

Sensitivity analysis

Assumption	Change in assumption	Change in defined benefit obligation
Discount rate	+ 0.5% / – 0.5%	– 7% / + 8%
RPI and CPI inflation	+ 0.5% / – 0.5%	+ 4% / – 4%
Assumed life expectancy	– 1 year / +1 year	– 3% / +3%

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	2018 %	2017 %
Equities and growth	**34.6**	37.9
Bonds	**26.5**	19.8
Gilts	**33.5**	39.6
Property	**-**	1.5
Cash	**5.4**	1.2
Total	**100.0**	100.0
Actual return on assets over the year	**(2.1)**	8.4

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

19 Retirement benefit obligations Continued

Reconciliation to the Balance Sheet

	2018 £m	2017 £m
Market value of assets	**102.6**	112.8
Present value of defined benefit obligation	**(93.4)**	(102.0)
Funded status	**9.2**	10.8
Accounting policy: derecognition of pensions surplus	**(9.2)**	(10.8)
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 year

	2018 £m	2017 £m
Value of defined benefit obligation at start of year	**102.0**	108.6
Interest cost	**2.4**	2.8
Past service cost	**0.5**	-
Benefits paid	**(9.2)**	(8.5)
Actuarial (gains): changes in demographic assumptions	**(4.3)**	(1.5)
Actuarial losses: changes in financial assumptions	**2.0**	0.6
Value of defined benefit obligation at end of year	**93.4**	102.0

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

	2018 £m	2017 £m
Market value of assets at start of year	**112.8**	111.2
Interest income	**2.6**	2.8
Actual (losses) / gains on assets	**(4.7)**	5.6
Employer contributions	**1.4**	2.0
Benefits paid	**(9.2)**	(8.5)
Administration costs	**(0.3)**	(0.3)
Market value of assets at end of year	**102.6**	112.8

Amount recognised in Income Statements

	2018 £m	2017 £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

	2018 £m	2017 £m
Actuarial gains on defined benefit obligations	**2.3**	0.9
Actual (losses) / gains return on assets	**(4.7)**	5.6
Change in effect of limit on scheme surplus	**1.3**	(8.2)
Amounts recognised in Statements of Comprehensive Income	**(1.1)**	(1.7)

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.

Notes to the Accounts for the year ended 31 December 2018

20 Other assets

	GROUP		SOCIETY	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Receivable from subsidiary undertakings	**-**	-	**3.3**	2.9
Prepayments and accrued income	**9.7**	9.7	**11.7**	12.6
Other	**3.0**	2.2	**0.5**	0.4
	12.7	11.9	**15.5**	15.9

21 Due to Members

	GROUP and SOCIETY	
	2018 £m	2017 £m
Held by individuals	**2,713.5**	2,788.4
Other shares	**0.2**	0.1
	2,713.7	2,788.5

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

Accrued interest	**12.9**	13.0
On demand	**1,351.2**	1,478.6
In not more than three months	**936.7**	830.0
In more than three months but not more than one year	**178.1**	275.2
In more than one year but not more than five years	**234.1**	189.9
In more than five years	**0.7**	1.8
	2,713.7	2,788.5

22 Due to other customers

	GROUP		SOCIETY	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Amounts owed to subsidiary undertakings	**-**	-	**1.1**	10.3
Other	**142.6**	226.2	**142.6**	226.2
	142.6	226.2	**143.7**	236.5

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

Accrued interest	**0.7**	0.7	**0.7**	0.7
On demand	**2.8**	3.0	**2.8**	3.0
In not more than three months	**53.4**	110.6	**53.4**	110.6
In more than three months but not more than one year	**85.7**	109.9	**86.8**	120.2
In more than one year but not more than five years	**-**	2.0	**-**	2.0
	142.6	226.2	**143.7**	236.5

Notes to the Accounts for the year ended 31 December 2018

23 Deposits from banks

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

	GROUP and SOCIETY	
	2018 £m	2017 £m
Accrued interest	**0.8**	0.3
In not more than three months	**53.5**	20.6
In more than three months but not more than one year	**44.5**	5.5
In more than one year but not more than five years	**311.0**	251.0
	409.8	277.4

24 Debt securities in issue

	GROUP and SOCIETY	
	2018 £m	2017 £m
Certificates of deposit	**-**	1.0

25 Other liabilities

	GROUP		SOCIETY	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Amounts payable to subsidiary undertakings	**-**	-	**5.9**	5.9
Obligations under finance leases	**0.9**	0.9	**0.9**	0.9
Other creditors	**2.2**	2.5	**1.4**	1.2
Accruals and deferred income	**8.9**	10.3	**7.5**	8.6
	12.0	13.7	**15.7**	16.6

Obligations under finance leases fall due as follows:

Within one year	**0.1**	0.1	**0.1**	0.1
In one to five years	**0.8**	0.8	**0.8**	0.8
	0.9	0.9	**0.9**	0.9

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

There is not a material difference between the minimum lease payment at the balance sheet date and their present value.

26 Provisions for liabilities and charges

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**

GROUP and SOCIETY

	FSCS Levy £m	Other Provisions £m	Total £m
Opening Provision at 1 January 2017	0.7	1.3	2.0
New Provisions during the year	0.1	0.9	1.0
Amounts utilised during the year	(0.5)	(0.8)	(1.3)
Closing Provision at 31 December 2017	0.3	1.4	1.7

Provision for Financial Services Compensation Scheme Levy

At 31 December 2018 the Society held a provision of £0.1m in relation to the 2018/19 Scheme year. The Society's provision is calculated based on the Society's current share of protected deposits and the latest FSCS data detailing the interest expense for the scheme year.

Other provisions

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

27 Subordinated liabilities

	GROUP and SOCIETY 2018 £m	2017 £m
3.849% fixed rate subordinated notes 2019	**25.0**	25.0
	25.0	25.0

On a winding up, the subordinated notes 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 are 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.

28 Subscribed capital

	GROUP and SOCIETY 2018 £m	2017 £m
12.625% permanent interest bearing shares	**10.0**	10.0
10.750% permanent interest bearing shares	**10.0**	10.0
12.000% permanent interest bearing shares	**-**	10.0
	20.0	30.0

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.

The £10m 12.0% PIBS was called by the Society on 18 December 2018.

29 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.

	GROUP and SOCIETY 2018 £m	2017 £m
Irrevocable undrawn committed loan facilities	**131.1**	110.4
Payments under non-cancellable operating lease agreements		
Total minimum lease payments:		
Within one year	**0.8**	0.9
In one to five years	**2.5**	2.4
Over five years	**1.2**	1.6
	4.5	4.9

30 Note to the Cash Flow Statements

	GROUP 2018 £m	GROUP 2017 £m	SOCIETY 2018 £m	SOCIETY 2017 £m
Reconciliation of profit before taxation to net cash inflow from operating activities				
Profit before taxation	**13.3**	13.1	**13.2**	12.7
Depreciation and amortisation	**2.9**	2.8	**1.2**	1.3
Interest on subordinated liabilities	**0.8**	2.1	**0.8**	2.1
Interest on subscribed capital	**3.5**	3.5	**3.5**	3.5
Decrease in derivative financial instruments	**(30.5)**	(22.5)	**(30.5)**	(22.5)
Decrease in other financial liabilities at fair value through profit or loss	**29.1**	24.0	**29.1**	24.0
Changes in retirement benefit obligations	**0.3**	0.3	**0.3**	0.3
Other non-cash movements	**(0.1)**	(4.8)	**0.4**	(4.9)
Net cash inflow before changes in operating assets and liabilities	**19.3**	18.5	**18.0**	16.5
Increase in loans and advances to customers	**(66.1)**	(142.7)	**(67.6)**	(144.6)
Decrease in cash collateral pledged	**25.7**	7.8	**25.7**	7.8
(Decrease) / Increase in shares	**(74.8)**	79.3	**(74.8)**	79.3
Increase in amounts due to other customers and deposits from banks	**48.8**	105.2	**39.6**	103.7
(Decrease) / Increase in debt securities in issue	**(1.0)**	1.0	**(1.0)**	1.0
(Increase) / decrease in other assets, prepayments and accrued income	**(0.8)**	(1.6)	**0.4**	0.7
(Decrease) in other liabilities	**(1.7)**	(0.6)	**(0.9)**	(1.8)
Net cash (outflow) / inflow from operating activities	**(50.6)**	66.9	**(60.6)**	62.6
Cash and cash equivalents				
Cash and balances with the Bank of England	**152.9**	182.0	**152.9**	182.0
Loans and advances to banks repayable on demand	**10.1**	1.5	**0.1**	0.1
Investment securities	**-**	0.1	**-**	0.1
At 31 December	**163.0**	183.6	**153.0**	182.2

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:

	Balance sheet 31 December 2017	**Non-Cash charges Accrued interest/lease charge**	**Cash flows Interest payment flows**	**Capital repayment flows**	**Other**	**Balance sheet 31 December 2018**
	£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**

	Balance sheet 31 December 2016	Non-Cash charges Accrued interest/lease charge	Cash flows Interest payment flows	Capital repayment flows	Other	Balance sheet 31 December 2017
	£m	£m	£m	£m	£m	£m
Subordinated liabilities	50.5	2.3	(2.8)	(25.0)	-	25.0
Subscribed capital (PIBS)	31.0	3.5	(3.5)	-	-	31.0
Finance lease arrangements	1.1	-	-	(0.1)	-	1.0

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 2018.

31 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

	2018 £000	2017 £000
At 31 December	**281**	296

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

	2018 £000	2017 £000
At 31 December	**403**	417

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 and property services from Newcastle Systems Management Limited and business support services from Newcastle Strategic Solutions Limited, both wholly owned subsidiaries of the Society. The Society provides financial and administrative services to both Newcastle Systems Management Limited and Newcastle Strategic Solutions Limited.

During the year, the following transactions were carried out with related parties:

(a) Sales of financial and administrative services

	2018 £000	2017 £000
Newcastle Systems Management Limited	**1,102**	938
Newcastle Strategic Solutions Limited	**8,382**	7,114

Sales of services are negotiated with related parties on commercial terms.

(b) Purchases of services:

	2018 £000	2017 £000
Managed IT and Property Services		
Newcastle Systems Management Limited	**6,613**	5,074
Business Support Services		
Newcastle Strategic Solutions Limited	**3,113**	6,670
Property Rental		
Newcastle Portland House Limited	**66**	66

Purchased services are negotiated with related parties on commercial terms.

31 Related parties Continued

At 31 December 2018 the following unsecured balances remained outstanding with related parties:

(c) Outstanding balances:

	Amounts owed to Society		Amounts owed by Society	
	2018 £000	2017 £000	**2018 £000**	2017 £000
Newcastle Systems Management Limited	**755**	661	**369**	493
Newcastle Strategic Solutions Limited	**2,524**	2,235	**1,704**	1,709
Newcastle Financial Advisers Limited	**-**	-	**882**	725
Newcastle Portland House Limited	**19**	19	**2,908**	2,920
Newcastle Mortgage Loans (Jersey) Limited	**16**	16	**-**	-

At 31 December 2018 the following borrowings and cash deposits remained outstanding with related parties:

(d) Borrowings/ cash deposits:

	Amounts borrowed from Society		Amounts deposited with Society	
	2018 £000	2017 £000	**2018 £000**	2017 £000
Newcastle Systems Management Limited	**23,522**	22,459	**679**	4,668
Newcastle Strategic Solutions Limited	**4,531**	4,226	**421**	5,657
Newcastle Mortgage Loans (Jersey) Limited	**2,386**	3,905	**-**	-

	Interest paid to Society		Interest paid by Society	
	2018 £000	2017 £000	**2018 £000**	2017 £000
Newcastle Systems Management Limited	**1,156**	1,003	**6**	5
Newcastle Strategic Solutions Limited	**305**	284	**9**	6
Newcastle Mortgage Loans (Jersey) Limited	**179**	283	**-**	-

(e) Lease relationships:

Newcastle Systems Management Limited and Newcastle Strategic Solutions Limited lease office space in the Group's head office from the Society under 5 contractual leases. At 31 December 2018, these were considered to be operating leases. In the next financial year the Society expects to receive £174,000 and £128,000 from the subsidiaries in respect of currently agreed leases from the subsidiaries respectively.

In over 1 year but not more than 5 years time the Society expects to receive £87,000 and £64,000 in respect of currently agreed leases from the subsidiaries respectively.

32 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 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), and fair value through profit or loss (FVTPL).

		Amortised Cost	FVOCI	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	32	-	-	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
Debit securities in issue	24	-	-	-	-
Derivative financial instruments	32	-	-	178.3	178.3
Subordinated liabilities	27	25.0	-	-	25.0
Subscribed capital	28	20.0	-	-	20.0
Other liabilities (of which financial)	25	9.9	-	-	9.9
Total financial liabilities		**3,321.0**	**-**	**178.7**	**3,499.7**

*Cash in hand includes £11.2m in cash held by the Society's subsidiary entities. Debt securities includes £8.5m in qualifying money market funds 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.

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.

32 Financial instruments Continued

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.

Debt securities in issue
Debt securities issued by 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 28.

		Amortised Cost	Available for sale	FVTPL	Total
Group as at 31 December 2017	Note	£m	£m	£m	£m
Financial assets					
Cash in hand*		182.0	-	-	182.0
Loans and advances to banks	10	227.7	-	-	227.7
Debt securities	11	-	380.1	-	380.1
Derivative financial instruments	32	-	-	4.9	4.9
Fair value adjustments for hedged risk	13	-	-	206.2	206.2
Loans and advances to customers	12	2,707.3	-	-	2,707.3
Other assets (of which financial)	20	8.6	-	-	8.6
Total financial assets		**3,125.6**	**380.1**	**211.1**	**3,716.8**
Financial liabilities					
Due to Members - shares	21	2,788.5	-	-	2,788.5
Fair value adjustments for hedged risk	13	-	-	1.6	1.6
Due to other customers	22	226.2	-	-	226.2
Deposits from banks	23	277.4	-	-	277.4
Debit securities in issue	24	1.0	-	-	1.0
Derivative financial instruments	32	-	-	210.2	210.2
Subordinated liabilities	27	25.0	-	-	25.0
Subscribed capital	28	30.0	-	-	30.0
Other liabilities (of which financial)	25	-	11.6	-	11.6
Total financial liabilities		**3,348.1**	**11.6**	**211.8**	**3,571.5**

The Group has not reclassified any financial assets during the year, other than on the transition to IFRS 9 on 1 January 2018.

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.

32 Financial instruments Continued

Group as at 31 December 2018

	Gross fair value presented in the Balance Sheet	Offsetting financial collateral (received*)/ pledged not meeting the offsetting criteria of IAS 32	Net collateralised position	Net position under Master Netting Agreements not meeting the offsetting requirements of IAS 32 (pre-collateral)
Financial assets	**£m**	**£m**	**£m**	**£m**
Interest rate swaps	3.5	-	3.5	-
Financial liabilities				
Interest rate swaps	(178.3)	200.3	22.0	(175.3)

Group as at 31 December 2017

	Gross fair value presented in the Balance Sheet	Offsetting financial collateral (received*)/ pledged not meeting the offsetting criteria of IAS 32	Net collateralised position	Net position under Master Netting Agreements not meeting the offsetting requirements of IAS 32 (pre-collateral)
Financial assets	£m	£m	£m	£m
Interest rate swaps	4.9	(0.1)	4.8	0.1
Financial liabilities				
Interest rate swaps	(210.2)	226.0	15.8	(208.2)

*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 2018, 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 £24.0m 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 2018. 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 £22.0m.

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	
	2018 £m	2017 £m
Cash collateral received under CSA agreements	**-**	-
Other financial assets collateral pledged under repurchase agreements	**611.5**	366.1
Cash collateral paid under CSA agreements	**200.3**	226.0

As at 31 December 2018 an immediate 100bp uplift in the zero-coupon 3-month yield curve would produce collateral inflows of **£77.1m** (2017: £84.6m).

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.

32 Financial instruments Continued

Fair value

During 2018 the Society crystallised gains/losses of £0.2m 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 2018.

GROUP

			Carrying value		Fair value	
	Note	Level*	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Financial assets						
Cash and balances with the Bank of England		3	**152.9**	182.0	**152.9**	182.0
Loans and advances to banks	10	3	**10.2**	227.7	**10.2**	227.7
Loans and advances to customers	12	3	**2,772.2**	2,707.3	**2,928.1**	2,894.8
Other assets (of which financial)	20	3	**6.9**	8.6	**6.9**	8.6
Financial liabilities						
Due to Members - shares	21	3	**2,713.7**	2,788.5	**2,709.8**	2,796.6
Due to other customers	22	3	**142.6**	226.2	**142.5**	225.8
Deposits due to other banks	23	3	**409.8**	277.4	**409.8**	277.4
Debt securities in issue	24	2	**-**	1.0	**-**	1.0
Subordinated liabilities	27	1	**25.0**	25.0	**25.3**	26.2
Subscribed capital	28	1	**20.0**	30.0	**34.3**	48.6
Other liabilities (of which financial)	25	3	**9.9**	11.6	**9.9**	11.6

*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 cashflows 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.

Debt securities in issue

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

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.

Notes to the Accounts for the year ended 31 December 2018

32 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	**2018 £m**	2017 £m
Financial assets			
Debt securities at FVOCI / Available for sale	1	**329.0**	380.1
Derivative financial instruments	1	**3.5**	4.9
Fair value adjustments for hedged risk on underlying instruments	2	**175.9**	206.2
Financial liabilities			
Derivative financial instruments	1	**178.3**	210.2
Fair value adjustments for hedged risk on underlying instruments	2	**0.4**	1.6

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' mis-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 details, 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 hedge 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.

Notes to the Accounts for the year ended 31 December 2018

32 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 2018	Notional amount	Fair value (on balance sheet*)	Repayable on demand	Up to 3 months	Between 3 months and 12 months	Between 1 year and 5 years	Over 5 years
Non-macro fair value hedges							
Hedging Instruments							
Swap assets *(derivative financial instrument assets)*	55.0	0.9	-	-	0.1	0.4	0.4
Hedged items							
Debt securities	30.0	(0.8)	-	(0.1)	(0.1)	(0.6)	-
Other	25.0	(0.1)	-	-	(0.1)	-	-
Hedging Instruments							
Swap liabilities *(derivative financial instrument liabilities)*	296.0	(94.8)	-	(30.3)	(7.4)	(32.7)	(24.4)
Hedged items							
Mortgage assets *(loans and advances to customers)*	242.9	92.3	-	29.6	7.2	31.9	23.6
Debt securities	51.5	1.5	-	0.1	0.2	1.2	-
Macro fair value hedges							
Hedging Instruments							
Swap assets *(derivative financial instrument assets)*	216.0	2.6	-	0.1	0.4	2.1	-
Hedged items							
Mortgage assets *(loans and advances to customers)*	208.0	(1.0)	-	-	(0.2)	(0.8)	-
Hedging Instruments							
Swap liabilities *(derivative financial instrument liabilities)*	483.0	(83.5)	-	(1.9)	(5.9)	(25.1)	(50.6)
Hedged items							
Mortgage assets *(loans and advances to customers)*	(486.0)	83.6	-	1.9	5.9	25.2	50.6
Debt securities	-	-	-	-	-	-	-

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'.

Notes to the Accounts for the year ended 31 December 2018

32 Financial instruments Continued

Hedge Ineffectiveness

	2018 £m
Gains / (losses) on non-macro hedging instruments	
Interest rate swaps	20.8
Gains / (losses) on non-macro hedged items	
Mortgage assets (loans and advances to customers)	(21.6)
Gains / (losses) on macro hedging instruments	
Interest rate swaps	9.7
Gains / (losses) on macro hedged items	
Mortgage assets (loans and advances to customers)	(8.8)
Net gains representing ineffective portions of the fair value hedges	**0.1**

Hedging gains and losses are recognised in the income statement as 'gains less losses on financial instruments and hedge accounting'

During 2017, fair value gains on hedging instruments of £22.4m were offset by fair value losses on hedged items of £22.3m with the gain of £0.1m represented ineffective portions of fair value hedges recorded in the portions of fair value hedges recored in the income statement. At 31 December 2018 there are no amounts included on the balance sheet as fair value adjustments for hedged risk in assets or liabilities relating to hedged items that have ceased to be adjusted for hedging gains or losses.

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 on page 35 of these Annual Accounts, maintain oversight of the Retail and Commercial Credit Committees. The Committees are 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 Modelling Committee also operates charged with oversight of the Group's IFRS 9 models and assessment and approval of its key model inputs. Through 2018 the Modelling 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 Group's policy with respect to accounting for impairment of financial assets is given in Note 1 of these financial statements. 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.

32 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 and legacy 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:
Housing association mortgages 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 collateralized 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.

32 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 benefitting 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.

32 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.

The Society's final expected credit losses are the losses calculated under each discrete scenario multiplied by a 'likelihood factor': currently set to 80% for the base scenario and 10% for each of the upside and downside scenarios.

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; and
- UK house price index

The Society's assessments as to which variables are key has not changed during 2018. Quarterly updates to the variables themselves to reflect the most recent market information have been reflected in the Society's impairment results.

32 Financial instruments Continued

Quantitative impairment impact

Reconciliation table	Loss allowance at 1 January 2018	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 2018
	£000	£000	£000	£000	£000	£000
Prime residential						
Stage 1	83.7	21.6	(4.2)	24.0	(76.7)	48.4
Stage 2	131.1	100.7	(7.9)	(57.5)	24.5	190.9
Stage 3	350.4	3.3	(32.7)	562.2	52.2	935.4
Total	**565.2**	**125.6**	**(44.8)**	**528.7**	**-**	**1,174.7**
Buy to Let						
Stage 1	0.7	0.5	(0.1)	2.0	(1.9)	1.2
Stage 2	2.7	1.0	(0.1)	(1.5)	2.0	4.1
Stage 3	0.4	-	-	(0.4)	-	-
Total	**3.8**	**1.5**	**(0.2)**	**0.1**	**0.1**	**5.3**
Commercial						
Stage 1	1,322.0	-	-	3.0	-	1,325.0
Stage 2	-	-	-	-	-	-
Stage 3	7,598.0	-	20.0	487.0	-	8,105.0
Total	**8,920.0**	**-**	**20.0**	**490.0**	**-**	**9,430.0**
Housing Association						
Stage 1	-	-	-	-	-	-
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
Total	**-**	**-**	**-**	**-**	**-**	**-**
Serviced Apartments						
Stage 1	-	-	-	-	-	-
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
Total	**-**	**-**	**-**	**-**	**-**	**-**
Policy Loans						
Stage 1	-	-	-	-	-	-
Stage 2	360.6	-	(174.9)	113.0	(298.6)	0.1
Stage 3	21.8	-	-	-	298.6	320.4
Total	**382.4**	**-**	**(174.9)**	**113.0**	**-**	**320.5**
Total						
Stage 1	**1,406.4**	**22.1**	**(4.3)**	**29.0**	**(78.6)**	**1,374.6**
Stage 2	**494.4**	**101.7**	**(182.9)**	**54.0**	**(272.1)**	**195.1**
Stage 3	**7,970.6**	**3.3**	**(12.7)**	**1,048.8**	**350.8**	**9,360.8**
Total	**9,871.4**	**127.1**	**(199.9)**	**1,131.8**	**0.1**	**10,930.5**

Notes to the Accounts for the year ended 31 December 2018

32 Financial instruments Continued

Quantitative impairment impact

Reconciliation table	Gross exposure at 1 January 2018 £m	Increases due to origination and acquisition £m	Decreases due to derecognition £m	Changes due to change in credit risk (net) £m	Transition between stages £m	Gross exposure at 31 December 2018 £m
Prime residential						
Stage 1	1,564.8	367.6	(242.2)	(54.0)	32.9	1,669.1
Stage 2	170.8	71.9	(17.0)	(4.4)	(34.9)	186.4
Stage 3	11.8	0.1	(1.8)	(0.4)	2.0	11.7
Total	**1,747.4**	**439.6**	**(261.0)**	**(58.8)**	**-**	**1,867.2**
Buy to Let						
Stage 1	175.8	63.8	(26.5)	(0.4)	0.4	213.1
Stage 2	10.6	3.8	(0.6)	-	(0.2)	13.6
Stage 3	0.2	-	-	-	(0.2)	-
Total	**186.6**	**67.6**	**(27.1)**	**(0.4)**	**-**	**226.7**
Commercial						
Stage 1	32.6	-	(5.0)	(0.7)	-	26.9
Stage 2	0.1	-	-	-	-	0.1
Stage 3	15.0	-	(0.1)	(3.1)	-	11.8
Total	**47.7**	**-**	**(5.1)**	**(3.8)**	**-**	**38.8**
Housing Association						
Stage 1	498.0	-	(66.4)	(6.9)	-	424.7
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
Total	**498.0**	**-**	**(66.4)**	**(6.9)**	**-**	**424.7**
Serviced Apartments						
Stage 1	21.1	-	(1.2)	(0.3)	-	19.6
Stage 2	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-
Total	**21.1**	**-**	**(1.2)**	**(0.3)**	**-**	**19.6**
Policy Loans						
Stage 1	4.2	-	-	(1.2)	-	3.0
Stage 2	0.6	-	(0.3)	-	(0.3)	-
Stage 3	-	-	-	-	0.3	0.3
Total	**4.8**	**-**	**(0.3)**	**(1.2)**	**-**	**3.3**
Total						
Stage 1	**2,296.5**	**431.4**	**(341.3)**	**(63.5)**	**33.3**	**2,356.4**
Stage 2	**182.1**	**75.7**	**(17.9)**	**(4.4)**	**(35.4)**	**200.1**
Stage 3	**27.0**	**0.1**	**(1.9)**	**(3.5)**	**2.1**	**23.8**
Total	**2,505.6**	**507.2**	**(361.1)**	**(71.4)**	**-**	**2,580.3**

The gross carrying values above reflect the Group's maximum exposure to credit risk as at 31 December 2018 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 2018.

The Society granted forbearance against (give details here from risk/ commercial).

There has been no material movement in loss allowances held against other financial assets during 2018. Debt securities held remain of very high credit quality at 31 December 2018 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 2018

32 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:

Upside weight	Base weight	Downside weight	Increase in provision £m
10%	80%	10%	-
10%	70%	20%	0.1
10%	60%	30%	0.2
10%	50%	40%	0.3
10%	40%	50%	0.5
10%	30%	60%	0.6

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 2018 is **62.0%** (2017: 59.3%) as detailed in the Strategic Report on page 14. 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 2018 there were 18 loans in 12 months arrears or more with balances of **£1.1m** (2017: 16 loans totalling £0.8m).

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)	2018 £m	2018 %	2017 £m	2017 %
<70%	**1,341.0**	**65.6**	1,321.7	68.4
70% - <80%	**282.5**	**13.8**	300.4	15.5
80% - <90%	**231.1**	**11.3**	214.6	11.1
>90%	**190.7**	**9.3**	96.4	5.0
	2,045.3	**100.0**	1,933.1	100.0

The table below provides further information by payment due status:

	2018 £m	2018 %	2017 £m	2017 %
Neither past due nor impaired	**2,030.2**	**99.3**	1,916.9	99.1
Past due up to 3 months but not impaired	**10.8**	**0.5**	11.3	0.6
Not past due but impaired	**-**	**-**	-	-
Impaired and past due up to 3 months	**-**	**-**	-	-
Impaired and past due 3 to 6 months	**2.0**	**0.1**	3.1	0.2
Impaired and past due over 6 months	**2.2**	**0.1**	1.8	0.1
LPA receivership	**-**	**-**	-	-
In possession	**0.1**	**-**	-	-
	2,045.3	**100.0**	1,933.1	100.0

Against past due and possession cases, **£36.7m** (2017: £42.5m) of collateral is held.

No loans that would be past due or impaired have had terms renegotiated.

The Society granted forbearance against 29 residential loans in 2018 in the form of reduced payments or payment breaks. With no alteration made to the contractual rates of interest and balances totalling £2.2m at 31 December 2018 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.

32 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)	2018 £m	2018 %	2017 £m	2017 %
<70%	**121.3**	**60.5**	78.3	51.4
70% - <80%	**77.1**	**38.4**	71.6	46.9
80% - <90%	**0.4**	**0.2**	0.7	0.5
>90%	**1.9**	**0.9**	1.9	1.2
	200.7	**100.0**	152.5	100.0

The table below provides further information by payment due status:

	2018 £m	2018 %	2017 £m	2017 %
Neither past due nor impaired	**199.4**	**99.2**	152.1	99.7
Past due up to 3 months but not impaired	**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	**0.3**	**0.2**	0.3	0.2
LPA receivership	**-**	**-**	-	-
In possession	**0.1**	**0.1**	0.1	0.1
	200.7	**100.0**	152.5	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)	2018 £m	2018 %	2017 £m	2017 %
<70%	**37.3**	**77.4**	49.8	85.6
70% - <80%	**10.7**	**22.2**	0.2	0.3
80% - <90%	**0.2**	**0.4**	8.0	13.8
>90%	**-**	**-**	0.2	0.3
	48.2	**100.0**	58.2	100.0

The table below provides further information by payment due status:

	2018 £m	2018 %	2017 £m	2017 %
Neither past due nor impaired	**42.6**	**88.3**	47.5	81.7
Past due up to 3 months but not impaired	**-**	**-**	10.5	18.0
Not past due but impaired	**-**	**-**	-	-
Impaired and past due up to 3 months	**-**	**-**	-	-
Impaired and past due up to 3 to 6 months	**5.6**	**11.7**	-	-
Impaired and past due over 6 months	**-**	**-**	-	-
LPA receivership	**-**	**-**	0.2	0.3
In possession	**-**	**-**	-	-
	48.2	**100.0**	58.2	100.0

Against past due and possession cases, **£11.3m** (2017 £22.4m) collateral is held.

32 Financial instruments Continued

Commercial lending book

The commercial lending book comprises:

GROUP	2018 £m	2018 %	2017 £m	2017 %
Loans secured on Commercial Property	**38.8**	**8.0**	47.7	8.4
Loans secured on Serviced Apartments	**19.6**	**4.1**	21.1	3.7
Loans to Housing Associations	**424.7**	**87.9**	498.0	87.9
	483.1	**100.0**	566.8	100.0

Loans secured on commercial property Loan to value (unindexed)	2018 £m	2018 %	2017 £m	2017 %
<70%	**15.9**	**41.0**	19.9	41.7
70% - <80%	**1.8**	**4.6**	1.8	3.8
80% - <90%	**-**	**-**	-	-
>90%	**21.1**	**54.4**	26.0	54.5
	38.8	**100.0**	47.7	100.0

Loans secured on serviced apartments Loan to value (unindexed)	2018 £m	2018 %	2017 £m	2017 %
<70%	**3.0**	**15.3**	3.4	16.3
70% - <80%	**10.4**	**53.2**	11.5	54.4
80% - <90%	**6.2**	**31.5**	6.2	29.3
>90%	**-**	**-**	-	-
	19.6	**100.0**	21.1	100.0

The table below provides further information by payment due status:

	2018 £m	2018 %	2017 £m	2017 %
Neither past due nor impaired	**27.0**	**69.7**	32.7	68.6
Past due up to 3 months but not impaired	**-**	**-**	-	-
Not past due but impaired	**11.8**	**30.3**	15.0	31.4
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	**-**	**-**	-	-
	38.8	**100.0**	47.7	100.0

32 Financial instruments Continued

At 31 December 2018 the Society had no commercial investment loans in arrears of 3 months or more (2017 none).

The Society had no commercial loans in possession or subject to LPA receivership at the end of 2018 (2017 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.

At 31 December 2018 the Society had granted forbearance to two loans with total balances of £0.5m. There has been no requirement identified to hold a specific provision against either of these loans.

Loans secured on commercial property are diversified by industry type and an analysis is shown below:

	2018 £m	2018 %	2017 £m	2017 %
Retail	**17.6**	**45.4**	21.8	45.7
Office	**9.4**	**24.2**	4.8	10.1
Industrial	**8.5**	**21.9**	16.3	34.2
Hotel / Leisure	**2.8**	**7.2**	4.4	9.2
Other	**0.5**	**1.3**	0.4	0.8
	38.8	**100.0**	47.7	100.0

Group and Society Loans to Housing Associations Loan to value (unindexed)	2018 £m	2018 %	2017 £m	2017 %
<70%	**215.0**	**50.6**	263.1	52.8
70% - <80%	**132.5**	**31.2**	160.3	32.2
80% - <90%	**77.2**	**18.2**	74.6	15.0
>90%	**-**	**-**	-	-
	424.7	**100.0**	498.0	100.0

Loans to Housing Associations are secured on residential property.
No Housing Association loans are past due or impaired.

32 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 £m	Stage 2 £m	Stage 3 £m	Stage 1 £000	Stage 2 £000	Stage 3 £000	Stage 1 %	Stage 2 %	Stage 3 %
0% - 1%	124.7	0.1	-	-	-	-	-	-	-
1% - 2%	755.5	-	-	(6.7)	-	-	-	-	-
2% - 3%	672.8	-	-	(15.0)	-	-	-	-	-
3% - 4%	121.6	-	-	(5.7)	-	-	-	-	-
4% - 5%	141.6	-	-	(5.9)	-	-	-	-	-
5% - 6%	4.6	-	-	-	-	-	-	-	-
6% - 7%	2.8	-	-	(0.1)	-	-	-	-	-
7% - 8%	1.6	0.5	-	-	-	-	-	-	-
8% - 9%	2.3	2.5	-	(0.1)	(0.1)	-	-	-	-
9% - 10%	2.6	4.5	-	(0.1)	(0.2)	-	-	-	-
10%	52.3	192.4	11.7	(16.0)	(194.6)	(935.3)	-	0.1	8.0

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.

The table below shows the impact of various interest rate scenarios on Group profit before tax, against the Society's current interest rate view. A positive item is an increase in margin and a negative item is a reduction.

At 31 December 2018	+1% £m	+2% £m	-1% £m	-2% £m
Next 12 months	1.2	2.4	(1.2)	(2.4)
Next 2 years	1.7	3.3	(1.7)	(3.3)
Next 3 years	2.8	5.5	(2.8)	(5.5)

The main risk measured by ALCO is an immediate 200bp parallel shift in rates.

An immediate 2% upwards movement in interest rates would increase members' interest by **£0.2m** (2017: £6.4m).

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.

IFRS 9 Transitional Disclosures

The following primarily reflect extracts of the Group's IFRS 9 transitional disclosures published in the 2018 Group Half Yearly Information.

The Group first applied the accounting requirements of IFRS 9 on 1 January 2018. Under IFRS 7, Financial Instruments: Disclosures, the Group is required to disclose quantified and qualitative information in this half-year report to detail the impact that transition to IFRS 9 has had between 31 December 2017 and 1 January 2018. As disclosed in the 2017 Annual Report and Accounts, the Group's closing IAS 39 balance sheet on 31 December 2017 and its opening balance sheet at the start of 1 January 2018 under IFRS 9 was as follows:

Balance Sheet Assets	Balance at 31 December 2017* £m	In scope for IFRS 9?	In scope for IFRS 9 impairment?	Current IAS 39 accounting classification	Agreed IFRS 9 accounting classification	Classification and measurement impact
Cash and balances with the Bank of England						
Balances with the Bank of England	176.9	**Yes**	**Yes**	AC	AC	None
Bank of England cash ratio deposit	3.4	**Yes**	**No**	AC	FVTPL	Limited. Fair value and amortised cost equivalent in value.
Physical cash	1.7	**Yes**	**No**	AC	AC	None
Loans and advances to banks						
Loans and advances to banks (collateral pledged)	226.1	**Yes**	**No**	AC	FVTPL	Limited. Fair value and amortised cost equivalent in value.
Loans and advances to banks (non-collateral pledged)	1.6	**Yes**	**Yes**	AC	AC	None
Debt Securities						
Gilts	84.8	**Yes**	**No**	AFS	FVOCI	Limited. Fair value through other comprehensive income is the equivalent of Available for sale.
Residential mortgage backed securities	157.2	**Yes**	**Yes**	AFS	FVOCI	
Covered bonds	138.1	**Yes**	**Yes**	AFS	FVOCI	
Derivative financial instruments						
Interest rate swaps	4.9	**Yes**	**No**	FVTPL	FVTPL	None
Loans and advances to customers						
Prime residential	1723.2	**Yes**	**Yes**	AC	AC	None
Buy-to-Let	186.5	**Yes**	**Yes**	AC	AC	None
Equity release	209.9	**No**	**No**	n/a IFRS 4 insurance contract	n/a IFRS 4 insurance contract	Equity release mortgages are not in IFRS 9 scope. IFRS 4 accounting approximates IAS 39 accounting and provisioning methodology
Policy loans	4.4	**Yes**	**Yes**	AC	AC	None
Housing Association	498.0	**Yes**	**Yes**	AC	AC	None
Commercial (including commercial residential)	64.2	**Yes**	**Yes**	AC	AC	None
Serviced apartments	21.1	**Yes**	**Yes**	AC	AC	None
Fair value adjustments for hedged risk						
Fair value adjustments for hedged risk	206.2	**Yes**	**No**	FVTPL	FVTPL	None
Investment in subsidiaries						
Investment in subsidiaries	(nil on a group basis)	**No**	**No**	n/a	n/a	n/a, out of scope
Property, plant and equipment						
Property, plant and equipment	38.8	**No**	**No**	n/a	n/a	n/a, out of scope
Deferred tax assets						
Deferred tax assets	3.2	**No**	**No**	n/a	n/a	n/a, out of scope
Retirement benefit asset						
Retirement benefit asset	-	**No**	**No**	n/a	n/a	n/a, out of scope
Other assets						
Trade and other receivables	11.9	**Yes**	**Yes**	AC	AC	None

Balances as at 31st December 2017 are net of IAS 39 provisions. The quantified impact of classification and measurement at 31st December 2017 is £nil.

***No measurement changes would have arisen between 31 December 2017 and 1 January 2018 if IAS 39 had been applied to both periods.**

***No balances were reclassified into the amortised cost category as a result of transition to IFRS 9.**

***No balances were reclassified out of the fair value through profit and loss category as a result of transition to IFRS 9.**

In the table above the following abbreviations are relevant: AC – amortised cost, FVTPL – fair value through profit or loss and FVOCI – fair value through other comprehensive income.

IFRS 9 Transitional Disclosures (continued)

Impairment

IFRS 9 replaced the IAS 39 'incurred losses' provisioning model with a forward looking assessment of impairment. Expected credit losses are recognised across applicable financial assets (as detailed in the table above) based on whether there has been a significant increase in credit risk since the asset's origination.

1 January 2018 Qualitative Impairment Impact

IFRS 9 had minimal impact on the Group's mortgage provisions. The Group's core lending, to prime residential and high quality buy to let customers was considered to be of low risk and securely collateralised. The Group continues to experience historic low levels of arrears and does not lend in excess of 95% LTV (75% LTV for Buy to Let). With the Group holding the first legal charge over the mortgaged property against which it lends, this protects the Group from borrower default as proceeds from the sale of any property are first used to extinguish the Group's exposure to its borrowers.

Historically, the Group has provided prudently against its overdue residential lending: providing for the full amount of expected loss, as assessed at a provisioning Committee level, against mortgages falling into arrears of three months or more.

The implementation of IFRS 9's provisioning requirements did not significantly impact the Group's legacy mortgage provisioning methodology.

The Society was not significantly impacted by the IFRS 9 impairment requirements with respect to its debt security exposures. No provisioning was required at 31 December 2017, 1 January 2018 or 31 December 2018.

The Group's impairment methodology is discussed in detail in Note 32 to these Accounts. The methodology applied on 1 January 2018 is consistent with the methodology applied at 31 December 2018.

The Society was not significantly impacted by the IFRS 9 impairment requirements with respect to its trade and other receivables. £30,000 was provided at 31 December 2017 and 1 January 2018. At 31 December 2018 £57,000 was provided.

IFRS 9 Quantitative Impairment Impact

The impact of IFRS 9's staging and consequent loss provisioning to the Society's closing 31 December 2017 balance sheet was as follows:

IFRS 9 Gross Exposure

	Stage 1 Of which Months in Arrears			**Stage 2** Of which Months in Arrears			**Stage 3** Of which Months in Arrears			**Total**
	<1 £m	1-3 £m	>3 £m	<1 £m	1-3 £m	>3 £m	<1 £m	1-3 £m	>3 £m	**£m**
Prime residential	1,564.8	-	-	155.8	15.0	-	3.9	1.1	6.8	1,747.4
Buy-to-Let	175.8	-	-	10.6	-	-	0.2	-	-	186.6
Commercial	32.6	-	-	-	0.1	-	15.0	-	-	47.7
Housing Association	498.0	-	-	-	-	-	-	-	-	498.0
Serviced Apartments	21.1	-	-	-	-	-	-	-	-	21.1
Policy Loans	4.2	-	-	0.6	-	-	-	-	-	4.8
Total	**2,296.5**	**-**	**-**	**167.0**	**15.1**	**-**	**19.1**	**1.1**	**6.8**	**2,505.6**

Expected Credit Losses

	Stage 1 Of which Months in Arrears			**Stage 2** Of which Months in Arrears			**Stage 3** Of which Months in Arrears			**Total**
	<1 £000	1-3 £000	>3 £000	<1 £000	1-3 £000	>3 £000	<1 £000	1-3 £000	>3 £000	**£000**
Prime residential	83.7	-	-	101.7	29.4	-	103.2	9.5	237.7	565.2
Buy-to-Let	0.7	-	-	2.7	-	-	0.4	-	-	3.8
Commercial	1,322.0	-	-	-	-	-	7,598.0	-	-	8,920.0
Housing Association	-	-	-	-	-	-	-	-	-	-
Serviced Apartments	-	-	-	-	-	-	-	-	-	-
Policy Loans	-	-	-	360.6	-	-	-	-	21.8	382.4
Total	**1,406.4**	**-**	**-**	**465.0**	**29.4**	**-**	**7,701.6**	**9.5**	**259.5**	**9,871.4**

For comparative 31 December 2018 positions see Note 32 to these Accounts.

Impairment Conclusion

The overall quantified impact of IFRS 9 to the Group's provisions compared to the existing IAS 39 provisions at 31 December 2017 was not material.

Hedge Accounting

IFRS 9's hedging requirements did not have significant impact to the Society's hedging activities, serving broadly to relax a number of the IAS 39 hedging criteria.

The Society elected to adopt IFRS 9's hedging requirements for its non-macro hedges at 1 January 2018 and continues to apply the IAS 39 hedging requirements to its macro hedge portfolio.

Annual Business Statement for the year ended 31 December 2018

1 Statutory percentages

	2018 %	Statutory %
Lending limit	**2.8**	25.00
Funding limit	**16.91**	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, as amended by the Building Societies Act 1997, 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:	2018 %	2017 %
Gross capital	**7.37**	7.36
Free capital	**6.20**	6.26
Liquid assets	**21.20**	23.94
Result for the year as a percentage of mean total assets	**0.29**	0.29
Management expenses as a percentage of mean total assets	**1.33**	1.24

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 2018 and 2017 total assets.

Annual Business Statement for the year ended 31 December 2018 (continued)

Directors at 31 December 2018

	Date of Birth	Date of Appointment	Business Occupation
DJ Buffham	**13.08.59**	**24.05.10**	**Company Director**
	Other Directorships: Newcastle Strategic Solutions Limited; Newcastle Systems Management Limited; Northern Homes and Estates Limited; William Leech (Investments) Limited; The William Leech Foundation Limited; Zytronic PLC.		
P Ferguson BSc, CA	**06.03.69**	**19.02.14**	**Building Society Strategy, Planning and Risk Director**
	Other Directorships: None.		
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.		
K Ingham	**20.02.65**	**04.09.14**	**Senior Operations Director**
	Other Directorships: Newcastle Strategic Solutions Limited; Senior Operations Director (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; The Northern College for Residential Adult Education 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**	**Company Director**
	Other Directorships: Newcastle Strategic Solutions Limited; Newcastle Systems Management Limited.		
J Morris BA, FCA	**13.09.56**	**31.10.11**	**Chartered Accountant**
	Other Directorships: None.		
DA Samper BA, CA	**21.12.74**	**20.12.18**	**Building Society Chief Financial Officer**
	Other Directorships: None.		
IW Ward FCIB	**04.05.49**	**09.07.13**	**Director**
	Other Directorships: Newcastle Financial Advisers Limited; Newcastle Systems Management Limited; 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, 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£3.7 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 is provided through Newcastle Strategic Solutions Limited and Information Technology services are provided through Newcastle Systems Management 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. The Society's Gibraltar branch was closed on 31st October 2017.

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 2018, 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 **£64.5m** (2017: £57.9m), 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 2018. 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 2018 tax losses from previous years that were used to extinguish a portion of its taxable profits in 2018 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 2018 the Group paid **£0.5m** in corporation tax.

d) Full-time equivalent employees ("FTEs")

The average number of Group full time equivalent employees was **969.5,** (2017: 954.2) of which **969.5** (2017: 948.9) were employed in the UK and nil (2017: 5.3) in Gibraltar.

e) Group profit before tax

Group profit before tax was **£13.3m** (2017: £13.1m) with a tax charge of **£2.5m** (2017: £2.2m). 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 2018 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 2018 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 in 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 Gary Shaw.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Newcastle upon Tyne
26 February 2019

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.

Net Promoter Score - Used to gauge the loyalty of customer relationships.

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
Berwick Upon Tweed - 12 Hide Hill, TD15 1AB	Tel: (01289) 306 417
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
Hartlepool - 133/135 York Road, TS26 9DR	Tel: (01429) 233 014
Hexham - 3 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 - 67 Fowler Street, NE33 1NS	Tel: (0191) 454 0407
Stokesley - 19 High Street, TS9 5AD	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 - 78/84 Park View, NE26 2TH	Tel: (0191) 252 0642
Yarm Library - 41 The High Street, TS15 9BH	Tel: (01642) 785 985

Agency

Allen Sykes, 17 Galgate, Barnard Castle, DL12 8EQ	Tel: (01833) 690 474