Connecting communities in the North East with a better financial future

Newcastle Building Society **Annual Report & Accounts 2017**

Newcastle
Building Society

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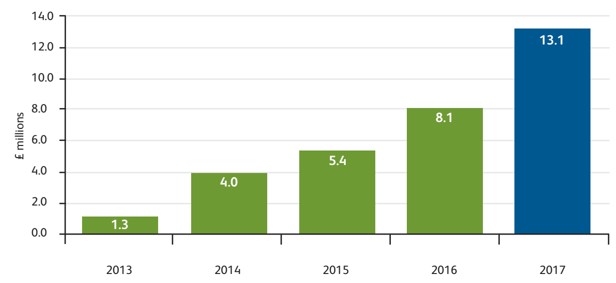

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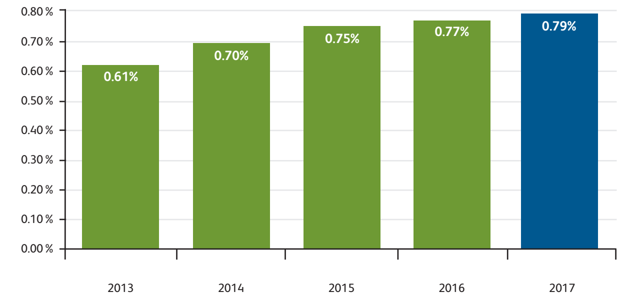

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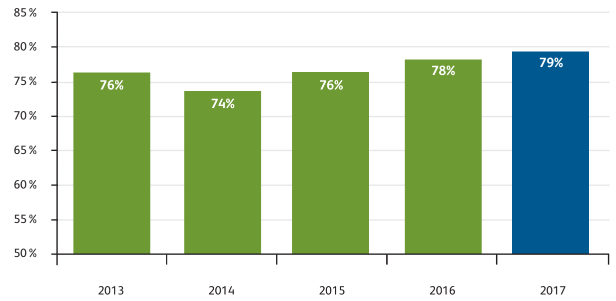

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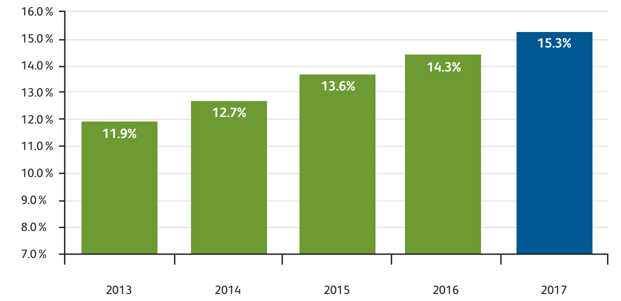

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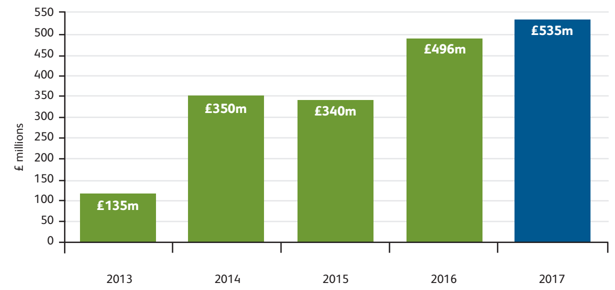

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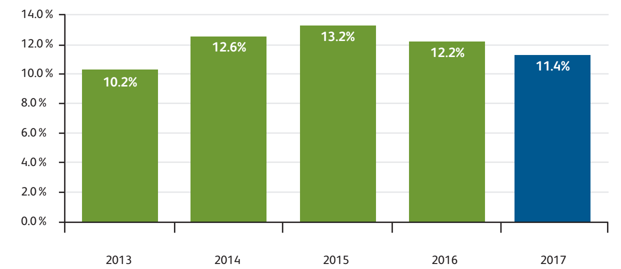

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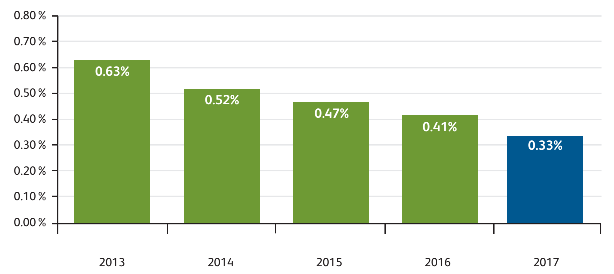

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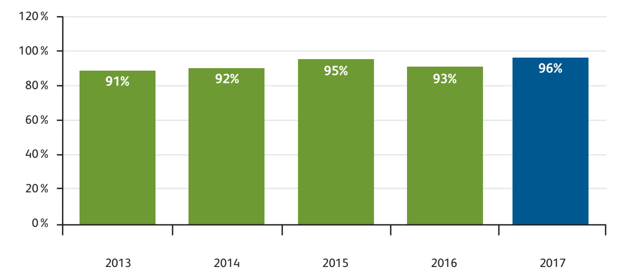


Chairman's Statement

2017 has been a year of achievement. Our Society has delivered strong financial growth, supported by investment in the recruitment and development of our colleagues and the delivery of major projects.

PHIL MOORHOUSE, CHAIRMAN

As the North East's largest building society, last year we defined and shared our Purpose - Connecting Communities in the North East with a Better Financial Future by:

- Encouraging people to save and plan their finances;
- Helping people own their home;
- Being a great place to work, where people can realise their potential;
- Helping our communities make positive changes; and
- Helping our clients and partners succeed through our excellent products and services.

Our Purpose is an inspiring framework for us to begin to build, challenge, and measure our performance, and alongside our behaviours framework, it will continue to set our direction and agenda for the years ahead.

Our commercial performance continued to make good progress and saw an increase in our profit before tax to £13.1m. It was pleasing to see our capital and liquidity ratios remain robust at 18.9% and 17.0%, respectively.

ECONOMY

Whilst political and economic uncertainty have characterised 2017, the economy has continued to grow, albeit at a reduced rate.

Consumers have felt a squeeze on living standards as wages have been outpaced by inflation – due in large part to the weakness of the pound resulting in a rise in the cost of imports.

MEMBERS

In November the Bank of England introduced the first interest rate rise in 10 years. It's been a long road for savers who have been on the end of repeated rate cuts and continuing low rates dictated by the bank base rate.

We were therefore very pleased to be one of the first financial organisations to commit to passing on the 0.25% base rate increase promptly, and in full to all of our individual variable rate savings accounts to enable savers to benefit. At the same time, Members with mortgages on our standard variable rate saw no change.

As part of our ongoing commitment to maintaining our branch network alongside our online and telephone servicing options for customers, 2017 saw us strengthen our regional heartland presence through a new branch review and investment programme, with new branches opening in Darlington and Durham.

We recorded a record turn-out at our Member information events at Alnwick Gardens in Northumberland and Preston Park in Stockton on Tees ahead of our Member Annual General Meeting in April. It's always very enjoyable to meet and hear feedback directly from our Members.

SUBSIDIARY COMPANIES

Newcastle Strategic Solutions, our award winning subsidiary which provides online savings management outsourcing for other financial institutions continued its progress, completing recruitment of a number of new roles to form its senior management team, including appointment of a Client Services Director. Newcastle Strategic Solutions remains a market leading provider of outsourced financial services, providing a substantial number of new jobs for the region.

Our Newcastle Systems Management Limited subsidiary provides technology solutions and support, both for the Group's various operations and other third party clients. It also manages the Group's property portfolio and in 2017 it completed the acquisition of our Cobalt offices in North Tyneside. The subsidiary has been awarded the Cyber Essentials Plus standard of assurance, a government backed cyber security certification scheme, endorsing the cyber security standards we employ across all areas of our business. We continue to maintain a sustained focus on this area.

COLLEAGUES

Our Society now employs over 1,000 people across its network of branches, support functions and subsidiaries. It is our people who set us apart in delivering the kind of organisation our Members want and we continue to invest in our colleagues as we seek to demonstrate a real difference through ongoing excellent service. We have many instances of feedback from our Members and across our wider customer base, outlining how outstanding personal service and customer care provided by our colleagues has positively impacted them.

We were thrilled to be become one of just a handful of companies in the region to achieve the prized 'Gold' Investors in People standard, reflecting the commitment we've made to being a great place to work, where people can realise their potential. This is a continuing journey and we are ambitious to build on this level of achievement.

2017 also saw us launch our first apprenticeship programme and develop our leadership programme for senior colleagues, as an addition to the range of development programmes we already have in place.

HELPING OUR COMMUNITIES

More and more colleagues have been using their allocated volunteering time of two days to make a positive impact on our local communities. In 2017 25% of colleagues volunteered at a range of initiatives, from food banks, charity shops and schools, to outdoors environmental improvements and animal shelters.

We also continued the progress of growing the Newcastle Building Society Community Fund at the Community Foundation, providing the opportunity for our Members to nominate North East projects they would like to support with a grant from the Fund.

2017 also saw donations to the Sir Bobby Robson Foundation surpass £2.5m. The Foundation's work benefits cancer patients across the Society's heartland and also contributes significantly to the global fight against the disease.

The Chief Executive's Review on pages 6 and 7 contains further detail on our significant achievements in 2017.

BOARD CHANGES

During 2017 we further strengthened our Board with the appointment of Bryce Glover and Anne Shiels, both of whom bring extensive experience. Stuart Miller also joined the Board in January 2018, taking up the role of Customer Director.

Ron McCormick departed the Board during the year, but remains as a non-executive director for Newcastle Strategic Solutions Limited.

This year we will also be saying goodbye to Angela Russell, our Deputy Chief Executive and Finance Director. Angela will step down from the Board in April 2018. Angela became Finance Director in 2010 and has played a key role in our Society's improving financial performance. I would like to extend all our thanks to Angela for her significant contribution during her seventeen years with the Society and to wish her all the best.

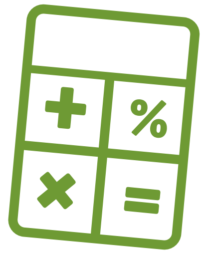
CONCLUSION

2017 has been notable for the progress our Society has made in delivering a number of key projects against a challenging backdrop of economic uncertainty and increasing competition.

Our colleagues have responded with enthusiasm to the challenges we've faced and I would like to personally thank them - their commitment and drive has been a core factor in our successes.

I would also like to extend my thanks to our Members for their continued support and loyalty, for which we are extremely grateful.

PHIL MOORHOUSE
CHAIRMAN
27 FEBRUARY 2018



£13.1m

Profit before tax

INVESTORS IN PEOPLE | Gold Until 2020

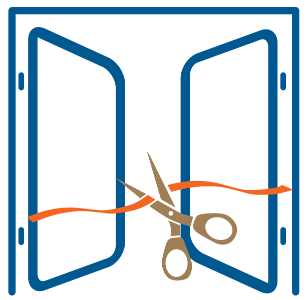
Achievement of Gold Investors in People Status

1,000+

employees

£770k

Total charitable contributions, 6% of profit before tax



2 new branches opened in Darlington and Durham

Chief Executive's Review

In 2017 we have made great progress, with higher levels of lending, more new savers, increased levels of ongoing financial advice business, and delivery of major regulatory and investment programmes to improve service and support growth.

ANDREW HAIGH, CHIEF EXECUTIVE

In terms of financial performance we are reporting increased profits, strong capital ratios, a robust liquidity position and record low levels of arrears, reflecting the excellent credit quality of our residential mortgage book.

For over 150 years Newcastle Building Society has been bringing communities in the North East together and connecting them with a better financial future. Our Members can rely on us to help save and plan their finances, buy their own home, make positive changes to local communities and of course be a great place for our colleagues to work and develop.

A few of the highlights of 2017 include: Achievement of Gold Investors in People status; significantly expanding our programme of grant giving from the Newcastle Building Society Community Fund; relocation and refurbishment of branches in Darlington and Durham; purchase of our flagship offices on Cobalt Business Park; delivery of critical projects covering regulatory, accounting and information technology enhancements; major investment in colleagues through leadership programmes; a new apprenticeship programme; and last but not least – a record customer satisfaction score of 96%.

FINANCIAL PERFORMANCE

Profit before tax improved to £13.1m for the year ended 31 December 2017 compared to £8.1m for 2016, an increase of 62%. This significant improvement was due mainly to a reduction in charges for impairment provisions and a non-recurring credit related to the purchase of our Cobalt office of £2.2m. Operating profit before provisions and exceptional items increased by £0.2m to £12.1m with overall growth in income of £3.3m, being offset by an increase in costs of £3.1m associated with the significant ongoing investment into the business. Net interest margin improved from 0.77% to 0.79% reflecting increased levels of residential mortgage lending despite a very competitive mortgage market and pressure on margins. Funding costs were slightly lower as the Society utilised the Bank of England Term Funding Scheme to provide cost effective 4 year financing.

Income from Newcastle Strategic Solutions, our savings management outsourcing business, increased by 3.5% while underlying profitability was lower reflecting a significant investment into the infrastructure. This included a strengthened senior management team, an enhanced project support team and a higher depreciation charge reflecting increased capital expenditure to upgrade and enhance infrastructure. The Solutions business provides a diversified income stream, based on core competencies within the building society business. All of the profits from this business are ploughed back into the Society and support increased investment in services for Members as well as providing capital to support and grow the business.

In 2017 we continued our significant investment programme in IT systems and supporting processes, particularly around cyber security, enhancing resilience and information security, reflecting the latest regulatory and accounting developments and improving functionality.

Mortgage impairment charges have fallen, as we expected, reducing from £1.8m to £0.2m and for the first time in 10 years, the Society had no charge in the period in relation to legacy commercial lending exposures with the book now representing only 1.5% of the total mortgage portfolio. Provisions for liabilities and charges increased by £0.4m from £0.6m to £1.0m. The charge for the Financial Services Compensation Scheme levy reduced from £0.6m to £0.1m reflecting a lower expected interest levy for the 2017/18 Scheme year. Offsetting this reduction was an increase in the provision for consumer redress of £0.9m reflecting increased costs of dealing with claims.

In February 2017 we purchased our office building at Cobalt Park in North Tyneside, a site that we have occupied for the last nine years, securing our future occupancy of the building. During the lease period the Society spread the effective cost of the lease over what was a 15 year term and built up a significant creditor for costs recognised but not billed during the rent free period. On purchase of the building this credit has been released, as it is no longer required, generating a £2.2m one-off profit in the year.

The Group's capital ratios continue to strengthen with Common Equity Tier 1 ratio improving from 14.3% to 15.3% and Tier 1 capital ratio increasing from 15.8% to 16.6%. The Group's overall capital ratio (Solvency ratio) was slightly higher at 18.9% compared to 18.7% at the end of 2016. The leverage ratio (on a transitional basis) remained at 5.2%.

Despite the mortgage market being extremely competitive in 2017 we achieved an increase in lending reflecting the investment we have made in distribution, our mortgage product range and online systems capability for brokers. Gross residential mortgage lending increased by 8% from £496m to £535m and net residential lending increased by 11% from £195m to £220m. 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 0.42% to 0.34%; lower than the industry average with 2017 seeing a record low since we have been tracking 3 months arrears. Possession cases also continued at very low levels reflecting the excellent credit quality of the Society's residential lending.

Our liquidity at the end of the year was 17.0%, excluding encumbered assets, down slightly compared to the level at the end of 2016 of 17.4% but well above our minimum operating requirements. The Society's liquidity coverage ratio was 180% against a minimum required level of 100% (from 1 January 2018). 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.

SUPPORTING OUR CUSTOMERS

As a building society, helping people own their home is at the heart of our purpose. In 2017 we have seen record low mortgage rates. We continued to offer a wide range of good value products to help house buyers, from 2 to 10 year fixed periods, variable and discounted rates, and fee free products. We have a range of retention products available on maturity for loyal customers. We also provide mortgages for borrowers with more specialist needs including building their own home and buying a property to let.

We launched an exclusive range of mortgages to help local people buy their own home in the North East which have been very popular particularly for borrowers requiring a 95% LTV mortgage. Whether it's first time buyers taking their first step on the property ladder, supporting existing house buyers move home, or simply helping people save money by re-mortgaging, we are focused on meeting the needs of our borrowers. We were delighted that our efforts were recognized in the "What Mortgage Awards 2017" when we received the award for Best Regional Building Society.

We believe it's important, for individuals and for wider society, that people are encouraged to save for their future and to plan their finances. Against a backdrop of falling individual savings levels, we have launched a range of regular savings products which include Help to Buy ISA and children's savings accounts with this range set to be expanded further in 2018 so we can encourage everyone to get into the regular savings habit.

In November 2017 the Bank of England increased the base rate from 0.25% to 0.5% giving savers the first sign in 10 years that savings rates may start to increase. In advance of the Bank of England announcement we committed to pass on the base rate increase to all of our retail savers with variable rate savings accounts, which was very positively received by customers.

Our financial advice subsidiary, Newcastle Financial Advisers Limited (NFAL), gives customers financial advice regardless of how much they have to invest. NFAL has a significant and growing level of funds under management for people in the region, and continues to invest in growing local financial adviser talent to meet a customer preference for face-to-face service. The subsidiary increased income and profits in 2017 and scores highly for customer satisfaction (currently at 98%). It has been particularly appreciated in areas of our region that have experienced loss of ongoing service from other providers of financial advice.

We are committed to our heartland area and continue to invest in a modern High Street branch network that is fit for the future and designed around the needs of our customers. Darlington branch was relocated to a facility that provides a greatly improved environment for our customers and colleagues, including more private meeting spaces to discuss financial matters with ease. Durham branch also has a new location, providing modern premises and facilities for our customers. Further plans are in place to invest in the relocation or refurbishment of our Carlisle and Berwick branches, which we expect to be completed in 2018.

Reflecting our strategic focus on our North East heartland, during the second half of the year we made the difficult decision to close our two geographically outlying branches - Dumfries closed in September and Gibraltar closed in October. We have plans to upgrade all of our remaining branches, which have not already been refurbished, over the next 2-3 years.

SUPPORTING OUR COLLEAGUES

In 2017 we were delighted to be awarded Investors in People – Gold status. This recognises our commitment to leadership development, our genuine involvement with local communities, our values and behaviours, and our investment in colleague engagement and communication, all of which are driving positive change across the organisation.

We have made significant progress towards our goal to make the Society a great place to work, where people can realise their potential. In 2017 we completed a major review of our pay and grading structures so we can ensure we have fair remuneration, competitive packages and all staff have a clear understanding of their roles. This was aligned with an extensive job evaluation exercise which will ensure we have the right pay and grading structures in place to attract and retain talent. This process will continue in 2018.

Part of our purpose of "Connecting Communities in the North East with a Better Financial Future" is delivered through the manner in which we support our colleagues in planning their own future. We were therefore very pleased to announce improved pension contributions for over 500 colleagues going into 2018. A corporate bonus was awarded to colleagues in relation to 2017 performance, which ranged from 0% to 6% of salary, with the majority of colleagues being paid 3%.

In 2017 we were officially accredited by the National Living Wage Foundation as a Real Living Wage employer. This goes further than the Government's national minimum wage. Real Living Wage Rates are independently calculated and are the only UK rates based on real living costs.

We have continued to invest in our Academy programme for financial advisers, which provides a professional training programme leading to qualified adviser status. Four new internal recruits joined the programme this year. Investing in our talent through this type of opportunity is core to our ongoing commitment to provide accessible, face to face, affordable financial advice for people across our region.

We also increased our investment in nurturing regional talent with the launch of our first ever apprenticeship programme. Five apprentices aged between 17 and 24 joined us to undertake a 12 to 18 month training and development programme resulting in a nationally recognised qualification. This supplements the student placement and undergraduate training programmes that we have already operated for many years. We plan to expand the apprenticeship programme in the years ahead.

SUPPORTING OUR COMMUNITIES

As a customer-owned business, supporting our communities and helping them make positive changes is part of our purpose. Since the launch of our Community Saver accounts, which generate a Society donation to the Newcastle Building Society Community Fund at the Community Foundation, we have provided grants to help local community groups continue, or enhance, their delivery of valuable local services. In 2017 we awarded £133,823 in grants to 76 charities and community groups, positively impacting an estimated 74,000 people across the North East region. From lunch clubs for the socially isolated, to a talking newspaper for the blind, and the provision of new children's toys for a local community play group, we have been privileged to play our part in creating a better outcome for a number of communities across the North East and Cumbria.

We have also continued to support the North East-based cancer research charity, the Sir Bobby Robson Foundation through our charity-linked savings accounts, and this year reached an impressive £2.5m in donations since the fund first started. Our support to the Sir Bobby Robson Foundation, combined with the contribution to the Community Foundation to build up the endowment for the Community Fund saw total charitable giving of £770,000 or 6% of our profit before tax.

Our financial education programme continues to deliver memorable opportunities for primary school children, the basis of which is a six week classroom based course of lessons all about money - delivered by our branch staff. The culmination of the programme is the Boardroom Charity Challenge which asks young participants to develop business ideas that will benefit their local community while making a profit. Our 2017 winner was Throckley Primary school in Newcastle. This programme is supplemented by an ongoing, region-wide series of 'Big Talks' which provide a review of developments in pensions, investments and protection. This year we supplemented our 'Big Talks' with First Time Buyer information events for those who are new to the process of buying a home.

Our colleague volunteering policy encourages all our colleagues to spend two days volunteering to support a range of charities and groups based in our local communities. Colleagues have supported more than 70 causes this year.

SUMMARY

I am very pleased with the Society's progress in 2017 which balances the need for a strong financial performance with investing in the products and services we provide for customers both now and for the longer term.

I would like to thank our colleagues for their fantastic contribution in 2017 and our Members for their ongoing support. While there may be economic uncertainty from global factors outside of our control and it is likely the UK mortgage market will continue to be extremely competitive in 2018, we are well placed to continue our progress in the year ahead.

Regardless of the economic backdrop we will be true to our purpose of "Connecting Communities in the North East with a Better Financial Future", encouraging people to save and plan their finances and helping people own their home. We will strive to be a great place to work where our staff can achieve their potential and help our communities make positive changes.

ANDREW HAIGH
CHIEF EXECUTIVE
27 FEBRUARY 2018

Strategic Report

The Directors present their Strategic Report on the Group for the year ended 31 December 2017.

PURPOSE AND STRATEGY

Newcastle Building Society is the largest building society based in the North East of England.

In recent years the Society has successfully followed a strategy which has seen improvement in areas of our services and financial strength. These improvements have been made by focusing on key stakeholders, our Members, Colleagues, Communities, and our Business Partners. At the start of 2017 we set out our purpose, "Connecting Communities in the North East with a Better Financial Future", which has both inspired and directed our actions throughout 2017. At the heart of our purpose lies our understanding of what it means to be "The North East's Building Society".

The Society's purpose is:-

"Connecting communities in the North East with a better financial future".

We aim to do this through:-

- Encouraging people to save and plan their finances;
- Helping people own their home;
- Being a great place to work, where people can realise their potential;
- Helping our communities make positive changes; and
- Helping our clients and partners succeed through our excellent products and services.

WHAT DO WE MEAN BY "CONNECTING"?

We recognise that connecting with customers in a meaningful way is the foundation of our 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. We appreciate that part of making a commitment to save, buy a home or invest for the future requires customers to understand how their goals can be achieved over time. Part of what we do is help people connect with these ideas, be clear about both the risks and the commitment they are making and offer both a route and support to achieve their goal.

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 communities around the branch; digital communities facing a common problem or goal; communities represented in generations of families; colleague communities; and charities we may 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 branch 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.

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.

KEY PERFORMANCE INDICATORS

	2017	2016
CUSTOMERS		
Customer satisfaction	96%	93%
Complaints handling % achievement within service level	100%	99%
Telephones - % achievement of all service levels	88%	90%
Servicing - % achievement of all service levels	97%	98%
PEOPLE		
Colleague turnover	11.4%	12.2%
FINANCIAL - PROFITABILITY		
Profit before tax	£13.1m	£8.1m
Net interest margin	0.79%	0.77%
Cost to income ratio	79%	78%
Solutions profit before tax	£5.5m	£6.8m
NFAL profit before tax	£1.3m	£1.1m
FINANCIAL - BALANCE SHEET		
Common Equity Tier 1 ratio	15.3%	14.3%
Leverage ratio	5.2%	5.2%
Liquidity as a percentage of shares, deposits and liabilities	23.9%	24.9%
Liquidity as a percentage of shares, deposits and liabilities, excluding encumbered assets	17.0%	17.4%
Liquidity coverage ratio	180%	202%
Gross lending	£535m	£496m
Net residential lending	£220m	£195m
3 months or more arrears for total mortgage portfolio, by number	0.34%	0.42%
3 months or more arrears for total mortgage portfolio, by balance	0.19%	0.24%

Key Performance Indicators (KPIs) are an important way of monitoring achievement of short-term objectives and progress against the strategic plan and are reported to the Board on a monthly basis.

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

OUR CUSTOMER PROMISE

In 2017 we simplified and updated our customer promise with eight published commitments as set out below.

If you are one of our customers we will:-

1. Treat you fairly and with respect;
2. Consider your needs in the products and services we offer;
3. Respond quickly with a solution;
4. Keep you informed;
5. Communicate clearly and honestly; and
6. Listen to and consider your feedback.

If you face difficulty we will:

7. Provide a named contact; and
8. Seek to adopt a flexible approach appropriate to your changed needs.

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 fantastic overall satisfaction score of 96% in 2017, an increase on the score for last year, which was 93%.

The 2017 survey highlighted improvements in many aspects of the service offered by the Society including the friendliness and helpfulness of colleagues in branches and over the phone and a higher net promoter score, which measures the loyalty of our customer relationship. In addition the overall satisfaction within the Society's financial advice subsidiary, Newcastle Financial Advisers Limited (NFAL), was a fantastic 98% (2016: 97%), a major testament to the quality and value our advice customers receive from the face-to-face financial planning service offered.

Other customer KPI metrics include customer service levels in our call and servicing centres and the timeliness of response following customer feedback on those occasions our service is not as good as we would want it to be. These metrics were ahead of target across 2017.

As anticipated the Bank of England raised the base rate in November 2017. The Society had committed that it would pass on the expected 0.25% interest rate rise to all of its individual variable rate retail savings customers.

We further strengthened our presence and investment in our heartland area through a new branch review and a continuing investment programme during 2017. We are committed to our heartland area and are continuing to invest in a modern High Street branch network that is fit for the future and designed around the needs of our customers.

Darlington branch was relocated to create a purpose-built branch and financial advice centre. The new branch provides a greatly improved environment for our customers and colleagues, including more private meeting spaces to discuss financial matters with ease.

Durham branch opened in a new location in January 2018 providing modern premises and facilities for our customers. Further plans are in place to invest in the relocation or refurbishment of our Carlisle and Berwick branches, which we expect to be completed in 2018. We expect to refurbish all remaining branches, which have not already been refurbished, over the next 2-3 years.

As part of a strategic decision to focus on the heartland area, which incorporates North East England and Cumbria, we decided to close our branches in Dumfries and Gibraltar. Support was provided to all customers and colleagues throughout the closure process.

Our latest branch investments are complemented by additional investment in digital and telephony options to support the first class service we aim to provide through whichever channels our customers choose to connect with us. Further details of what the Society has been doing for Members and customers are included in the Chief Executive's Review on pages 6 and 7.

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 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. Further details are given in the Community Support Report on page 14 and 15.

As the first building society to achieve Investors in People (IIP) status in 1992 it was extremely pleasing to achieve IIP Gold status in 2017 for the first time. Over 85% of colleagues completed the on-line survey and independent assessors gathered additional information, involving colleagues from across the business. Achieving Gold status reflects a key part of our Purpose 'to be a great place to work where people can realise their potential'.

Strategic Report (continued)

Through our apprenticeship, graduate and 12 month placement programmes we are investing in our people and our future by attracting new talent and ensuring colleagues have the support and tools they need to succeed.

The Society launched its first apprenticeship programme, taking on five apprentices aged between 17 and 24 who will undertake a 12 to 18 month training and development programme resulting in a nationally recognised qualification. As part of recognising the value and contribution of its apprentices to the business, the Society has chosen to pay them more than double the minimum pay level set by the Government. Each of the new apprentices will be supported through tailored development activities provided by the Society's learning and development team, specialist training providers and colleagues from across the wider business, which will support their individual roles and personal aspirations.

We celebrated the first two graduates from our 'Academy' programme in 2017. Working with our business partner, Openwork, we provide a bespoke training programme for talented colleagues within the Society to train to become professional financial advisers. In 2017 we deployed the building blocks that will deliver a much stronger approach to leadership, development and management as we seek to realise the potential of colleagues across our Society. This investment in developing our people will continue into 2018. In the first half of the year we completed a major review of our pay and grading structures so we could ensure we had fair remuneration, competitive packages and all staff had a clear understanding of their roles. This was aligned with an extensive job evaluation exercise which will ensure we have the right pay and grading structures in place to attract and retain talent.

As a leading North East employer we are proud to pay the Real Living Wage rate to colleagues, going further than the Government's minimum wage. To qualify as a Real Living Wage employer we needed to ensure that any of our partners who deliver services into our organisation also pay above the threshold. This ultimately means that the benefits of our actions are felt even beyond our own colleagues.

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 2017 Corporate Bonus Scheme will pay all eligible colleagues an amount based on their annual assessment rating, for 2017 this was between 0% and 6% (2016: 3.0%) of salary. The majority of staff received a 3% bonus with a small portion (15%) receiving an enhanced bonus payment of 6%. 4% of staff did not quality for a bonus payment. Unite has negotiating rights on behalf of all colleagues up to and including senior management level and in 2017 a pay award of 2.5% was given.

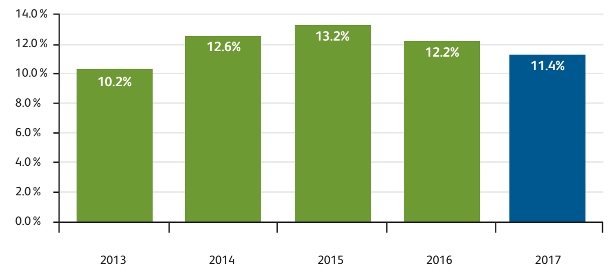
The Society operates an Equal Opportunities Policy. It is the intention of the Society that no applicant or employee receives less favourable treatment on the grounds of disability, sex, transgender status, sexual orientation, marital status, civil partnership status, race, ethnic origin, colour, age, 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 2017 are as follows:

	Female		Male	
	2017	2016	2017	2016
Directors	23%	18%	77%	82%
Senior Managers	33%	25%	67%	75%
Managers	40%	51%	60%	49%
Employees	67%	63%	33%	37%
Overall	**60%**	**60%**	**40%**	**40%**

The Board views the colleague turnover KPI as an important reflection of the success of the people agenda. The Group colleague turnover rate decreased slightly to 11.4% in 2017 from 12.2% in 2016, this is better than the KPI target and should be considered against the background of a competitive jobs market.

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.

FINANCIAL KPIS AND ANALYSIS

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	2017 £m	2016 £m
Net interest income	29.1	27.1
Other income and Charges	28.8	27.5
Total operating income	**57.9**	**54.6**
Administrative Expenses	(43.0)	(40.3)
Depreciation	(2.8)	(2.4)
Operating profit before impairments, provisions and exceptional items	**12.1**	**11.9**
Impairment charges	(0.2)	(3.2)
Provision for liabilities and charges	(1.0)	(0.6)
Exceptional Gain on Purchase of Cobalt Offices	2.2	-
Profit for the year before taxation	**13.1**	**8.1**

Profit before tax increased by £5.0m to £13.1m in 2017 from £8.1m in 2016 due mainly to a fall in impairment charges and the Financial Services Compensation Levy and a one-off credit of £2.2m arising on the purchase of our Cobalt offices.

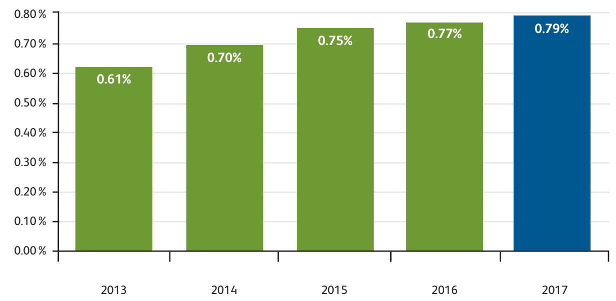
Operating profit before provisions and one-off gains increased slightly to £12.1m in 2017 (2016: £11.9m). Whilst overall income was up by 6%, the significant ongoing investment into the business resulted in higher costs, so the growth in overall operating profit was only £0.2m. Operating profit before provisions and exceptional items is considered an important reflection of the operating strength of the Group's business.

Segmental information is available in note 8 and details the Member business and Solutions business segments. A detailed review of central overhead cost allocations took place in 2017 which resulted in a higher allocation of costs to the Solutions business particularly in relation to IT, senior management time, risk, key support functions and depreciation charges. Solutions business profit figure for 2017 was £5.5m (2016: £6.8m).

NET INTEREST MARGIN

Net interest income increased by £2.0m and net interest margin improved from 0.77% to 0.79% due to growth in mortgage lending and slightly lower funding costs as the Society benefitted from accessing cheaper funding provided by the Bank of England's Term Funding Scheme.

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 40) – 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 in total across the Group increased by £1.3m to £28.8m in 2017 from £27.5m in 2016. This was due to growth in Newcastle Strategic Solutions income and higher recurring income arising from increased funds under ongoing service agreements within our financial advice subsidiary (NFAL). The divisional performance of the Member and Solutions businesses are shown in Note 8 on page 52.

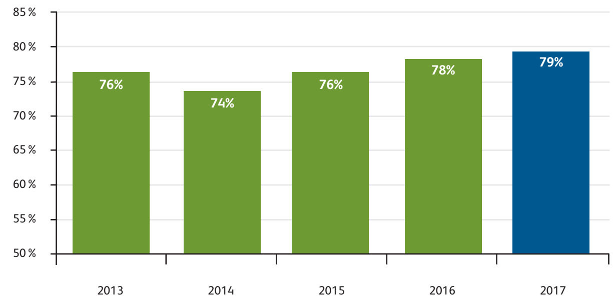
ADMINISTRATIVE EXPENSES AND DEPRECIATION

Administrative expenses increased by 6.7% or £2.7m from £40.3m to £43.0m in 2017. This reflects inflationary increases and the impact of the pay and grading review but also increased headcount across the business to support long term growth. This covered, inter alia, the Solutions and advice businesses, investment in IT projects and development resource, increased resource within risk and change management and ongoing projects to improve infrastructure, resilience and services. Depreciation expense increased by 17% from £2.4m to £2.8m reflecting higher levels of capital expenditure on IT and branches and the purchase of the Cobalt Office building. Long term capital investment in branches ensures they offer Members a modern, welcoming and inviting environment in which to do business with us. 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.

Overall management expenses (the sum of depreciation and administrative expenditure) increased to £45.8m from £42.7m. The ratio of management expenses to mean total assets increased to 1.24% in 2017 compared to 1.21% in 2016. Although a traditional method of measuring cost management for building societies, the Board considers the management expense ratio to be less reflective of the Group's business model in that the Solutions business income stream requires minimal assets to support it. The management expenses ratio excluding the Solutions business was 0.76% for 2017 compared to 0.77% in 2016 reflecting significant levels of investment in colleagues and infrastructure during the year.

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 rose by 1% from 78% in 2016 to 79% in 2017, due to increased administration expenses detailed above. 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 40) 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 fallen overall to £0.2m in 2017 from £3.0m in 2016, (excluding provision charges for suspended interest). The Society has been successful in its strategy in winding down the commercial portfolio and reducing risk with the commercial balances, net of impairment provisions amounting to less than £40m representing 1.5% of the total mortgage book. Due to the more positive market backdrop for commercial property in 2017 and the reduction in the size and risk within the portfolio we have been able to reduce the level of commercial loan provisions which resulted in a credit for the year of £0.5m.

IMPAIRMENT CHARGES BY AREA	2017 £m	2016 £m
Commercial	(0.5)	2.5
Residential (1)/ Other	0.7	0.7
Provisions charge for the year	0.2	3.2
Interest adjustment to provisions (2)	-	(0.2)
Total charge recognised	**0.2**	**3.0**

(1) Residential includes provisions in relation to owner occupier and buy to let properties.
(2) Interest provisions flow through net interest margin and relate primarily to commercial loans.

From 1 January 2018 the Group's recognition of impairment losses will be calculated under IFRS 9 'Financial Instruments' as the reporting standard replaces the current provisioning requirements of IAS39. Note 11 on page 55 and Note 30 on page 71 contain further details. The move to IFRS 9 is not expected to have a material impact on the overall level of impairment provisions.

PROVISIONS FOR LIABILITIES AND CHARGES

The 2017 charge of £1.0m recognised in the Income Statement compares to a charge of £0.6m for the prior year, an increase of £0.4m. 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 23 on page 63.

EXCEPTIONAL GAIN ON PURCHASE OF COBALT OFFICES

In February 2017 we purchased our office building at Cobalt Park, a site that we have occupied for the last nine years, securing our future occupancy of the building and providing additional space to further grow and develop our business. During the lease period the Society spread the effective cost of the lease over what was a 15 year term and built up a significant creditor for costs recognised but not billed

Strategic Report (continued)

during the rent free period. On purchase of the building this credit has been released, as it is no longer required, generating a £2.2m one-off profit in the year.

TAXATION

The Group shows an effective corporation tax rate of 17% or £2.2m in 2017. The tax charge relates to the reduction in the deferred tax asset carried on the balance sheet as taxable losses from previous years are used to extinguish the current year corporation tax charge. In addition there was a £0.1m adjustment in respect of prior year items. The Society and Group have not paid any corporation tax since 2007 due to the taxable losses available however it is expected that the Group will start to pay corporation tax in 2018.

Other Taxes paid by the Society are summarised in the table below:

TAXATION	2017 £m	2016 £m
Employers' National Insurance	2.4	2.1
Value Added Tax	1.9	1.6
Total	**4.3**	**3.7**

BALANCE SHEET

LIQUID ASSETS

The Society has continued to maintain a level of high quality liquid assets throughout 2017. All of the Society's 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	2017 %	2016 %
Cash in hand and balances with the Bank of England	32.3	36.2
Gilts	15.0	13.3
Residential mortgage backed securities	27.9	28.2
Covered bonds	24.5	21.9
Other	0.3	0.4
	100.0	**100.0**

The Society has access to the Bank of England liquidity schemes and has pre-positioned mortgage collateral and asset backed securities that provide funding as part of business as usual and contingency funding plans.

The Society liquid assets increased slightly during the year with the statutory liquidity percentage reported at 31 December 2017 being 23.9% compared to 24.9% in 2016. Excluding encumbered collateral balances liquidity was 17.0% compared to 17.4% at the previous year end – well 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 2017 was 180%, comfortably in excess of the minimum regulatory limit set by the PRA of 100% from 1 January 2018.

LOANS AND ADVANCES TO CUSTOMERS

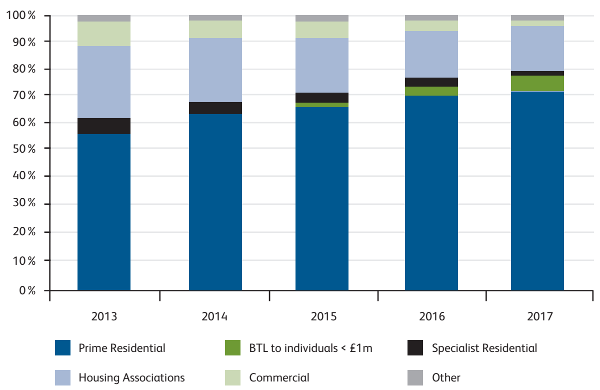
Loans and advances to customers increased by £142m overall in 2017 as shown in the table below, which highlights the Society's strategy to grow prime residential mortgage business whilst winding down legacy portfolios.

LOAN PORTFOLIOS	2017 £m	2017 LTV%	2016 £m	2016 LTV%
Prime Residential	1,933	55.7	1,796	53.9
Prime Retail BTL <£1m	153	67.7	79	67.5
Specialist Residential	58	57.1	68	59.5
Housing Associations	498	64.4	521	64.2
Commercial	47	124.2	81	100.5
Other	29	62.9	31	63.3
	2,718		2,576	
Provisions	(11)		(12)	
	2,707	**59.3**	**2,564**	**58.1**

The £142m increase in gross mortgage balances before provisions includes a £78m fall in legacy books and a £220m increase in residential lending including £74m of net lending on buy to let properties to individuals. The Society does not lend 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 30.

Mortgage book profile



MORTGAGE CREDIT QUALITY

ARREARS

The Society has KPI measures for 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 2017 %	By number of loans 2016 %	By balance 2017 %	By balance 2016 %
Residential	0.33	0.41	0.24	0.32
Other	1.12	0.94	0.45	0.36
Total	**0.34**	**0.42**	**0.19**	**0.24**

The overall level of mortgage arrears experienced has fallen once again in 2017, continuing well below UK Finance reported averages and at a record low for the Society. Overall by number of loans arrears are down by 8bp to 0.34%, and by balance down by 5bp to 0.19%, reflecting the excellent credit quality of the book. 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 2017. Note 30 on page 71 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 2017 the Society had 2 possession properties in relation to owner occupied loans, 1 buy to let possession property 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 increased by £80m during 2017 to £2.8bn. Wholesale funding, including drawdown on Bank of England Funding Schemes, increased during the year by £106m. This increase in wholesale balances has resulted in the percentage of wholesale balances to total share and deposit liabilities increasing from 13.66% in 2016 to 15.40% in 2017. The Group's mortgage loans remain wholly funded by retail savings balances.

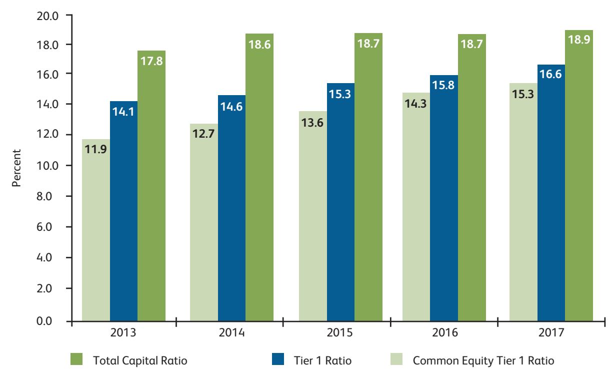
CAPITAL

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

CAPITAL	2017 £m	2016 £m
Tier 1 Capital		
Common Equity Tier 1 Capital	182.5	169.8
Additional Tier 1	15.0	18.0
	197.5	187.8
Tier 2 Capital		
Tier 2 Capital	24.5	30.3
Collective Impairment Allowance	3.2	3.3
	27.7	33.6
Total Capital	225.2	221.4
Risk Weighted Assets		
Liquid Assets	45.5	54.6
Loans and Advances to Customers	995.8	999.4
Other Assets	51.6	34.2
Off Balance Sheet	18.2	21.2
Operational Risk	81.9	76.8
	1,193.0	1,186.2
Capital Ratios	**%**	**%**
Common Equity Tier 1 Ratio	15.3	14.3
Tier 1 Ratio	16.6	15.8
Total Capital Ratio	18.9	18.7
Leverage Ratio	5.2	5.2

The Group complied with Individual Capital Guidance plus capital buffers, as notified by the Prudential Regulation Authority, throughout 2017. The total capital ratio was 18.9% (2016: 18.7%); Tier 1, and more importantly Common Equity Tier 1, offer the greatest protection to Member's funds in the unlikely event of unforeseen financial stress; these increased to 16.6% and 15.3%, respectively in 2017.

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 2017 the figure was 5.2% (2016: 5.2%). This is, and has remained throughout 2017, 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 2017 was £153.4m. 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 32 to 35.

OUTLOOK

The economic, political and competitive backdrop remains uncertain and we expect in 2018 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
ANGELA RUSSELL
DEPUTY CHIEF EXECUTIVE & FINANCE DIRECTOR
27 FEBRUARY 2018

Community Support

Newcastle Building Society Community Fund
at the Community Foundation

Working to help our communities make positive changes

As the largest building society based in the North East, we continued with our drive to support our regional communities. Our Community Fund continues to go from strength to strength, and our colleague volunteering programme more than doubled, benefiting more local people than ever before.

Growing Grants

Following on from our successful launch of the Newcastle Building Society Community Fund at the Community Foundation, we have grown our grant impact almost seven times over during 2017.

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.

In 2017 we awarded £133,823 in grants to 76 charities and communities across our heartland region. Here are some of the local community projects which received a grant.

Tea Dancers Whitley Bay

Whitley Bay Tea Dance Club committee received a £1,760 grant, which secured the hire of the Masonic Hall for the weekly tea dance for the next 12 months, after being nominated by Newcastle Building Society customer Julia Ashley. The Whitley Bay Tea Dance Club attracts around 40 people from across the local area to its weekly dance sessions. Plans are also afoot to host a "Beginners Ballroom" and a "Celebration Dance" event for the public.

Tees Valley Wildlife Trust

Tees Valley Wildlife Trust is working with the Friends of Linthorpe Cemetery in Middlesbrough to use their grant of £1,330 to enhance a patch of land near the cemetery's baby memorial area. Rachel Murtagh, a customer at our Yarm Library partnership branch successfully nominated the Trust, who actioned their landscape renovation plans in August. The flowers will bloom this Spring.

Pelton Fell Community

Eric Brown, a customer at our Chester-Le-Street branch, nominated Pelton Fell Community Partnership for a £3,000 grant to help ensure the partnership can continue to run a wide range of activities for children on a weekly basis. Sessions are designed to give children the chance to experience various activities which might not otherwise be accessible to them. Activities offered range from cooking and art and crafts, through to life skills advice and support.

Talkin Tarn

A grant of £2,410 helped Talkin Tarn Amateur Rowing Club to purchase a new boat to hold 'Learn to Row' courses, giving both adults and juniors the opportunity to give rowing a try. David Bailey, a customer at our Penrith branch successfully applied for the grant after first taking part in Talkin Tarn 50 years ago and re-joining the clubs senior section in 2013.

Men In Sheds

Customer, William Jeromson, Treasurer of the Men In Sheds South Tyneside Group, has helped secure a £2,571 grant to buy the group a range of new tools. The group provides a fantastic environment for members to use and develop their practical skills or simply chat to others over a cup of tea whilst working on a piece of furniture.

Annie Mawson's Sunbeams Music Trust

Annie Mawson's Sunbeams Music Trust has been working for the last 25 years to improve the health and well-being of people with special needs through music. After being nominated by customer, Michael Lawson-Johnson, the Trust was awarded a grant of £2,768 to plant dozens of apple trees on site in Cumbria in the Spring.

Sir Bobby Robson Foundation

In 2017, we were delighted to surpass the £2.5m mark in donations to the Sir Bobby Robson Foundation. Our funding commitment to the charity will continue but will now be made through the Newcastle Building Society Community Fund at the Community Foundation. The Sir Bobby Robson Foundation funds cancer research projects within the Newcastle Upon Tyne Hospitals NHS foundation Trust.

Community Award Win

We were thrilled to receive recognition for the ways we support our communities when we won the Mortgage Finance Gazette 2018 award for Community Service in the Medium to Large Lenders category. This commended our Society for the work undertaken through the Newcastle Building Society Community Fund at the Community Foundation, our volunteering programme, the Boardroom Challenge and our BIG Talk Seminars.

The Boardroom Charity Challenge

Through our ongoing Financial Education programme and the Boardroom Charity Challenge, we've educated over 2,000 children in schools across our heartland about the importance of managing money and becoming more financially independent later in life. Throckley Primary School were this year's winners, securing the £1,000 prize to host a carnival this summer to raise money for the Batten Disease Family Association.

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 member of the Board of the Community Foundation Tyne & Wear and Northumberland and Vice Chairman of the Northern Association of Building Societies.

ANGELA RUSSELL
DEPUTY CHIEF EXECUTIVE & FINANCE DIRECTOR

Deputy Chief Executive and Finance Director, Angela is a Fellow of the Institute of Chartered Accountants and a Certified Public Accountant with 29 years' experience in finance in the UK and abroad.

She has worked in a variety of positions covering finance, risk, audit, project and corporate planning roles. In particular, she has many years' experience in finance roles within the building society sector, including her current role as Finance Director for Newcastle Building Society, which she has held since 2010. Angela is also Deputy Chief Executive for the Society. Prior to joining the building society sector Angela spent 12 years at PricewaterhouseCoopers LLP.

After 17 years of service, Angela has made the decision to leave the Society and will step down from the Board following April's AGM.

PATRICK FERGUSON
STRATEGY, PLANNING & RISK DIRECTOR

As Strategy, Planning and 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 18 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 a Director of the Society in January 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 over 30 years' 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 Audit, Group Risk and Nominations Committees and is Chairman of the Remuneration Committee.

IAN WARD
NON-EXECUTIVE DIRECTOR

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

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 Nominations Committees. He is also a member of the Risk and Audit Committees.

Ian is Senior Independent Director of Harrogate and District NHS Foundation Trust and a member of its Audit and Finance Committees. He has been a non-executive director of Newcastle Building Society since 2013 and chairs both Newcastle Systems Management Limited and Newcastle Financial Advisers Limited. He is also a member of the 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.

He was Vice Chairman of Cumbria Partnership NHS foundation trust for four years, and is currently chair of MPAC Group PLC. Phil brings 38 years' business experience to the Society's Board. His skills and expertise were recognised when he was awarded 'North East Non-Executive of the Year 2015' at the North East Business Executive of the Year Awards.

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 has 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 Chairman of Group Risk Committee and also as a member of the Nominations and Remuneration Committees. He is a Director of 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.

RICHARD BOTTOMLEY OBE
NON-EXECUTIVE DIRECTOR

Richard joined the Board in 2014 as a Non-Executive Director and he is also Chair of the Audit Committee.

He is a Fellow of the Institute of Chartered Accountants and in 2010 was awarded an Order of the British Empire for services to the Accountancy Profession and Business in the North East. He was Managing Partner at KPMG for 12 years prior to his retirement in 2008, and is a past President of the North East Chamber of Commerce.

In a professional career spanning over 30 years he gained experience in corporate finance, strategic planning and was the Lead Audit Partner on some of the region's largest companies. Richard is Chairman at both Greggs PLC Retirement Benefits Scheme and TL Dallas Group.

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 Newcastle Building Society's Remuneration Committee. Karen also plays an active role within the North East Chamber of Commerce and is a member of techUK.

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 advisor 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 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 his 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 Non Executive Director of Cygnet Properties and Leisure PLC and Echo Financial Services Limited. Bryce is a member of the Society's Group Risk Committee.

Directors' Report

The Directors present their Annual Report and Accounts and Annual Business Statement for the year ended 31 December 2017, 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 on page 8 of the Strategic Report.

Business Review and Future Developments

The Chief Executive's Review on page 6 and Strategic Report on page 8 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 (KPIs), which include customer, people and financial KPIs, details of the Group's customer focus and people agenda, financial analysis, mortgage credit quality and capital position.

The Annual Business Statement on page 85 and the Credit Risk section of Note 30 on page 76 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 32.

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 on page 32 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 30 to the accounts on page 71 sets out the metrics associated with the key risks including sensitivity analysis and exposure levels.

Mortgage arrears

As at 31 December 2017 there were 16 cases (2016: 24) where payments were 12 months or more in arrears. The capital balances of these loans were £0.9m (2016: £1.3m). The total amount of arrears on these loans was £0.1m (2016: £0.2m).

Political and charitable gifts

Charitable donations: The Society is pleased to be able to give back to its heartland communities, through charitable donations, staff fundraising and volunteering. Through a variety of savings accounts, including the Newcastle Community Saver and the Sir Bobby Robson Foundation Saver, a total of £770,000 was donated to charitable causes, including the Newcastle Building Society Community Foundation and the Sir Bobby Robson Foundation. This equates to 6% of the Group profit before tax.

Our colleagues undertook a variety of fundraising activities during 2017 in aid of the Newcastle Building Society Community Fund, raising in excess of £16,000 for important local causes.

Throughout 2017, colleagues volunteered 2,600 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 2017, can be found in the Community Support Report on page 14.

The Group has not made any political donations during 2017 (2016: £nil).

Supplier Payment Policy

The Group follows an internal policy that payment to suppliers will be made within 30 days from receipt of an invoice and endeavours to meet individual suppliers' payment terms which may be set at shorter timescales. At 31 December 2017, the number of creditor days was 25 (2016: 27 days).

Directors

As at 31 December 2017, the members of the Board, who have served at any time during the year and continue to act as Directors, are as follows:

Richard Bottomley, David Buffham, Patrick Ferguson*, Bryce Glover (joined the board on 11 August 2017), Andrew Haigh*, Karen Ingham, Phil Moorhouse, John Morris, Angela Russell*, Anne Laverack (business name: Anne Shiels) (joined the board on 17 July 2017) and Ian Ward.

Damian Thompson* resigned from the board on 24 April 2017.

At the Annual General Meeting (AGM), to be held on 25 April 2018, all of the current Directors will offer themselves up for either election or re-election, with the exception of Angela Russell who will step down at the conclusion of the meeting.

Stuart Miller* was appointed Customer Director after the year-end on 16th January 2018. He will offer himself for election at the AGM.

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 28 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 16 and 17 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 20 to 24.

Statement of Directors' Responsibilities

The following statement, which should be read in conjunction with the statement of auditors' responsibilities on page 39, 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
27 FEBRUARY 2018

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 revised 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 the Code within the 2017 Annual Report and Accounts.

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. The most recent changes to the Code were particular to the make-up of Audit Committees, with the Society's Audit Committee members already meeting the expanded requirement to have, as a whole, competence relevant to the Society's operating sector.

This report outlines the approach taken by the Society and how the Board considers it has demonstrated application of the principles of the 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 16 and 17. 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 21.

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 appointed Deputy Chairman on 26th April 2017, following Ron McCormick's retirement from the Board at the last AGM. David Buffham was appointed to the role of 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 at the end of 2017 the Board comprised of eight Non-Executive Directors and three Executive Directors.

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

Matters Reserved to the Board
The Board's Terms of Reference are reviewed on a regular basis and were last agreed by the Board in June 2017. 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 options and resolution pack; monitoring any Recovery Plan and approving appropriate management actions; and approving budgets, forecasts and major capital expenditure.
- **Culture –** overseeing and setting the tone for the culture, values and behaviours of the Society.
- **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, and ensuring the strategy and risk appetite are consistent. 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).
- **Strengthening Accountability in Banking –** 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.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.

Board Changes and Elections/Re-elections
It is recognised that changes need to be made to the Board from time to time. In 2017, Ron McCormick retired and two new Non Executives were appointed, namely Bryce Glover and Anne Shiels. During 2017, Damian Thompson resigned as Customer Director and was replaced in 2018 by Stuart Miller, who will continue to strengthen the Society's focus around engaging and providing excellent service to customers.

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, with the exception of Angela Russell who is standing down as Deputy Chief Executive and Finance Director at the end of the AGM. The biographies of all of the Directors are detailed on pages 16 and 17.

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 2017, 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 24. 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 25. Through the work of the Audit Committee and the Internal Audit Services department during 2017, 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 28.

Group Risk Committee
Details of the Group Risk Committee are contained in the Risk Management Report on page 32.

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 2018.

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 and John Morris.

NomCo operates to a rolling agenda to ensure it discharges its full responsibilities. It normally meets a minimum of twice a year and in 2017 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 2017 the Society utilised the services of independent recruitment specialists, Hitchner Wakeford, and Odgers Berndston 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.

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 qualities of its Directors. Giving specific regard to gender ratios, there were three female directors on the Board last year, when Anne Shiels joined in July 2017.

It is important to note that all Board appointments are made on the basis of individual competence, skills and expertise measured against

Report of the Directors on Corporate Governance (continued)

identified objective criteria. Appointment is therefore based on merit and the Board has not set any measurable objectives for diversity although the position will be kept under review.

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 25th April 2018.

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 was carried out by NomCo in January 2018, 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 2018.

In January 2015, one of the Non-Executive Directors, Ian Ward, was appointed as a director of a number of companies within the Charter Court Financial Services Group PLC, including Charter Savings Bank. He has previously advised the Board of the existence of this relationship and under the Conflicts of Interest Policy has undertaken to advise the Board if any actual conflict arises.

The Society recognises that it is good corporate governance to have a Senior Independent Director. David Buffham was appointed to this role on 1st January 2016 and it is intended that, subject to re-election, he continues in this role.

During 2017, 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, 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 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 2017 where it was concluded the NSSL Board was effective.

Further details of the activities of NSSL are given on page 8 of the Strategic Report.

Newcastle Systems Management Limited (NSML)

NSML Board Members are:

Ian Ward (NSML Chairman), Phil Moorhouse, David Buffham, 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 evaluate and monitor the performance of NSML against the objectives set, which includes assessing performance in terms of service delivery, contribution and effective management of risk and compliance;
- 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 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 October 2017 where it was concluded the NSML Board was effective.

Newcastle Financial Advisers Limited (NFAL)

NFAL Board Members are:

Ian Ward (NFAL Chairman), Angela Russell (the Society's Deputy Chief Executive and FD), 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 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 2017 where it was concluded the NFAL Board was effective.

Relations with Members

Member engagement is at the heart of our strategy and the Society develops relationships with Members on a number of different levels. The first and most obvious is through the AGM voting process where Members are encouraged, as owners of the business, to use their vote and we try to make this process as easy as possible, including the ability to vote online and by post. We also try to make the AGM as engaging as possible and encourage Members to attend.

Understanding what Members think about our products and service is also extremely important. Members are encouraged to join our customer panel and we consult with this group on a range of topics. We also use customer satisfaction surveys and obtain feedback from different types of product holders and from customers who choose to deal with us through each channel i.e. our branches, over the telephone, by post and via the internet.

We also conduct satisfaction surveys and run a regular broker forum event for intermediaries that introduce mortgage business to the Society. The information which is collected from these sources is used to help to develop and improve our offering.

Special Members' seminars are held on a regular basis and are designed to provide customers with useful information to help them understand and make sense of what is becoming an increasingly complex financial world.

These seminars 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 range of financial grants to North East community projects nominated by our Members. We intend that this financial support for our heartland communities will continue to grow in scope and scale.

We have also helped to raise money for local, worthy causes, and delivered a continuing financial education programme to local junior and middle schools, in addition to providing careers skills support and guidance in senior schools.

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 we are pleased to see the enthusiasm and commitment with which they have responded since we introduced a new volunteering policy in 2015. Further details of Member and Community Engagement are given in the Community Support Report on page 14.

Report of the Directors on Corporate Governance (continued)

Board and Board Committee Membership Attendance Record

The table below sets out the number of meetings attended by Directors during 2017 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	11 (11)	-	-	-	2 (2)	5 (6)	3 (4)	5 (5)*
David Buffham	10 (11)	-	5 (5)	3 (3)	2 (2)	-	4 (4)	-
Richard Bottomley	11 (11)	5 (5)	-	-	-	-	-	-
Patrick Ferguson	11 (11)	-	-	-	-	-	-	-
Bryce Glover	3 (3)	-	1 (1)	-	-	-	-	-
Andrew Haigh	11 (11)	-	-	-	-	-	-	-
Karen Ingham	9 (11)	-	-	3 (3)	-	6 (6)	-	-
John Morris	11 (11)	5 (5)	4 (5)	3 (3)	2 (2)	-	-	-
Angela Russell	11 (11)	-	-	-	-	-	-	5 (5)
Anne Shiels	4 (4)	2 (3)	-	-	-	-	-	-
Ian Ward	10 (11)	-	5 (5)	-	-	-	4 (4)	3 (3)
Ron McCormick	5 (5)	1 (1)	1 (2)	-	-	1 (1)	-	-
Damian Thompson	4 (4)	-	-	-	-	-	-	1 (1)

*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 AGM 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
27 FEBRUARY 2018

Audit Committee Report

Audit Committee

Members of Audit Committee at 31 December 2017 were:
Richard Bottomley (Committee Chair), John Morris, and Anne Shiels (appointed to the Committee 17 July 2017).

The Audit Committee's extensive experience and qualifications are detailed on pages 16 and 17 of the Annual Report and Accounts. The Committee's combined financial sector experience and competence is 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 pages 28 to 31 of the Annual Report and Accounts. The Report on Corporate Governance on pages 20 to 24 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 2017 review on 27 November 2017.

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, Deputy Chief Executive and 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 24 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 Deputy Chief Executive and 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 2017 were as follows:

- IFRS 9 Financial Instruments: The Group will apply the accounting requirements of IFRS 9 from 1 January 2018. The Group established an IFRS 9 Steering Committee charged with the implementation of IFRS 9 which reported key progress and judgements to the Audit Committee throughout 2017. The Audit Committee assessed the Group's implementation under three discrete work streams:
  - Classification and measurement: The Audit Committee reviewed the Group's IFRS 9 scoping documents, agreeing the financial instruments to be considered under IFRS 9 and approved the business model and cash flow classification conclusions reached by the Steering Committee as aligned with the requirements of the Standard.
  - Provisioning: The Audit Committee assessed and agreed the Group's proposed IFRS 9 provisioning methodology and scope of application. The Committee were kept appraised of key policy decisions, in particular concluding on the Group's modification and de-recognition, default definition, curing, staging, and forward-looking macroeconomic forecast policies.
  - Hedging: The Audit Committee approved the Group's proposed hedge accounting strategy: maintaining IAS 39's existing methodology for the Group's macro hedges and transitioning to IFRS 9 hedging methodology for non-macro hedges.

An additional IFRS 9 specific Audit Committee meeting was held in September 2017 to review the Group's cumulative policy decisions, impacts and implications. The meeting was presented by the IFRS 9 Steering Committee and attended by the Group's external auditors, PwC, offering the Audit Committee dedicated opportunity to consider and question key areas of subjectivity and compliance.

The Audit Committee concluded that the Group's IFRS 9 implementation proposals were appropriate for implementation from 1 January 2018 and also concluded satisfactorily on the Group's IFRS 9 disclosures in the 2017 Annual Report and Accounts, as detailed on page 80.

- **Commercial and residential loan impairment provisions:** 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 IAS 39 methodology as at 31 December 2017) 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 Committee also considers the Society's residential provisioning however the residential provisions are small relative to

Audit Committee Report (continued)

commercial provisions. 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.

- **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.
- **Intra-Company accounting:** The Audit Committee considered the operational agreements in place between the Society and its Subsidiary entities assessing the legal standing and completeness of the Group's arrangements first formalised as part of 2015's subsidiarisation of the Society's IT, Property Services and Solutions businesses. The Committee considered the stand-alone resilience and operational effectiveness of each entity including assessment of the intra-group legal service agreements and governance procedures established by each entity. The Committee concluded satisfactorily on the assessment.
- **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 Deputy Chief Executive and 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 disclosures in the Annual Report and Accounts. The Committee has concluded satisfactorily in this area.
- **Taxation:** Recovery of deferred tax assets is the main area of focus of the Committee in relation to taxation and this is considered in conjunction with the review and approval of the Going Concern and Business Viability Review. The Committee was satisfied that deferred tax assets are recoverable. 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.
- **Pension:** Consideration of the assumptions and disclosures relating to the defined benefit pension scheme with advice provided by independent actuary; Deloitte LLP.
- 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 2017 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 2017.

ii) Internal Control and Risk Management

The Audit Committee works closely with the Group Risk Committee to ensure that management and staff 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 32 to 35 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 Group's procedures for detecting fraud and whistle blowing and ensure that arrangements are in place by which employees 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.
- reporting to the Board on significant findings concerning risk management, internal control, financial reporting and other aspects of relevance.

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 2017 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 2017. 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, Internal Audit and External Audit functions.

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.

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 2017 the External Auditors were engaged to provide data audit services and advance audit assurance in relation to the Group's IFRS 9 implementation proposals. 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 5 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 is expected to be conducted in advance of the 2020 audit cycle. Mandatory rotation of the audit firm's senior partner, Gary Shaw (the partner since 2015), falls at the end of the 2018 audit.

On behalf of the Board
RICHARD BOTTOMLEY
CHAIRMAN OF THE AUDIT COMMITTEE
27 FEBRUARY 2018

Remuneration Committee Report

Introduction

This report details the Society's approach to pay for the period 1 January to 31 December 2017. 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 main areas; the Statement by the Chairman of the Remuneration Committee, the Report on Remuneration and the Directors' Remuneration Policy.

i) Statement by the Chairman of the Remuneration Committee

The Remuneration Committee operates within the Terms of Reference (TOR) agreed by the Board. The TOR are reviewed annually and were last reviewed on 28 November 2017. The effectiveness of the committee is also reviewed on an annual basis and was last reviewed, and found effective, on 28 November 2017.

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

- To ensure a formal and transparent procedure is in place for developing policy on Executive remuneration and for fixing the remuneration packages of individual Directors;
- To design an Executive remuneration policy that promotes the long term success of the Society;
- To ensure compliance with the Regulators' Remuneration Code through at least annual review;
- To determine and agree with the Board the framework for Executive and senior management remuneration and conditions of employment;
- Approval of the Society's Remuneration Policy Statement, Remuneration Committee Reports in the Group's Annual Report and Accounts and Summary Financial Statements, and the remuneration section of the Society's Pillar III disclosures;
- To consider and make recommendations to the Board on the general framework of staff bonus schemes; and
- To consider recommendations made by the Chief Executive to the Board 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, whilst avoiding paying more than is necessary for this purpose. The Remuneration Policy, therefore, focuses on rewarding our most senior 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.

No major structural decisions or changes relating to directors' remuneration were made during 2017. A Group wide pay and grading exercise was undertaken during 2017 however, the Remuneration Committee has not yet implemented any changes to Executive Directors' remuneration as a result of this exercise.

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 and Karen Ingham. The Chairman and Chief Executive (except for items relating to their remuneration) also attend meetings but are not members of the Committee. The HR Director acts as Secretary to the Committee.

During the year the Committee met three 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; and
- Consideration of the disclosure requirements for the Remuneration Report including Pillar 3 disclosures.

The Society's Remuneration Policy does not include significant performance related variable remuneration. The Society has adopted a simple remuneration structure which is appropriate to its business and is efficient and cost effective in promoting its long term strategy.

Transparent salary, other benefits and pension contributions are supplemented by a modest and straightforward Corporate Bonus Scheme that promotes continued involvement in the Society's ongoing success through ongoing performance targets without over-emphasising reward based on short term results.

ii) Report on Remuneration

The total remuneration received by Executive Directors is shown on page 29. The information has been audited and shows remuneration for the years ended 31 December 2016 and 31 December 2017 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.

The Chief Executive is the Society's most highly paid employee and no employee earns more than any Executive Director. Compared to 2016's annual figure. Mr A Haigh's overall remuneration increased in 2017 by 8.5%. A 2.5% pay increase was received by all staff in April 2017.

Details of other non-society board positions held by the Society's Executive Directors are shown in the Annual Business Statement on page 87 of the Annual Report and Accounts. None of the current Executive Directors retained any remuneration as a result of their non-Society positions.

iii) Directors' Remuneration Policy

The Society's Remuneration Policy is designed to provide competitive remuneration packages that attract, retain and reward our senior team, to deliver business objectives in support of the Society's strategy whilst providing value for Members. The Society's Remuneration Policy does not include significant performance-related variable remuneration.

The Society operates a Corporate Bonus scheme that is simple, modest and fair and applies to everyone across the Society. Basic remuneration (salary, other benefits and pensions) is not pre-determined against targeted Society performance, and is periodically reassessed by the Remuneration Committee with regard to actual Society performance.

With regard to Directors' annual pay rise, Directors normally receive the same percentage increase as the Society's wider employee base (2017: 2.5%), unless there is a change in their responsibilities.

In implementing the Policy, the following key principles are 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.

There have been no significant changes made to the Society's Remuneration Policy, or application, since its implementation in April 2015. The table on page 30 shows the elements of remuneration for Executive Directors and the way they operate.

Directors' Emoluments (Audited)

Emoluments of the Society's Directors are detailed below:

	Year	Salary or fees	Other benefits	Annual bonus (Note 1)	Pension contributions to defined contribution scheme (Notes 2 and 3)	Total contractual benefits
Executive Directors		£000	£000	£000	£000	£000
AS Haigh - Note 2	**2017**	**293**	**40**	**9**	**-**	**342**
	2016	269	37	8	-	314
AM Russell - Note 3	**2017**	**191**	**26**	**6**	**2**	**225**
	2016	186	15	6	12	219
P Ferguson	**2017**	**139**	**10**	**4**	**13**	**166**
	2016	135	10	4	12	161
D Thompson (Resigned 24 April 2017)	**2017**	**53**	**10**	**-**	**4**	**67**
	2016	58	7	-	5	70
Total for Executive Directors	**2017**	**676**	**86**	**19**	**19**	**800**
	2016	648	69	18	29	764
Non-Executive Directors						
PJ Moorhouse	**2017**	**68**	**-**	**-**	**-**	**68**
	2016	66	-	-	-	66
RJ Bottomley OBE	**2017**	**41**	**2**	**-**	**-**	**43**
	2016	39	2	-	-	41
DJ Buffham	**2017**	**54**	**-**	**-**	**-**	**54**
	2016	50	-	-	-	50
K Ingham	**2017**	**39**	**-**	**-**	**-**	**39**
	2016	37	-	-	-	37
RJ McCormick (Retired 26 April 2017)	**2017**	**17**	**1**	**-**	**-**	**18**
	2016	53	1	-	-	54
J Morris	**2017**	**50**	**2**	**-**	**-**	**52**
	2016	49	2	-	-	51
IW Ward	**2017**	**47**	**1**	**-**	**-**	**48**
	2016	43	1	-	-	44
BP Glover (Appointed 11 August 2017)	**2017**	**15**	**1**	**-**	**-**	**16**
	2016	-	-	-	-	-
A Laverack (Appointed 17 July 2017)	**2017**	**18**	**-**	**-**	**-**	**18**
(Business name: Anne Shiels)	2016	-	-	-	-	-
Total for Non-Executive Directors	**2017**	**349**	**7**	**-**	**-**	**356**
	2016	337	6	-	-	343
Total for all Directors	**2017**	**1,025**	**93**	**19**	**19**	**1,156**
	2016	985	75	18	29	1,107

Notes:

1. The Society's Executive Directors participate in the Group's annual Corporate Bonus Scheme. The annual corporate bonus is determined based on achievement of the current year's corporate KPIs. There is no consequent deferral of the bonus payment or vested element.
2. Mr AS Haigh has elected to take his pension contribution amounting to £26,690 as a cash payment. He is liable for his own tax and national insurance contributions on this payment.
3. Mrs A M Russell has elected to take a proportion of her pension contribution amounting to £15,504 as a cash payment.

Remuneration Committee Report (continued)

Remuneration for Executive Directors

The table below shows the elements of remuneration for Executive Directors and the way they operate.

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. 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.
Short Term Incentive 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.	Performance measures and targets are set on an annual basis and are measured over the financial year. Payment is made in cash, after performance has been assessed. Payment is made at the discretion of the Committee.	The Committee determines the maximum incentive. Bonuses are paid as a percentage of basic salary and are based on the annual assessment rating of each individual. A corporate bonus payment of 3% of base salary has been awarded to Executive Directors in relation to 2017.	The performance measures considered by the Committee in respect of the Corporate Bonus Scheme are delivery of the Corporate Key Performance Indicatorss (KPIs) which include: • Group profit, capital and liquidity targets; • Quality measures around service, complaints and customer satisfaction; • Targets for savings and mortgage business; and • Other KPIs covering people, Solutions Business and delivery of major projects. Further information on KPI performance can be found on page 8 of the Strategic Report. The above measures are assessed by the Committee in establishing the range of bonus payment that may be made. The annual assessment rating of each individual determines where they fall into the agreed range.

Notes to the table

As noted above, the Committee has complete discretion to make payment under the Corporate Bonus Scheme and also has discretion to amend or remove the 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. Fees set by the Remuneration Committee.
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. Reimbursement of travel and subsistence expenses are presented in other benefits.

The Remuneration Committee also determines the Chairman's fee.

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 Corporate 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. 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 with the exception of Executive Directors 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. Members voted and gave their support (89.35% voted to approve the policy with 18,145 votes for, 2,163 against and 539 withheld) to the policy in April 2015 which took immediate effect. In accordance with the Code, the policy will be put forward for vote again in 2018. Member approval was given to the 31 December 2016 Directors' Remuneration Report (90.99% approval with 16,143 votes for, 1,599 against and 329 withheld) in April 2017.

Summary of the Remuneration of Code Staff

A summary of the remuneration of Code Staff during 2017 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	**2017**	**4**	**781**	**19**	**800**
		2016	4	746	18	764
Other Executives	HR Director, Managing Director NSML, Managing Director NSSL.	**2017**	**3**	**290**	**9**	**299**
		2016	6	500	13	513
Control Functions	Compliance, Underwriting, Internal Audit, Customer Outcomes, Treasury, Balance Sheet Management and Marketing	**2017**	**7**	**476**	**14**	**490**
		2016	2	128	2	130
Total		**2017**	**14**	**1,547**	**42**	**1,589**
		2016	12	1,374	33	1,407

Notes:

1. Variable remuneration reflects participation in the Group's annual Corporate Bonus Scheme.
2. The Group has revised its interpretation of code staff during 2017 in line with the senior managers' regime.

There was no deferred remuneration during 2017. As the Society's Remuneration Policy does not include significant performance related variable remuneration, no formal ratio between fixed and variable remuneration is relevant.

JOHN MORRIS
CHAIRMAN OF THE REMUNERATION COMMITTEE
27 FEBRUARY 2018

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 2017, all of whom were Non-Executive Directors, were David Buffham (Committee Chairman), Ron McCormick (retired 26 April 2017), John Morris, Ian Ward, and Bryce Glover (appointed 11 August 2017).

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;
- Approval of stress testing and scenario testing; and
- Approval of ICAAP and ILAAP.

During 2017 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;
- Review and approval of 2017 ICAAP and ILAAP; and
- Review of compliance with Building Society Sourcebook limits (Supervisory Statement SS20/15).

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 2017 RCC met monthly.

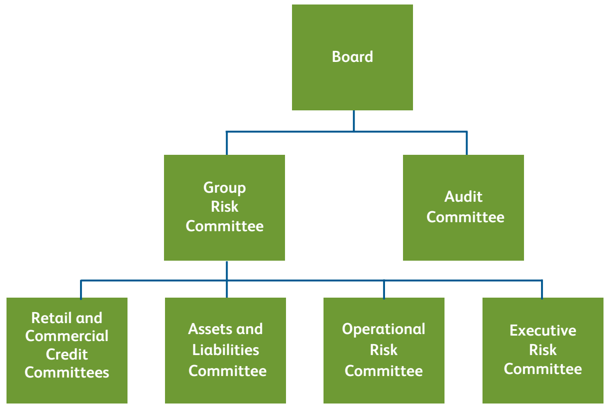
The Commercial Credit Committee (CCC) is responsible for credit risk across the Group's non-retail mortgage portfolio including loan strategy, limit monitoring, risk indicators and stress factors, annual reviews and breach reports, loan renegotiations, monitoring risk trends on the portfolio, and stress testing. During 2017 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 2017 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 2017 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 2017 ALCO met monthly.

Risk Governance Structure



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 increased its lending to retail borrowers in 2017, including BTL lending to individuals, and has a strategy to continue to do so. 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% 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 Management Report (continued)

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 Executive Risk Committee (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 Treating Customer Fairly dashboard, which looks at evidence supporting good customer outcomes (or suggesting poor outcomes) and this is reviewed quarterly and reported to the Board. The Society maintains an annual Compliance Plan, which is risk based, reporting to ERC with oversight from the GRC. (See also Operational Risk).	←	The Society has a simple product range covering mortgages, savings, insurance, and financial advice via Newcastle Financial Advisers Limited (an Appointed Representative of Openwork). Customer redress provisions have been increased in 2017, primarily in response to the FCA's treatment of PPI customers where there was commission (known as "Plevin"), and the FCA's advertising campaign on PPI.
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 30 gives details of the derivative financial instruments held at 31 December 2017, 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.	↑	The regulatory environment is largely dependent on the EU regulations, including the ability of EU firms to passport permissions into the UK. 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. The Society closed its Gibraltar branch in 2017.

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 regular updates on the Society's Pension Scheme including mitigation strategies.	↓	The pension fund surplus on an IAS 19 basis improved to £10.8m at 31 December 2017 compared to a surplus of £2.6m at the end of 2016. The scheme is still exposed to significant 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. The growth and potential impact of cybercrime is a challenge facing many businesses, not just the financial services sector.	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 you would expect, your Board takes the possible threat from cybercrime very seriously and has put in place appropriate measures to safeguard our Members and the business clients of NSSL.	↑	As the Society's business model includes diversification via the Solutions Business, this increases exposure to operational risk particularly in relation to IT systems capability and human error. The value of savings balances managed by the Solutions business and the level of income increased during 2017 (see segmental analysis in Note 8). The risk of cybercrime is an area which remains under constant review utilising both internal and external expertise to inform our strategy.
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 Internal Capital Adequacy Assessment Process 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 15.3% from 14.3%. Capital requirements will increase 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
27 FEBRUARY 2018

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 2017 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 IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986.

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 2017; 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 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 5 to the financial statements, we have provided no non-audit services to the group or the Society in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview

Materiality:

- Overall group materiality: 1,226,000 (2016: 1,240,000), based on 0.5% of Net Assets.
- Overall Society materiality: £1,220,000 (2016: £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 the group's financial performance and/or position.

Key Audit Matters:

- Allowances for losses on loans and advances secured on commercial property/land, residential equity release.
- Valuation of derivative financial instruments and application of hedge accounting.
- IAS 8 disclosure on impact of adoption of IFRS 9.

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 Prudential Regulation Authority's regulations. Our tests included, but were not limited to, agreement of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the Financial Conduct Authority and Prudential Regulation Authority, 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 determined allowances for losses on loans and advances secured on commercial property/land, valuation of derivative financial instruments and application of hedge accounting, IAS 8 disclosure on impact of adoption of IFRS 9 to be key audit matters, and these are discussed further below. 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

Allowances for losses on loans and advances secured on commercial property/land

See note 1 to the annual accounts for the Directors' disclosures of the related accounting policies, judgements and estimates and notes 11 and 30 for detailed disclosures.

The Society has recognised an impairment credit on loans and advances to customers secured on commercial property/land of £0.5m (2016: charge of £2.5m) in the year, leaving a balance of £47.7m on the balance sheet (2016: £82.1m). This balance includes a specific provision of £7.7m (2016: £7.1m) and a collective provision of £1.3m (2016: £2.7m) for cases in the portfolio where an impairment event has occurred but has not been specifically identified.

Significant judgement needs to be applied by the Directors to estimate the potential loss on loans where an impairment event has occurred. Judgement is required in respect of identifying an impairment trigger event on loans and, once identified as impaired, the estimate of loss on a loan is calculated by use of models to discount the future cash flows expected to be received on the loan. This calculation is impacted by a number of assumptions which we focussed on, including, but not limited to:

The value of the underlying security;

Likelihood of re-letting where part/all of property remains vacant or tenancy agreements contain break clauses which pre-date the loan's maturity; and We also paid particular attention to the Director's assumptions in assessing the timing and value of future cash flows, as this is subject to significant estimation uncertainty and as a result there is an increased risk that impairment allowances may be materially understated.

How our audit addressed the key audit matter

We evaluated and challenged the Directors' future cash flow forecasts for loans where specific impairment allowances had been recognised, and the process by which they were drawn up. We tested the significant inputs in the models to underlying evidence, for example agreeing property values to valuations provided by external third parties and other details to tenancy agreements. For properties which were sold post year end, we agreed cash proceeds to amounts used in the models.

Where the Directors had obtained and relied upon third party property valuations, we obtained and read copies of these reports to check that the valuations were consistent with those applied in the Directors' cash flow models, and found no exceptions. We also independently assessed the competency of the external third party property valuers contracted by the group to undertake these valuations as well as their independence and objectivity. We did not identify any issues with the quality of the valuations undertaken, with the organisations involved, or with the validity of other evidence provided.

Our work on the cash flow forecasts also involved assessing the reasonableness of the assumptions used (as described above) to derive the expected future cash flows. We also undertook sensitivity analyses to assess the changes required in those assumptions to result in material misstatement of the allowances, and the likelihood of such changes arising individually and in aggregate.

We evaluated the outcome of commercial loans redeemed in the year by comparing these to management's previously expected outcome to ascertain whether losses realised were consistent with previously recorded provision allowances. No significant variances were noted during this testing, which provides us with further evidence over the Directors' ability to estimate future cash flows accurately.

The appropriateness of the collective provision of £1.3m was assessed through utilising the evidence we had obtained from the procedures outlined above against the impairment criteria defined in accounting standards. We did not identify any material error in the collective provision based on the evidence obtained from those procedures.

In evaluating the completeness of specific impairment provision allowances on commercial loans and the appropriateness of the collective provision, we:

Re-performed controls relied upon by the Directors to address accurate capture of arrears information, including testing over the allocation of cash receipts from borrowers to the correct loan accounts and recalculation of arrears for a sample of borrowers;

Obtained "watch lists" representing borrowers being closely monitored by the Commercial Credit Committee and minutes of the committee's meetings to identify any loans of higher risk and we investigated the past performance of these loans to assess if an impairment event had occurred and the likelihood of loss in the event of default;

Identified specific commercial loans which had not been assessed by the Directors as impaired but in our view represented a heightened risk of potential impairment, including loans with significant balances outstanding at the balance sheet date, with high Loan to Values ("LTVs") and loans in arrears or where forbearance had been granted and again investigated the past performance of these loans to assess whether an impairment event had occurred and the likelihood of loss in the event of default;

In order to assess completeness we reviewed the 'good book' to ensure loans should not be provided against. The loans were sampled to ensure payments were being made on account in accordance with their agreement and the interest rate was recalculated to gain comfort over the accuracy of the payment.

Following completion of the above procedures, we did not identify any errors in the capturing and recording of arrears information and we did not identify any loans recorded on the watch lists or identified as higher risk through use of our own selection criteria for which we considered there to be evidence of a need for a specific provision.

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 11 for detailed disclosures.

The Society has legacy equity release loans with a total value of £209.9m (2016: £219.8m). The valuation of these loans is judgemental, and is based on a number of assumptions.

The Society has 'standard' equity release products, where the return to the Society is unknown, as it is based on the future loan value at the point of redemption which is not a fixed point in time given that redemption occurs on the death of the borrower or 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 fixed reversion loans 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 an industry standard valuation method, appropriately disaggregated by region.

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 internal 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.

Key audit matter

Valuation of derivative financial instruments and application of hedge accounting

See note 1 to the annual accounts for the Directors' disclosures of the related accounting policies and note 30 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 group, 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

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

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 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.

IAS 8 disclosures on impact of adoption of IFRS 9

See IFRS 9 Financial Instruments on page 80 of 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 is effective from 1 January 2018. In line with the requirements of IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" the Society has made disclosures in the year in relation to the expected impact of this new standard on the financial statements.

The most significant impact of the new standard is expected to be 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 and commercial 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.

We have reviewed the policy documents prepared by management to support the judgements taken on the impact of IFRS 9. This has included; the classification of financial instruments, the Society's definition of default, and the policies which underpin the provisioning model, such as probability of default and expected loss given default. During the course of this review we noted some improvements which could be made to the documentation of these judgements. We have reviewed the final documentation and are comfortable with the conclusions which have been drawn.

We used specialists to review the code within the IFRS 9 model, and perform a detailed review of various policy documents in line with wider industry approach. We have also reperformed the provision model on a sample basis to check the accuracy of the calculation. We have not identified any errors from this testing.

We are comfortable that the disclosure accurately reflects management's current expectations of the impact of the adoption of IFRS 9.

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 8 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 NFSL, leasehold land and buildings recorded in NPHL and reviewed 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 (2015: £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.

Society financial statements

Overall materiality	£1,240,000 (2015: £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 £128,000 - £602,000. 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 £60k (Group and Society audit) (2016: £60k) 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.

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, Directors' Report and Corporate Governance Statement, 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, (BSA 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 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (BSA 1986).

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. (BSA 1986).

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 18 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 18 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 18, 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 25 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

Opinions on other matters prescribed by the Buildings Societies Act 1986

In our opinion:

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

Propriety of accounting records and information and explanations received

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the Directors on 24 April 1994 to audit the financial statements for the year ended 30 December 1994 and subsequent financial periods. The period of total uninterrupted engagement is 24 years, covering the years ended 30 December 1994 to 31 December 2017.

GARY SHAW (SENIOR STATUTORY AUDITOR)
FOR AND ON BEHALF OF PRICEWATERHOUSECOOPERS LLP
CHARTERED ACCOUNTANTS AND STATUTORY AUDITORS
NEWCASTLE UPON TYNE
27 FEBRUARY 2018

Income Statements for the year ended 31 December 2017

	Note	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £m
Interest receivable and similar income	2	**65.6**	69.8	**66.9**	70.5
Interest payable and similar charges	3	**(36.5)**	(42.7)	**(36.5)**	(42.7)
Net interest income		**29.1**	27.1	**30.4**	27.8
Other income	4	**31.7**	30.1	**20.5**	29.9
Other charges	4	**(3.0)**	(2.7)	**(3.0)**	(2.7)
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**	3.0
Total operating income		**57.9**	54.6	**49.3**	58.1
Administrative expenses	5	**(43.0)**	(40.3)	**(36.3)**	(43.2)
Depreciation	14	**(2.8)**	(2.4)	**(1.3)**	(1.3)
Operating profit before impairments, provisions and exceptional items		**12.1**	11.9	**11.7**	13.6
Impairment charges on loans and advances to customers	11	**(0.2)**	(3.2)	**(0.2)**	(3.2)
Provisions for liabilities and charges	23	**(1.0)**	(0.6)	**(1.0)**	(0.6)
Exceptional gain on purchase of Cobalt Offices	22	**2.2**	-	**2.2**	-
Profit for the year before taxation		**13.1**	8.1	**12.7**	9.8
Taxation expense	7	**(2.2)**	(2.0)	**(2.0)**	(2.0)
Profit after taxation for the financial year		**10.9**	6.1	**10.7**	7.8

The notes on pages 46 to 79 form part of these Accounts.

Statements of Comprehensive Income for the year ended 31 December 2017

	Note	GROUP 2017 £m	GROUP Restated 2016 £m	SOCIETY 2017 £m	SOCIETY Restated 2016 £m
Profit for the financial year		**10.9**	6.1	**10.7**	7.8
Other comprehensive income / (expense):					
Items that may be reclassified to income statement					
Movement on available for sale reserve		**1.8**	1.0	**1.8**	1.0
Income tax on items that may be reclassified to income statement	15	**(0.3)**	(0.2)	**(0.3)**	(0.2)
Total items that may be reclassified to income statement		**1.5**	0.8	**1.5**	0.8
Items that may not be reclassified to income statement					
Actuarial remeasurements on retirement benefit obligations	28	**-**	2.6	**-**	2.6
Income tax on items that will not be reclassified to income statement	15	**-**	-	**-**	-
Derecognition of pensions surplus	28	**(1.7)**	(2.6)	**(1.7)**	(2.6)
Total items that will not be reclassified to income statement		**(1.7)**	-	**(1.7)**	-
Total comprehensive income for the financial year		**10.7**	6.9	**10.5**	8.6

The notes on pages 46 to 79 form part of these Accounts.

Balance Sheets as at 31 December 2017

	Note	GROUP 2017 £m	GROUP Restated 2016 £m	SOCIETY 2017 £m	SOCIETY Restated 2016 £m
ASSETS					
Cash and balances with the Bank of England		**182.0**	196.4	**182.0**	196.4
Loans and advances to banks	9	**227.7**	235.8	**226.3**	234.7
Debt securities	10	**380.1**	344.3	**380.1**	344.3
Derivative financial instruments	30	**4.9**	6.5	**4.9**	6.5
Loans and advances to customers	11	**2,707.3**	2,563.8	**2,703.0**	2,557.6
Fair value adjustments for hedged risk	12	**206.2**	233.8	**206.2**	233.8
Investment in subsidiaries	13	**-**	-	**42.0**	28.3
Property, plant and equipment	14	**38.8**	22.8	**12.0**	12.3
Deferred tax assets	15	**3.2**	5.6	**3.3**	5.5
Retirement benefit asset	28	**-**	-	**-**	-
Other assets	16	**11.9**	10.3	**15.9**	16.6
TOTAL ASSETS		**3,762.1**	3,619.3	**3,775.7**	3,636.0

The notes on pages 46 to 79 form part of these Accounts.

Balance Sheets as at 31 December 2017

	Note	GROUP 2017 £m	GROUP Restated 2016 £m	SOCIETY 2017 £m	SOCIETY Restated 2016 £m
LIABILITIES					
Due to Members	17	**2,788.5**	2,709.2	**2,788.5**	2,709.2
Fair value adjustments for hedged risk	12	**1.6**	5.2	**1.6**	5.2
Due to other customers	18	**226.2**	211.1	**236.5**	222.9
Deposits from banks	20	**277.4**	187.3	**277.4**	187.3
Debt securities in issue	21	**1.0**	-	**1.0**	-
Derivative financial instruments	30	**210.2**	234.3	**210.2**	234.3
Other liabilities	22	**13.7**	14.1	**16.6**	18.4
Provisions for liabilities and charges	23	**1.7**	2.0	**1.7**	2.0
Subordinated liabilities	24	**25.0**	50.0	**25.0**	50.0
Subscribed capital	25	**30.0**	30.0	**30.0**	30.0
Reserves		**186.8**	176.1	**187.2**	176.7
TOTAL LIABILITIES		**3,762.1**	3,619.3	**3,775.7**	3,636.0

These Accounts were approved by the Board of Directors on 27 February 2018 and signed on its behalf by:

PHIL MOORHOUSE, CHAIRMAN
RICHARD BOTTOMLEY, CHAIRMAN OF AUDIT COMMITTEE
ANDREW HAIGH, CHIEF EXECUTIVE

The notes on pages 46 to 79 form part of these Accounts.

Statements of Movements in Members' Interests for the year ended 31 December 2017

GROUP	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**

Restated	General reserve £m	Available for sale reserve £m	Total £m
At 1 January 2016	169.7	(0.5)	169.2
Movement in the year	6.1	0.8	6.9
At 31 December 2016	**175.8**	**0.3**	**176.1**

SOCIETY	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**

Restated	General reserve £m	Available for sale reserve £m	Total £m
At 1 January 2016	168.6	(0.5)	168.1
Movements in the year	7.8	0.8	8.6
At 31 December 2016	**176.4**	**0.3**	**176.7**

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

The notes on pages 46 to 79 form part of these Accounts.

Cash Flow Statements for the year ended 31 December 2017

	Note	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £m
Cash inflows from operating activities	27	**66.9**	18.1	**62.6**	15.4
Payment into defined benefit pension scheme		**(2.0)**	(2.0)	**(2.0)**	(2.0)
Net cash inflows from operating activities		**64.9**	16.1	**60.6**	13.4
Cash (outflows) / inflows from investing activities					
Purchase of property, plant and equipment		**(18.8)**	(2.1)	**(1.1)**	(1.2)
Sale of property, plant and equipment		**-**	0.2	**-**	0.2
(Increase) / decrease in loans to subsidiary undertakings		**-**	-	**(13.7)**	1.5
Purchase of investment securities		**(185.1)**	(133.3)	**(185.1)**	(133.3)
Sale and maturity of investment securities		**154.9**	137.2	**154.9**	137.2
Net cash (outflows) / inflows from investing activities		**(49.0)**	2.0	**(45.0)**	4.4
Cash outflows from financing activities					
Interest paid on subordinated liabilities		**(2.1)**	(2.6)	**(2.1)**	(2.6)
Interest paid on subscribed capital		**(3.5)**	(3.5)	**(3.5)**	(3.5)
Repayment of subordinated liabilities		**(25.0)**	-	**(25.0)**	-
Repayments under finance lease agreements		**(0.1)**	(0.1)	**(0.1)**	(0.1)
Net cash outflows from financing activities		**(30.7)**	(6.2)	**(30.7)**	(6.2)
Net (decrease) / increase in cash		**(14.8)**	11.9	**(15.1)**	11.6
Cash and cash equivalents at start of year		**198.4**	186.5	**197.3**	185.7
Cash and cash equivalents at end of year	27	**183.6**	198.4	**182.2**	197.3

The notes on pages 46 to 79 form part of these Accounts.

1 Significant Accounting Policies

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

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

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

The Annual Accounts have been prepared under the historical cost convention except for those financial assets and hedging instruments which are required by IAS 39 to be carried at fair value through profit and loss or as available for sale. A summary of the Group's principal accounting policies is set out below:

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

Income Recognition
Interest Income and Expense
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 IAS 39, Financial Instruments: Recognition and Measurement, the Group classifies its financial assets into the following categories:

Loans and Receivables
The Group's mortgage assets and similar loans are classified as loans and receivables and measured at amortised cost using EIRM. 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 Group's equity release mortgage assets are accounted for under IFRS 4 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 2017 the insurance component of the Group Equity Release assets is wholly immaterial.

For further detail, see note 19 on page 61 of the Report and Accounts.

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

Derivatives are recognised at fair value on the date the derivative contract is entered into, and subsequently re-measured at their fair value. In accordance with IAS 39, 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. 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.

Available for Sale
These assets are non-derivative financial instruments where the intention is to hold for an indefinite period of time. They are initially measured at fair value, with subsequent fair value movements recognised directly in Members' Interests, until the asset is derecognised or impaired, at which point the cumulative gain or loss previously recognised in Members' Interests is recognised in the Income Statements. Interest received on the asset is recognised immediately in the Income Statements.

Significant Accounting Policies Continued

Cash and Cash Equivalents
For the purpose of the Cash Flow Statements, 'Cash and cash equivalents' comprises cash in hand, balances with the Bank of England, loans and advances to banks available on demand or with original maturities of three months or less and investment securities with a maturity period of three months or less i.e. highly liquid assets readily convertible into cash. For operational purposes, the Group's debt security portfolio is maintained for liquidity purposes with the assets therein demonstrably convertible into cash regardless of maturity. The Group does not include encumbered assets in its cash and cash equivalents. The Group does not consider the timing of derivative collateral inflows to be sufficiently reliably estimated to include such collateral placed with counterparties as a liquid asset for cash flow presentation.

Impairment of Financial Assets
Individual assessments are made against all those known loans and advances in arrears, in possession, where an event of default has occurred, where fraud has been identified or where any other potential loan servicing issues arising from assessments or professional advice are known. The value of those loans and advances that are considered to be impaired is reduced on an individual basis. Impairment calculations are carried out by considering future discounted cash flows as per rules laid out in international accounting standard, IAS39. In considering future cash flows the Society estimates the future valuation of the security less anticipated disposal costs, any irrecoverable hedging costs, and other payments and charges, which are then discounted using the original effective interest rate based on the Group's approved strategy for the loan at the balance sheet date. Collective impairment allowances are also made to reduce the value of those loans and advances where there has been an event which may give rise to impairment but of which the Society is not yet aware at the balance sheet date, with the result that the amount advanced may not be recovered in full. For the purposes of the collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Any impairment loss or allowance is recognised in the Income Statements.

Loans are classed as renegotiated when their terms have changed during the year (without a new product being taken). The Group applies a policy of capitalising arrears on residential loans with the customer's agreement, once the customer has made six contractual monthly mortgage repayments following the instance of non-payments. Capitalisation is only applied where there is no realistic alternative and this is expected to be of long-term benefit to the borrower.

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 and capital protection bond 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.

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 2017. 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 property reflects purchase during 2017 of a previously leased office property. The property was elected to be held at its depreciated cost in line with IAS 40. Cost includes the purchase price of the asset and any directly attributable expenditure, primarily legal fees associated with the purchase. Depreciation commenced when the property was purchased and is provided for over a 50 year term- 2% per annum straight line. Further details are given in note 14 on page 57.

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 measurements recognised in the Statement of Comprehensive Income. IAS 19 service costs are recognised in the income statements.

Significant Accounting Policies Continued

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

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

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

Pensions
Significant judgements are required in relation to the assumptions for the valuation of the pension scheme surplus or deficit including discount, interest and mortality rates, inflation, take up of the Pension Increase Exchange offer and future salary increases. The Board receives independent external advice from actuarial consultants in arriving at the scheme assumptions which are outlined together with sensitivity analysis in Note 28 to the Annual Accounts. The Group does not recognise IAS 19 pensions surpluses on balance sheet.

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.

Impairment of Financial Assets
On loans fully secured on residential property the key assumptions in assessing the underlying value of the assets held as security for the loans is based on historic data and prudent expectations around future conditions. An estimate of forced sale adjustments (covering house price falls and disposal costs) has an impact on the level of provisioning for possession and arrears exposures.

A 5% forced sale discount would not significantly impact the Society's provisions, increasing provisions required by less than £0.1m. Loans secured on commercial property or land are more individually significant. Provision is made against loans in arrears, possession or Law of Property Act 1925 (LPA) receivership, or where a trigger event raises the likelihood of future problems servicing the loan. 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 of the future value of underlying assets held as security for loans advanced, based on historic data, professional advice and expectations around future conditions including tenancy levels;
- Any sale adjustments, disposal costs, fees or other cash flows applicable;
- Any applicable adjustments arising on hedging instruments relating to the loan as employed by the Society; and
- Timing of cash flows.

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 30 to the Accounts.

Financial Services Compensation Scheme Provision
The Society is obligated to pay a levy to the Financial Services Compensation Scheme (FSCS). The provision for FSCS interest costs in this year's accounts is dependent on the interest charge levied which will not be invoiced until July 2018. The Society has estimated its obligation to the Scheme with reference to currently available external information on interest due on the loan.

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 15 to the Annual Accounts the Group has deferred tax assets which are considered recoverable given the Society and Group plans over the planning horizon.

Changes in Accounting Policy
During 2017 the Group changed it's accounting policy with respect to the recognition of pensions surpluses on balance sheet. For further details see note 28 on page 66.

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 2017.

Amendments to IAS 12, 'Income taxes' on Recognition of deferred tax assets for unrealised losses (effective 1 January 2017). The amendments clarify when a deferred tax asset may be recognised for deductible temporary differences (where sufficient future profitability to ensure recovery is expected) and do not significantly impact the Society or Group.

Amendments to IAS 7, Statement of cash flows (effective 1 January 2017). This introduces narrow scope amendments to improve disclosures around changes in liabilities arising from financing activities arising from cash flows and non cash changes, as reflected in these Annual Report and Accounts.

Developments not effective at 31 December 2017
There are a number of new or amended standards which become effective in 2018, and beyond, which allow for early adoption but the Society is not taking up any of those standards before their mandatory date.

- IFRS 9 Financial instruments will supersede IAS 39 impacting classification and measurement, impairment and hedge accounting for financial instruments. The Society has monitored the development of IFRS 9 closely. IFRS 9 is effective for periods beginning on or after 1 January 2018. Further detail is given on page 80.
- IFRS 15 Revenue from contracts with customers supersedes IAS 18 Revenue and establishes 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 risks and rewards, to the transfer of control of goods or services 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 9, in precedence to IFRS 15, dictates the accounting for revenue linked to most financial instruments, including the Group's mortgages. IFRS 15 is only materially applicable to the Group's Solutions business and is not expected to have a significant impact on the Society or Group. IFRS 15 is effective for periods beginning on or after 1 January 2018.

2 Interest receivable and similar income

	GROUP		SOCIETY	
	2017 £m	2016 £m	**2017 £m**	2016 £m
On loans and advances to customers	**87.1**	89.2	**88.4**	89.9
On debt securities				
- interest and other income	**3.7**	5.0	**3.7**	5.0
- profits net of losses on realisation	**-**	0.2	**-**	0.2
On other liquid assets				
- interest and other income	**1.1**	1.5	**1.1**	1.5
Net expense on derivatives hedging assets	**(26.3)**	(26.1)	**(26.3)**	(26.1)
	65.6	69.8	**66.9**	70.5

Interest receivable and other income includes **£3.6m** (2016: £4.6m) from fixed income securities.

3 Interest payable and similar charges

	GROUP		SOCIETY	
	2017 £m	2016 £m	**2017 £m**	2016 £m
On shares held by individuals	**31.4**	37.1	**31.4**	37.1
On subscribed capital	**3.5**	3.5	**3.5**	3.5
On deposits and other borrowings				
- subordinated liabilities	**2.1**	2.6	**2.1**	2.6
- to other depositors and borrowers	**2.5**	3.1	**2.5**	3.1
Net income on derivatives hedging liabilities	**(3.0)**	(3.6)	**(3.0)**	(3.6)
	36.5	42.7	**36.5**	42.7

4 Other income and charges

	GROUP		SOCIETY	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Other income				
Fee and commission income	**7.2**	7.1	**3.4**	3.7
Other operating income	**24.5**	23.0	**17.1**	26.2
	31.7	30.1	**20.5**	29.9

	GROUP		SOCIETY	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Other charges				
Fee and commission expense	**3.0**	2.7	**3.0**	2.7

	GROUP		SOCIETY	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Dividend income				
Received from subsidiary undertakings	**-**	-	**1.3**	3.0

5 Administrative expenses

	Note	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £m
Staff costs	6	**30.7**	27.6	**15.2**	15.2
Rentals under operating leases for land and buildings					
- payable to third parties		**1.1**	1.6	**1.1**	1.6
- payable to subsidiary undertaking		**-**	-	**0.7**	0.1
Other administrative expenses		**11.2**	11.1	**19.3**	26.3
		43.0	40.3	**36.3**	43.2

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

	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £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**	-
	0.3	0.2	**0.3**	0.2

Fees payable to the Society's auditor for the audit of consolidated financial statements includes **£18k** (2016: £17k) attributable to subsidiary companies.

Fees payable to the Society's auditors for other services includes **£nil** (2016: £1k) for tax services, and **£55k** (2016: £38k) for other non-audit services.

Fees payable to the Society's auditors for other services includes £50k for the advanced audit of the Group's IFRS 9 implementation project, including consideration of the Group's IFRS 9 models and disclosures made in these Annual Report and Accounts.

6 Staff costs

	Note	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £m
Wages and salaries		**25.8**	23.2	**12.6**	12.6
Social security costs		**2.4**	2.1	**1.1**	1.1
Pension costs for defined contribution scheme		**2.5**	2.3	**1.5**	1.5
	5	**30.7**	27.6	**15.2**	15.2

Directors' emoluments are disclosed in the Remuneration Committee report on page 29.

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

	GROUP 2017	GROUP 2016	SOCIETY 2017	SOCIETY 2016
Full time	**822**	745	**346**	346
Part time	**211**	206	**140**	150
	1,033	951	**486**	496
Principal Office	**844**	763	**319**	326
Branches	**189**	188	**167**	170
	1,033	951	**486**	496

7 Taxation expense

	Note	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £m
Deferred tax					
Current year		**2.3**	2.0	**2.2**	2.0
Adjustments in respect of prior years		**(0.1)**	-	**(0.2)**	-
Total deferred tax		**2.2**	2.0	**2.0**	2.0
Total taxation expense in the Income Statements	15	**2.2**	2.0	**2.0**	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 2017	GROUP 2016	SOCIETY 2017	SOCIETY 2016
Profit for the year before taxation	**13.1**	8.1	**12.7**	9.8
Profit before taxation at the standard rate of corporation tax in the UK of **19%** (2016: 20%)	**2.5**	1.6	**2.4**	2.0
Expense not deductible for tax purposes:				
Non-taxable dividend income received	**-**	-	**(0.3)**	(0.6)
Other	**(0.6)**	-	**(0.5)**	-
Expenses	**0.4**	0.1	**0.5**	0.4
Rate change	**-**	0.3	**-**	0.2
Adjustments in respect of previous years	**(0.1)**	-	**(0.1)**	-
Total taxation expense	**2.2**	2.0	**2.0**	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 15).

8 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 exceptional items 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.

A comprehensive cost allocation exercise was carried out in 2017 to reflect increasing technology and support service charges provided to the Solutions business. This has resulted in the Solutions business reporting higher annual administration and depreciation charges with the 2016 comparative positions also restated to reflect the revised allocations: to present the segmental analysis on a like for like basis. Prior to this restatement, Solutions' 2016 administration charges had been disclosed at £11.9m, depreciation at £0.7m and profit for the year before taxation at £9.4m.

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**

Year to 31 December 2016	Restated Member Business £m	Restated Solutions Business £m	Restated Total £m
Net interest receivable	27.1	-	27.1
Other income and charges	5.1	22.4	27.5
Administrative expenses	(25.7)	(14.6)	(40.3)
Depreciation	(1.4)	(1.0)	(2.4)
Operating profit before impairments, provisions and exceptional items	5.1	6.8	11.9
Impairment charges on loans and advances to customers	(3.2)	-	(3.2)
Provisions for liabilities and charges	(0.6)	-	(0.6)
Profit for the year before taxation	1.3	6.8	8.1
Taxation expense			(2.0)
Profit after taxation for the financial year			6.1
Total assets	3,617.6	3.9	3,621.5

9 Loans and advances to banks

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

	GROUP		SOCIETY	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Accrued interest	**0.1**	-	**0.1**	-
On demand	**1.5**	1.8	**0.1**	0.7
In not more than three months	**227.6**	235.6	**227.6**	235.6
Gross loans and advances to banks	**229.2**	237.4	**227.8**	236.3
Less: allowance for losses on loans and advances to banks	**(1.5)**	(1.6)	**(1.5)**	(1.6)
	227.7	235.8	**226.3**	234.7

Allowance for losses on loans and advances to banks

	GROUP and SOCIETY	
	2017 £m	2016 £m
Balance at 1 January	**1.6**	11.8
Amounts utilised during the year	**(0.1)**	(10.2)
At 31 December	**1.5**	1.6

At 31 December 2017 the Society had legacy loans and advances to Icelandic banks totalling **£1.6m** (2016: £1.8m), against which allowance for losses of **£1.5m** (2016: £1.6m) has been made.

10 Debt securities

	GROUP and SOCIETY	
Transferable debt securities	**2017 £m**	2016 £m
Issued by public bodies - listed	**84.8**	72.3
Issued by other borrowers - unlisted	**295.3**	272.0
	380.1	344.3

These have remaining maturities as follows:		
Accrued interest	**1.9**	2.7
In not more than one year	**43.2**	104.6
In more than one year but not more than five years	**250.7**	157.2
In more than five years	**84.3**	79.8
	380.1	344.3

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.

11 Loans and advances to customers

	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £m
Loans fully secured on residential property	**2,635.5**	2,455.9	**2,631.2**	2,449.7
Loans fully secured on land	**68.0**	103.9	**68.0**	103.9
Other loans	**14.6**	15.6	**14.6**	15.6
Gross loans and advances	**2,718.1**	2,575.4	**2,713.8**	2,569.2
Less: allowance for losses on loans and advances	**(10.8)**	(11.6)	**(10.8)**	(11.6)
	2,707.3	2,563.8	**2,703.0**	2,557.6

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

	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £m
On demand	**7.1**	5.5	**7.1**	5.5
In not more than three months	**40.0**	57.1	**39.9**	57.1
In more than three months but not more than one year	**62.2**	71.7	**62.1**	71.7
In more than one year but not more than five years	**258.9**	235.2	**258.6**	234.9
In more than five years	**2,349.9**	2,205.9	**2,346.1**	2,200.0
Gross loans and advances	**2,718.1**	2,575.4	**2,713.8**	2,569.2
Less: allowance for losses on loans and advances	**(10.8)**	(11.6)	**(10.8)**	(11.6)
	2,707.3	2,563.8	**2,703.0**	2,557.6

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.

11 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 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)
At 31 December 2017	**0.2**	**1.3**	**7.7**	**1.3**	**0.3**	**-**	**8.2**	**2.6**	**10.8**

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 2016	0.7	0.2	15.2	2.0	0.3	-	16.2	2.2	18.4
Charge for the year	0.3	0.4	1.3	1.2	-	-	1.6	1.6	3.2
Utilised during the year	(0.1)	-	(9.7)	-	-	-	(9.8)	-	(9.8)
Interest suspended adjustment	-	-	0.3	(0.5)	-	-	0.3	(0.5)	(0.2)
At 31 December 2016	**0.9**	**0.6**	**7.1**	**2.7**	**0.3**	**-**	**8.3**	**3.3**	**11.6**

12 Fair value adjustment 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 **£206.2m** (2016: £233.8m).

The cumulative fair value adjustment for hedged risk for liabilities for the Group and Society was **£1.6m** (2016: £5.2m).

Notes to the Accounts for the year ended 31 December 2017

13 Investment in subsidiaries undertakings

SOCIETY

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**

Investments in subsidiary undertakings	Shares £m	Loans £m	Total £m
Cost			
At 1 January 2016	12.0	21.5	33.5
Additions	-	1.2	1.2
Repayments received	-	(2.7)	(2.7)
At 31 December 2016	**12.0**	**20.0**	**32.0**
Provisions			
At 1 January and 31 December 2016	**0.6**	**3.1**	**3.7**
Net book amount at 31 December 2016	**11.4**	**16.9**	**28.3**

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 the Related Parties note, Note 29 on pages 69 and 70.

Notes to the Accounts for the year ended 31 December 2017

14 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 2017	6.4	12.2	18.6	6.2	43.4
Additions	-	15.6	2.4	0.8	18.8
Disposals	-	-	(0.3)	-	(0.3)
At 31 December 2017	**6.4**	**27.8**	**20.7**	**7.0**	**61.9**
Accumulated depreciation					
At 1 January 2017	1.1	3.8	11.1	4.6	20.6
Charge for the year	0.1	0.5	1.7	0.5	2.8
Disposals	-	-	(0.3)	-	(0.3)
At 31 December 2017	**1.2**	**4.3**	**12.5**	**5.1**	**23.1**
Net book amount at 31 December 2017	**5.2**	**23.5**	**8.2**	**1.9**	**38.8**

The Society's subsidiary, Newcastle Systems Management Limited (NSML) purchased Cobalt 21 in February 2017. For Group purposes, the purchase is consolidated into the leasehold land and buildings classification above. Under IAS 40 (Investment Property), both NSML and the Group has elected to account for the property at cost, recognising depreciation in line with IAS 16 (Property, Plant and Equipment) and the existing freehold land and buildings policy. Depreciation is charged at 2% per annum on a straight line basis. From the perspective of the Group, on consolidation, approximately 3/8ths of the Cobalt property is 'investment property', as approximately 3/8ths of the property is occupied by a third party external to the Group. At the date of purchase £5.9m of the £15.6m property was therefore investment property with £0.1m of the year's £0.3m depreciation charge attributable to the investment property portion.

The purchase price of £15.6m is considered to reflect the fair value of the property at 31 December 2017. No formal third party valuation of the property has been undertaken at 31 December 2017; an independant valuation was undertaken at the time of purchase.

Rental income of £0.3m was recognised through 2017 in respect of the Cobalt property. Directly attributable operating expenses to the investment property portion are not measured as both Group and third parties occupy the property.

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 2016	6.7	12.2	18.3	5.6	42.8
Additions	-	-	1.5	0.6	2.1
Disposals	(0.3)	-	(1.2)	-	(1.5)
At 31 December 2016	**6.4**	**12.2**	**18.6**	**6.2**	**43.4**
Accumulated depreciation					
At 1 January 2016	1.1	3.6	10.6	4.1	19.4
Charge for the year	0.1	0.2	1.6	0.5	2.4
Disposals	(0.1)	-	(1.1)	-	(1.2)
At 31 December 2016	**1.1**	**3.8**	**11.1**	**4.6**	**20.6**
Net book amount at 31 December 2016	**5.3**	**8.4**	**7.5**	**1.6**	**22.8**

Notes to the Accounts for the year ended 31 December 2017

14 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 2017	6.4	0.9	12.9	1.7	21.9
Additions	-	-	0.9	0.2	1.1
Disposals	-	-	(0.3)	-	(0.3)
At 31 December 2017	**6.4**	**0.9**	**13.5**	**1.9**	**22.7**
Accumulated depreciation					
At 1 January 2017	1.1	0.1	7.1	1.3	9.6
Charge for the year	0.1	-	1.0	0.2	1.3
Disposals	-	-	(0.2)	-	(0.2)
At 31 December 2017	**1.2**	**0.1**	**7.9**	**1.5**	**10.7**
Net book amount at 31 December 2017	**5.2**	**0.8**	**5.6**	**0.4**	**12.0**

SOCIETY

	Freehold buildings £m	Leasehold land and buildings £m	Equipment, fixtures, fittings and motor vehicles £m	Intangible Assets £m	Total £m
Cost					
At 1 January 2016	6.7	0.9	12.7	1.5	21.8
Additions	-	-	1.0	0.2	1.2
Disposals	(0.3)	-	(0.8)	-	(1.1)
At 31 December 2016	**6.4**	**0.9**	**12.9**	**1.7**	**21.9**
Accumulated depreciation					
At 1 January 2016	1.1	0.1	6.8	1.1	9.1
Charge for the year	0.1	-	1.0	0.2	1.3
Disposals	(0.1)	-	(0.7)	-	(0.8)
At 31 December 2016	**1.1**	**0.1**	**7.1**	**1.3**	**9.6**
Net book amount at 31 December 2016	**5.3**	**0.8**	**5.8**	**0.4**	**12.3**

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 2017 £m	2016 £m
Cost		
At 1 January	**0.8**	0.8
Accumulated depreciation	**(0.1)**	(0.1)
Net book amount	**0.7**	0.7

Notes to the Accounts for the year ended 31 December 2017

15 Deferred tax assets

The movement on the deferred tax account is shown below.

	GROUP 2017 £m	GROUP Restated 2016 £m	SOCIETY 2017 £m	SOCIETY Restated 2016 £m
At 1 January	**5.6**	7.8	**5.5**	7.7
Income Statements expense	**(2.2)**	(2.0)	**(2.0)**	(2.0)
Other	**0.1**	-	**0.1**	-
Credited on items taken directly through reserves	**(0.3)**	(0.2)	**(0.3)**	(0.2)
At 31 December	**3.2**	5.6	**3.3**	5.5

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

	GROUP 2017 £m	GROUP Restated 2016 £m	SOCIETY 2017 £m	SOCIETY Restated 2016 £m
Deferred tax assets				
Other items	**(0.4)**	(0.2)	**(0.4)**	(0.2)
Trading losses	**2.1**	4.4	**2.1**	4.2
Depreciation in excess of capital allowances	**1.5**	1.4	**1.6**	1.5
	3.2	5.6	**3.3**	5.5

	GROUP 2017 £m	GROUP Restated 2016 £m	SOCIETY 2017 £m	SOCIETY Restated 2016 £m
Deferred tax assets				
Deferred tax asset to be recovered in less than 12 months	**0.9**	1.9	**0.9**	1.9
Deferred tax asset to be recovered in more than 12 months	**2.3**	3.7	**2.4**	3.6
	3.2	5.6	**3.3**	5.5

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

	GROUP 2017 £m	GROUP Restated 2016 £m	SOCIETY 2017 £m	SOCIETY Restated 2016 £m
Other items	**(0.2)**	(0.3)	**(0.2)**	(0.3)
Trading losses	**(2.2)**	(1.7)	**(2.2)**	(1.8)
Depreciation in excess of capital allowances	**0.2**	-	**0.4**	0.1
	(2.2)	(2.0)	**(2.0)**	(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.

16 Other assets

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Receivable from subsidiary undertakings	**-**	-	**2.9**	1.4
Prepayments and accrued income	**9.7**	7.8	**12.6**	13.0
Other	**2.2**	2.5	**0.4**	2.2
	11.9	10.3	**15.9**	16.6

17 Due to Members

	GROUP and SOCIETY	
	2017	2016
	£m	£m
Held by individuals	**2,788.4**	2,709.0
Other shares	**0.1**	0.2
	2,788.5	2,709.2

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

Accrued interest	**13.0**	12.7
On demand	**1,478.6**	1,541.0
In not more than three months	**830.0**	757.0
In more than three months but not more than one year	**275.2**	104.5
In more than one year but not more than five years	**189.9**	293.6
In more than five years	**1.8**	0.4
	2,788.5	2,709.2

18 Due to other customers

	GROUP		SOCIETY	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Amounts owed to subsidiary undertakings	**-**	-	**10.3**	11.8
Other	**226.2**	211.1	**226.2**	211.1
	226.2	211.1	**236.5**	222.9

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

Accrued interest	**0.7**	1.1	**0.7**	1.1
On demand	**3.0**	2.9	**3.0**	2.9
In not more than three months	**110.6**	109.6	**110.6**	109.6
In more than three months but not more than one year	**109.9**	97.5	**120.2**	109.3
In more than one year but not more than five years	**2.0**	-	**2.0**	-
	226.2	211.1	**236.5**	222.9

19 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	Insurance Liability	Net Position presented on balance sheet
	£m	£m	£m
31 December 2017	**209.9**	**(0.3)**	**209.6**
31 December 2016	219.8	(0.3)	219.5

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 £645.0m is held against the Group's equity release exposures at 31 December 2017. By their nature, equity release mortgages are not considered to hold a pre-determined maturity date.

The average Loan to Value across the Society's equity release portfolios at 31 December 2017 was 33% (2016: 31%).

The insurance liability of £0.3m reflects discrete provisions made against equity release mortgages with an expected shortfall. Collective provisions of £0.5m have also been made, reflecting managements judgement of the tail risk within the book.

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

	Interest Income	Insurance Liability Charge	Insurance Liability Release
	£m	£m	£m
2017	**13.8**	**0.1**	**-**
2016	15.0	0.3	(0.1)

There were no amounts re-credited to the income statement during 2017 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 S1PxA (pensioner mortality projection) tables, with 2016 CMI mortality improvement factors.

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	Additional Insurance Liability Charge in 2017
	%	vs. base	£m
Surrenders per annum	1.00%	-1.0%	0.1
HPI growth	3.00%	-1.0%	0.6
Discount rate	1.19%	-0.50%	-

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 £1.5m. The base variables reflect the Group's best estimates towards future positions in house prices, mortality rates and discount rates as at 31 December 2017. 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 on page 32.

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

20 Deposits from banks

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

	GROUP and SOCIETY 2017 £m	2016 £m
Accrued interest	**0.3**	0.2
In not more than three months	**20.6**	133.6
In more than three months but not more than one year	**5.5**	3.5
In more than one year but not more than five years	**251.0**	50.0
	277.4	187.3

21 Debt securities in issue

	GROUP and SOCIETY 2017 £m	2016 £m
Certificates of deposit	**1.0**	-

Debt securities have remaining maturities of more than 3 months but not more than one year.

22 Other liabilities

	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £m
Amounts payable to subsidiary undertakings	**-**	-	**5.9**	5.5
Obligations under finance leases	**0.9**	1.1	**0.9**	1.1
Other creditors	**2.5**	1.7	**1.2**	1.2
Accruals and deferred income	**10.3**	11.3	**8.6**	10.6
	13.7	14.1	**16.6**	18.4
Obligations under finance leases fall due as follows:				
Within one year	**0.1**	0.1	**0.1**	0.1
In one to two years	**-**	0.1	**-**	0.1
In two to five years	**-**	0.1	**-**	0.1
In more than five years	**0.8**	0.8	**0.8**	0.8
	0.9	1.1	**0.9**	1.1

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.

During 2017 the Group released a £2.2m lease creditor provision, previously presented as part of other liabilities, to the income statement. This reflects purchase of the Group's office building at Cobalt Park in North Tyneside, a site that the Group has occupied for the last nine years. During the lease period the Society spread the effective cost of the lease over what was a 15 year term and built up a significant creditor for costs recognised but not billed during the rent free period. On purchase of the building this credit has been released, as it is no longer required, generating a £2.2m one-off profit in the year.

23 Provisions for liabilities and charges

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**

GROUP and SOCIETY

	FSCS Levy £m	Other Provisions £m	Total £m
Opening Provision at 1 January 2016	1.1	1.6	2.7
New Provisions during the year	0.6	-	0.6
Amounts utilised during the year	(1.0)	(0.3)	(1.3)
Closing Provision at 31 December 2016	0.7	1.3	2.0

Provision for Financial Services Compensation Scheme Levy

FSCS is the compensation scheme for customers of UK authorised financial services firms. The FSCS can compensate customers if a firm has stopped trading or does not have enough assets to pay claims made against it.

In the latter part of 2008, claims against the FSCS were triggered following the default of a number of deposit takers. The FSCS has met these claims by way of loans received from HM treasury. The FSCS is liable to pay interest on the loans from HM Treasury.

The FSCS recovers the interest cost, together with ongoing management expenses, by way of annual levies on Member firms.

At 31 December 2017 the Society held a provision of £0.2m in relation to the 2017/18 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.

24 Subordinated liabilities

	GROUP and SOCIETY 2017 £m	GROUP and SOCIETY 2016 £m
7.190% fixed rate subordinated notes 2017	-	25.0
3.849% fixed rate subordinated notes 2019	**25.0**	25.0
	25.0	50.0

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.

The 7.190% fixed rate subordinated notes were repaid on maturity on 3 October 2017.

25 Subscribed capital

	GROUP and SOCIETY 2017 £m	GROUP and SOCIETY 2016 £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**	10.0
	30.0	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 can be called by the Society on 18 December 2018 by giving 30 to 60 days notice to the PIBS holders, subject to having gained regulatory consent in advance of sending the notices.

26 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 2017 £m	GROUP and SOCIETY 2016 £m
Irrevocable undrawn committed loan facilities	**110.4**	124.6
Payments under non-cancellable operating lease agreements		
Total minimum lease payments:		
Within one year	**0.9**	1.4
In one to five years	**2.4**	3.9
Over five years	**1.6**	2.0
	4.9	7.3

27 Note to the Cash Flow Statements

Reconciliation of profit before taxation to net cash inflow from operating activities	GROUP 2017 £m	GROUP 2016 £m	SOCIETY 2017 £m	SOCIETY 2016 £m
Profit before taxation	**13.1**	8.1	**12.7**	9.8
Depreciation and amortisation	**2.8**	2.4	**1.3**	1.3
Interest on subordinated liabilities	**2.1**	2.6	**2.1**	2.6
Interest on subscribed capital	**3.5**	3.5	**3.5**	3.5
(Decrease) / increase in derivative financial instruments	**(22.5)**	44.7	**(22.5)**	44.6
Decrease / (increase) in other financial liabilities at fair value through profit or loss	**24.0**	(43.1)	**24.0**	(43.1)
Changes in retirement benefit obligations	**0.3**	(2.2)	**0.3**	(2.2)
Other non-cash movements	**(4.8)**	(5.5)	**(4.9)**	(5.4)
Net cash inflow before changes in operating assets and liabilities	**18.5**	10.5	**16.5**	11.1
Increase in loans and advances to customers	**(142.7)**	(78.4)	**(144.6)**	(80.6)
Decrease / (increase) in cash collateral pledged	**7.8**	(41.6)	**7.8**	(41.6)
Increase in shares	**79.3**	30.4	**79.3**	30.4
Increase in amounts due to other customers and deposits from banks	**105.2**	92.3	**103.7**	91.8
Increase in debt securities in issue	**1.0**	-	**1.0**	-
(Increase) / decrease in other assets, prepayments and accrued income	**(1.6)**	1.6	**0.7**	2.0
(Decrease) / increase in other liabilities	**(0.6)**	3.3	**(1.8)**	2.3
Net cash inflow from operating activities	**66.9**	18.1	**62.6**	15.4
Cash and cash equivalents				
Cash and balances with the Bank of England	**182.0**	196.4	**182.0**	196.4
Loans and advances to banks repayable on demand	**1.5**	1.8	**0.1**	0.7
Investment securities	**0.1**	0.2	**0.1**	0.2
At 31 December	**183.6**	198.4	**182.2**	197.3

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.

For the first time in 2017, IAS 7 "statement of cash flows" 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 2016 £m	Non-Cash charges Accrued interest/lease charge £m	Cash flows Interest payment flows £m	Capital repayment flows £m	Other £m	Balance sheet 31 December 2017 £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**

	Balance sheet 31 December 2015 £m	Non-Cash charges Accrued interest/lease charge £m	Cash flows Interest payment flows £m	Capital repayment flows £m	Other £m	Balance sheet 31 December 2016 £m
Subordinated liabilities	50.5	3.0	(3.0)	-	-	50.5
Subscribed capital (PIBS)	30.4	3.5	(2.9)	-	-	31.0
Finance lease arrangements	1.1	-	-	-	-	1.1

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 2017.

28 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 2017 was 18 years. (2016: 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. In addition, the Society will pay £0.3m per annum to meet the cost of running the Scheme.

The Society therefore expects to pay £2.0m to the Scheme during the accounting year beginning 1 January 2018, unless a trigger is reached for employer contributions to cease or reduce.

Assumptions

The assumptions and data underpinning the triennial valuation at 30 June 2016 have been fed through to the position at 31 December 2017 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	**2017**	2016
Discount rate	**2.45%**	2.60%
RPI inflation	**3.10%**	3.30%
CPI inflation	**2.10%**	2.30%
Mortality assumption		
Mortality (post-retirement)	**SAPS 'S2'CMI 2016 [1.25%] (yob)**	S2PA CMI_2015_M/F [1.25%] (yob)
Other actuarial assumptions		
RPI pension increases	**3.05%**	3.20%
Revaluation of deferred pensions in excess of GMP	**2.10%**	2.30%
Life expectancies (in years)		
For an individual aged 62		
Male	**24.8 years**	24.9 years
Female	**26.7 years**	27.1 years
At age 62 for an individual aged 42 in 2017		
Male	**26.3 years**	26.8 years
Female	**28.3 years**	29.0 years

Notes to the Accounts for the year ended 31 December 2017

28 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:** 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:** a significant proportion of the Scheme's defined benefit obligation is linked to inflation, therefore higher inflation will result in a higher defined benefit obligation (subject to the appropriate caps in place), although the Scheme's LDI holdings look to hedge inflation rate changes to some extent.
- **Life expectancy:** 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:** investments are well diversified, such that the failure of any single investment would not have a material impact on the overall level of assets.
- **Investment strategy:** the Trustees are required to review their investment strategy on an annual 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:** an option allows members 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 on 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%	– 8% / + 9%
RPI and CPI inflation	+ 0.5% / – 0.5%	+ 5% / – 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	**2017 %**	2016 %
Equities and growth assets	**37.9**	45.7
Bonds	**19.8**	18.3
Gilts	**39.6**	35.2
Property	**1.5**	-
Cash	**1.2**	0.8
Total	**100.0**	100.0
Actual return on assets over the year	**8.4**	20.5

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

28 Retirement benefit obligations Continued

Reconciliation to the Balance Sheets

	2017 £m	Restated 2016 £m
Market value of assets	**112.8**	111.2
Present value of defined benefit obligation	**102.0**	108.6
Funded status	**10.8**	2.6
Accounting policy: derocognition of pensions surplus	**10.8**	2.6
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

	2017 £m	2016 £m
Value of defined benefit obligation at start of year	**108.6**	93.7
Interest cost	**2.8**	3.4
Benefits paid	**(8.5)**	(3.0)
Actuarial (gains): experience differing from that assumed	**-**	(5.1)
Actuarial (gains) / losses: changes in demographic assumptions	**(1.5)**	0.7
Actuarial losses: changes in financial assumptions	**0.6**	18.9
Value of defined benefit obligation at end of year	**102.0**	108.6

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

	2017 £m	2016 £m
Market value of assets at start of year	**111.2**	92.0
Interest income	**2.8**	3.4
Actual return on assets less interest	**5.6**	17.1
Employer contributions	**2.0**	2.0
Benefits paid	**(8.5)**	(3.0)
Administration costs	**(0.3)**	(0.3)
Market value of assets at end of year	**112.8**	111.2

Amount recognised in Income Statements

	2017 £m	2016 £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

	2017 £m	Restated 2016 £m
Actuarial gains / (losses) on defined benefit obligations	**0.9**	(14.5)
Actual return on assets less interest	**5.6**	17.1
Pension (assets) not recognised on the balance sheet	**(8.2)**	(2.6)
Amounts recognised in Statements of Comprehensive Income	**(1.7)**	-

28 Retirement benefit obligations Continued

The Society, under re-assessment of the pensions trust deed, no longer feels it is appropriate to continue to recognise any net defined benefit asset surplus as the Society does not have the unconditional ability to access any surplus without approval from the pensions scheme trustees.

The Group has elected not to recognise the IAS 19 pensions surplus of £10.8m on balance sheet at 31 December 2017. The Group does not expect to realise economic benefits with respect to the surplus through refunds from the plan. Valuation of pensions assets and pensions liabilities is volatile and highly subjective to external circumstances outside of management's control. As such, management do not consider there to be sufficient certainty towards the Society's future plan contributions to recognise the point-in-time IAS 19 surplus at 31 December 2017.

This reflects a change in the Group's accounting policy during 2017 as previously the Group has recognised IAS 19 surpluses on balance sheet at their funded status. IAS 8, Accounting Policies, requires the adoption of accounting policies that promote relevant and reliable presentations of financial positions, including the prudent and faithful representation of financial position and reflection of the economic substance of transaction and not merely the legal form.

IAS 8 expects an accounting policy to be changed where the change results in the financial statements providing reliable and more relevant information than the existing policy would provide. The Group, in line with its expectation that an IAS 19 funded status will not result in any withdrawal of either the current surplus or sufficient certainty to any future contribution reductions, elects not to recognise the IAS 19 surplus as an asset on balance sheet as a result.

IAS 8 expects a retrospective application of accounting policy changes. The Group and Society have consequently restated the 2016 closing pensions surplus from its previously published balance sheet value of £2.6m to £nil and has similarly restated the corresponding deferred tax liability of £0.4m to £nil. Where pensions and deferred taxation positions impact with other notes to these financial statements, restated positions have been provided.

29 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 13 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

	2017 £000	2016 £000
At 31 December	**296**	314

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

	2017 £000	2016 £000
At 31 December	**417**	412

Amounts deposited by Directors and members of their close families earn interest on the same terms and conditions applicable to other customers.

Financial Planning Services received by Directors and their close family members

During 2017, in the normal course of business, Directors and their close family members paid £2,141 (2016: £nil) for financial planning services received from Newcastle Financial Advisers Limited. These services were made and charged under normal commercial terms. No amounts remain unpaid with respect to these transactions as at 31 December 2017

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

	2017 £000	2016 £000
Newcastle Systems Management Limited	**938**	991
Newcastle Strategic Solutions Limited	**7,114**	4,732

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

(b) Purchases of services:

	2017 £000	2016 £000
Managed IT and Property Services		
Newcastle Systems Management Limited	**5,074**	4,436
Business Support Services		
Newcastle Strategic Solutions Limited	**6,670**	13,709
Property Rental		
Newcastle Portland House Limited	**66**	66

29 Related parties Continued

Purchased services are negotiated with related parties on commercial terms.

At 31 December 2017 the following unsecured balances remained outstanding with related parties:

(c) Outstanding balances:	Amounts owed to Society		Amounts owed by Society	
	2017 £000	2016 £000	**2017 £000**	2016 £000
Newcastle Systems Management Limited	**661**	732	493	492
Newcastle Strategic Solutions Limited	**2,235**	606	1,709	1,341
Newcastle Financial Advisers Limited	**-**	-	725	797
Newcastle Portland House Limited	**19**	19	2,920	2,920
Newcastle Mortgage Loans (Jersey) Limited	**16**	34	-	-

At 31 December 2017 the following borrowings and cash deposits remained outstanding with related parties:

(d) Borrowings/ cash deposits:	Amounts borrowed from Society		Amounts deposited with Society	
	2017 £000	2016 £000	**2017 £000**	2016 £000
Newcastle Systems Management Limited	**22,459**	7,050	4,668	5,663
Newcastle Strategic Solutions Limited	**4,226**	3,941	5,657	6,151
Newcastle Mortgage Loans (Jersey) Limited	**3,905**	5,922	-	-

	Interest paid to Society		Interest paid by Society	
	2017 £000	2016 £000	**2017 £000**	2016 £000
Newcastle Systems Management Limited	**1,003**	475	**5**	13
Newcastle Strategic Solutions Limited	**284**	265	**6**	14
Newcastle Mortgage Loans (Jersey) Limited	**283**	413	**-**	-

(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 year operating leases.

In the next financial year the Society expects to receive £174,000 and £128,000 from the subsidiaries respectively.

In over 1 year but not more than 5 years time the Society expects to receive £261,000 and £193,000 in respect of currently agreed operating leases from the subsidiaries respectively.

Newcastle Building Society and Newcastle Strategic Solutions Limited lease office space from Newcastle Systems Management Limited under 5 year operating leases. In the next financial year the Society expects to pay £789,400 to Newcastle Systems Management Limited in respect of this lease arrangement. In over 1 year but no more than 5 years the Society expects to pay £2,565,550.

30 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 materially different from the Group basis for any of the disclosures in this note.

Categories of financial instruments

The accounting policies note (Note 1 on page 46) 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.

Group as at 31 December 2017	Note	Amortised Cost £m	Available for sale £m	Fair value through income statements £m	Total £m
Financial assets					
Cash in hand and balances with Bank of England		182.0	-	-	182.0
Loans and advances to banks	9	227.7	-	-	227.7
Debt securities	10	-	380.1	-	380.1
Derivative financial instruments	30	-	-	4.9	4.9
Fair value adjustments for hedged risk	12	-	-	206.2	206.2
Loans and advances to customers	11	2,707.3	-	-	2,707.3
Total financial assets		**3,117.0**	**380.1**	**211.1**	**3,708.2**
Financial liabilities					
Due to Members - shares	17	2,788.5	-	-	2,788.5
Fair value adjustments for hedged risk	12	-	-	1.6	1.6
Due to other customers	18	226.2	-	-	226.2
Deposits from banks	20	277.4	-	-	277.4
Debit securities in issue	21	1.0	-	-	1.0
Derivative financial instruments	30	-	-	210.2	210.2
Subordinated liabilities	24	25.0	-	-	25.0
Subscribed capital	25	30.0	-	-	30.0
Total financial liabilities		**3,348.1**	**-**	**211.8**	**3,559.9**

At 31 December 2017 the Group held **£11.9m** (2016: £10.3m) 'Other assets' on Balance Sheet of which **£8.6m** (2016: £5.1m) were financial assets. The assets are held at amortised cost which also reflects the asset's fair value.

At 31 December 2017 the Group held **£13.7m** (2016: £14.1m) 'Other liabilities' of which **£11.6m** (2016: £13.4m) were financial in nature. The liabilities are held at amortised cost which also reflects the liabilities' fair value.

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.

30 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 25.

Group as at 31 December 2016	Note	Amortised Cost £m	Available for sale £m	Fair value through income statements £m	Total £m
Financial assets					
Cash in hand and balances with Bank of England		196.4	-	-	196.4
Loans and advances to banks	9	235.8	-	-	235.8
Debt securities	10	-	344.3	-	344.3
Derivative financial instruments	30	-	-	6.5	6.5
Fair value adjustments for hedged risk	12	-	-	233.8	233.8
Loans and advances to customers	11	2,563.8	-	-	2,563.8
Total financial assets		**2,996.0**	**344.3**	**240.3**	**3,580.6**
Financial liabilities					
Due to Members - shares	17	2,708.8	-	0.4	2,709.2
Fair value adjustments for hedged risk	12	-	-	5.2	5.2
Due to other customers	18	211.1	-	-	211.1
Deposits from banks	20	187.3	-	-	187.3
Derivative financial instruments	30	-	-	234.3	234.3
Subordinated liabilities	24	50.0	-	-	50.0
Subscribed capital	25	30.0	-	-	30.0
Total financial liabilities		**3,187.2**	**-**	**239.9**	**3,427.1**

Fair values 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.

30 Financial instruments Continued

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)

Group as at 31 December 2016

	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	6.5	(1.0)	5.5	0.4
Financial liabilities				
Interest rate swaps	(234.3)	233.8	(0.5)	(226.7)

*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 2017, 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 £18.2m has been placed with an LCH counterparty with respect to 'initial margin': an amount calculated by central counterparties to protect against potential future exposures that could arise from valuation changes. This is in addition to a typical 'variation margin', covering the LCH's accounting exposure to the Society as at 31 December 2017. 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 £16.8m.

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 2017 £m	2016 £m
Cash collateral received under CSA agreements	**-**	1.0
Other financial assets collateral pledged under repurchase agreements	**366.1**	362.4
Cash collateral paid under CSA agreements	**226.0**	233.8

At 31 December 2017 an immediate 100bp uplift in the zero-coupon 3-month yield curve would produce collateral inflows of **£84.6m** (2016: £85.3m).

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.

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. 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 2017.

GROUP

	Note	Level*	Carrying value 2017 £m	Carrying value 2016 £m	Fair value 2017 £m	Fair value 2016 £m
Financial assets						
Cash and balances with the Bank of England		1	**182.0**	196.4	**182.0**	196.4
Loans and advances to banks	9	1	**227.7**	235.8	**227.7**	235.8
Loans and advances to customers	11	3	**2,707.3**	2,563.8	**2,894.8**	2,776.7
Financial liabilities						
Due to Members - shares	17	2	**2,788.5**	2,709.2	**2,796.6**	2,716.2
Due to other customers	18	2	**226.2**	211.1	**225.8**	211.1
Deposits due to other banks	20	2	**277.4**	187.3	**277.4**	187.3
Debt securities in issue	21	2	**1.0**	-	**1.0**	-
Subordinated liabilities	24	2	**25.0**	50.0	**26.2**	52.5
Subscribed capital	25	2	**30.0**	30.0	**48.6**	43.8

*Level defined below. The Group does not trade in financial instruments. Sale of financial assets to demonstrate their liquidity have had a minimal impact on the Group's financial result during 2017.

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.

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:

	2017 Level 1 £m	2017 Level 2 £m	2017 Level 3 £m	2017 Total £m	2016 Level 1 £m	2016 Level 2 £m	2016 Level 3 £m	2016 Total £m
Financial assets								
Debt securities - available for sale	**380.1**	**-**	**-**	**380.1**	344.3	-	-	344.3
Derivative financial instruments	**-**	**4.9**	**-**	**4.9**	-	6.5	-	6.5
Fair value adjustments for hedged risk on underlying instruments	**-**	**206.2**	**-**	**206.2**	-	233.8	-	233.8
Financial liabilities								
Derivative financial instruments	**-**	**210.2**	**-**	**210.2**	-	234.3	-	234.3
Fair value adjustments for hedged risk on underlying instruments	**-**	**1.6**	**-**	**1.6**	-	5.6	-	5.6

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.

30 Financial instruments Continued

Derivatives held for hedging

Derivative financial instruments used by the Group have been described previously in the Risk Management Report and footnotes to the table on page 71 of Note 30. The derivative financial instruments are held primarily to mitigate interest rate risk across the Group's balance sheet. The Group actively monitors and manages interest rate risk using hedging as part of that strategy in line with IAS 39. Both fair value and cash flow hedge transactions have been undertaken with the fair values of the derivative instruments held at the Balance Sheet date set out below:

	2017 Notional Amount £m	2017 Fair Value Assets £m	2017 Fair Value Liabilities £m	2016 Notional Amount £m	2016 Fair Value Assets £m	2016 Fair Value Liabilities £m
At 31 December						
Interest rate swaps designated as fair value hedges	**1,195.2**	**4.7**	**210.2**	1,186.3	6.4	(234.2)
Interest rate swaps designated as cash flow hedges	**475.0**	**0.2**	**-**	425.0	0.1	(0.1)
		4.9	**210.2**		6.5	(234.3)

Hedge Ineffectiveness

	2017 £m	2016 £m
Gains / (losses) on hedging instruments	**22.4**	(44.6)
Gains / (losses) on hedged items attributable to the hedged risk	**(22.3)**	44.6
Net gains representing ineffective portions of the fair value hedges	**0.1**	**-**

Liquidity risk

Liquidity risk is the risk that the Society does not hold sufficient liquid resources (resources readily transferable to cash or cash equivalents) to meet its obligations as they fall due.

For each material category of financial liability a maturity analysis is provided in Notes 17 to 22 , which represents the contractual maturities. The table below analyses the Group's Financial Liabilities, which will be settled on a net basis, into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

Maturity has been defined by the earliest contractual date of repayment with reference to product terms and conditions. However, management information, both internally generated and through experience, indicates deposits are likely to be repaid later than the earliest date on which repayment is contractually required. The amounts disclosed in the table are contractual undiscounted cash flows and reflect a worst case repayment scenario.

The Group's liquidity risk is managed by the Asset and Liability Committee (ALCO). ALCO reviews and approves the results of liquidity stress testing scenarios monitoring cashflow forecasts for the next 5 years under base case and stressed scenarios. ALCO appraise long term funding plans and scenarios to ensure adequate liquid assets are in place to meet both regulatory and operational requirements. For further detail see the Risk Management Report on page 32.

GROUP

At 31 December 2017	**Repayable on demand £m**	**Up to 3 months £m**	**Between 3 and 12 months £m**	**Between 1 and 5 years £m**	**Over 5 years £m**	**Total £m**
Due to Members - shares	**1,491.6**	**830.0**	**275.2**	**189.9**	**1.8**	**2,788.5**
Due to other customers	**3.7**	**110.6**	**109.9**	**2.0**	**-**	**226.2**
Deposits from banks	**0.3**	**20.6**	**5.5**	**251.0**	**-**	**277.4**
Debt securities in issue	**-**	**-**	**1.0**	**-**	**-**	**1.0**
Derivative financial instruments	**-**	**-**	**0.4**	**7.2**	**202.6**	**210.2**
Fair value adjustments for hedged risk	**-**	**-**	**0.4**	**1.2**	**-**	**1.6**

At 31 December 2016	Repayable on demand £m	Up to 3 months £m	Between 3 and 12 months £m	Between 1 and 5 years £m	Over 5 years £m	Total £m
Due to Members - shares	1,553.7	757.0	104.5	293.6	0.4	2,709.2
Due to other customers	4.0	109.6	97.5	-	-	211.1
Deposits from banks	0.2	133.6	3.5	50.0	-	187.3
Debt securities in issue	-	-	-	-	-	-
Derivative financial instruments	-	0.1	1.6	7.2	225.4	234.3
Fair value adjustments for hedged risk	-	-	-	5.2	-	5.2

Notes to the Accounts for the year ended 31 December 2017

30 Financial instruments Continued

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 32 of these Annual Report and Accounts, maintains oversight of the Retail and Commercial Credit Committees. The Committees are involved in the monitoring of the credit risk within the Group's assets.

Note 11 of the Annual Report and Accounts on page 54 contains details of total mortgage assets.

Once a mortgage has been written down as a result of an impairment loss, interest income is recognised in line with adjusted expected future cash flows on the mortgage. Interest receivable and similar income on loans and advances to customers includes **£0.3m** (2016: £0.6m) of interest accrued on impaired mortgage assets.

The Group's lending is all secured with a first charge registered against the collateral property. The average loan to value of the Group's loan portfolios at 31 December 2017 is **59.3%** (2016: 58.1%) as detailed in the Strategic Report on page 12. Quarterly regional Halifax House Price Index data is used to monitor the value of residential collateral. Provisions are held against loan assets where the recovery of the asset is uncertain. Provisions of **£10.8m** (2016: £11.6m) are held against the Group's loans and advances to customers at 31 December 2017, as detailed in Note 11 to the Accounts on page 54. The Group's Commercial Credit and Provisioning Committees consider a range of factors in identifying a loan's impaired status. These include where a property has been taken into possession, where a loan is no longer being serviced or difficulty in future servicing is expected, and review of watch lists.

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 2017 there were 16 loans in 12 months arrears or more with balances of **£0.8m** (2016: 24 loans totalling £1.3m).

The Group's non-impaired commercial loan assets are also considered to be of a good credit quality.

Prime residential mortgage book

The Prime residential mortgage book consists of traditional residential loans. No sub-prime or self-certification lending has been undertaken.

Loan to value (indexed)	2017 £m	2017 %	2016 £m	2016 %
<70%	**1,321.7**	**68.4**	1,256.1	69.9
70% - <80%	**300.4**	**15.5**	289.3	16.1
80% - <90%	**214.6**	**11.1**	181.0	10.1
>90%	**96.4**	**5.0**	69.2	3.9
	1,933.1	**100.0**	1,795.6	100.0

The table below provides further information by payment due status:

	2017 £m	2017 %	2016 £m	2016 %
Neither past due nor impaired	**1,916.9**	**99.1**	1,776.0	98.9
Past due up to 3 months but not impaired	**11.3**	**0.6**	13.8	0.8
Impaired and past due 3 to 6 months	**3.1**	**0.2**	3.2	0.2
Impaired and past due over 6 months	**1.8**	**0.1**	2.5	0.1
In possession	**-**	**-**	0.1	-
	1,933.1	**100.0**	1,795.6	100.0

Against past due and possession cases, **£42.5m** (2016: £55.9m) collateral is held.
No loans that would be past due or impaired have had their terms renegotiated.

Retail Buy to Let Mortgage book

The Retail BTL mortgage book consists of buy-to-let to individuals <£1m.

Loan to value (indexed)	2017 £m	2017 %	2016 £m	2016 %
<70%	**78.3**	**51.4**	42.7	54.1
70% - <80%	**71.6**	**46.9**	33.3	42.2
80% - <90%	**0.7**	**0.5**	1.7	2.2
>90%	**1.9**	**1.2**	1.2	1.5
	152.5	**100.0**	78.9	100.0

Notes to the Accounts for the year ended 31 December 2017

30 Financial instruments Continued

The table below provides further information by payment due status:

	2017 £m	2017 %	2016 £m	2016 %
Neither past due nor impaired	**152.1**	**99.7**	78.2	99.2
Past due up to 3 months but not impaired	**-**	**-**	0.2	0.2
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**	0.4	0.5
In possession	**0.1**	**0.1**	0.1	0.1
	152.5	**100.0**	78.9	100.0

Against past due and possession cases, **£0.5m** (2016: £0.2m) collateral is held.

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)	2017 £m	2017 %	2016 £m	2016 %
<70%	**49.8**	**85.6**	52.8	77.8
70% - <80%	**0.2**	**0.3**	5.5	8.0
80% - <90%	**8.0**	**13.8**	8.1	11.9
>90%	**0.2**	**0.3**	1.5	2.3
	58.2	**100.0**	67.9	100.0

The table below provides further information by payment due status:

	2017 £m	2017 %	2016 £m	2016 %
Neither past due nor impaired	**47.5**	**81.7**	53.3	78.6
Past due up to 3 months but not impaired	**10.5**	**18.0**	13.2	19.4
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	**-**	**-**	-	-
LPA receivership	**0.2**	**0.3**	1.4	2.0
In possession	**-**	**-**	-	-
	58.2	**100.0**	67.9	100.0

Against past due and possession cases, **£22.4m** (2016: £0.9m) collateral is held.
The average LTV of the specialist residential mortgage book is **57.1%** (2016: 51.2%) at 31 December 2017.

Commercial lending book

The commercial lending book comprises:

GROUP	2017 £m	2017 %	2016 £m	2016 %
Loans secured on Commercial Property	**47.7**	**8.4**	82.1	13.2
Loans secured on Serviced Apartments	**21.1**	**3.7**	22.7	3.6
Loans to Housing Associations	**498.0**	**87.9**	520.5	83.2
	566.8	**100.0**	625.3	100.0

30 Financial instruments Continued

Loans secured on commercial property

Loan to value (unindexed)	**2017 £m**	**2017 %**	2016 £m	2016 %
<70%	**19.9**	**41.7**	46.2	56.3
70% - <80%	**1.8**	**3.8**	2.4	2.9
80% - <90%	**-**	**-**	-	-
>90%	**26.0**	**54.5**	33.5	40.8
	47.7	**100.0**	82.1	100.0

The table below provides further information by payment due status:

	2017 £m	**2017 %**	2016 £m	2016 %
Neither past due nor impaired	**32.7**	**68.6**	65.3	79.6
Past due up to 3 months but not impaired	**-**	**-**	-	-
Not past due but impaired	**15.0**	**31.4**	16.8	20.4
Impaired and past due up to 3 months	**-**	**-**	-	-
Impaired and past due 3 to 6 months	**-**	**-**	-	-
Impaired and past due over 6 months	**-**	**-**	-	-
Impaired LPA receivership	**-**	**-**	-	-
In possession	**-**	**-**	-	-
	47.7	**100.0**	82.1	100.0

At 31 December 2017 the Society had no commercial investment loans in arrears of 3 months or more (2016: none).

The Society had no commercial loans in possession at the end of 2017 (2016: none). At the end of 2017 the Society had no commercial investment exposures subject to LPA receivership (2016: 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.

The Society granted forbearance against four loans during 2017 with total balances of £27.2m. Forbearance granted ranged from term extensions on commercial terms to reduced preferential interest rates and agreements to reduce debt through the waiver of exit fees.

Specific provisions of £1.0m are held against one of the properties that was granted forbearance during 2017. There has been no requirement identified to hold specific provisions against the remaining loans, but the collective provision remains in place to cover any shortfall.

30 Financial instruments Continued

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

	2017 £m	**2017 %**	2016 £m	2016 %
Retail	**21.8**	**45.7**	47.0	57.3
Office	**4.8**	**10.1**	13.9	16.9
Industrial	**16.3**	**34.2**	16.0	19.5
Hotel / Leisure	**4.4**	**9.2**	4.7	5.7
Other	**0.4**	**0.8**	0.5	0.6
	47.7	**100.0**	82.1	100.0

Loans to Housing Associations **Loan to value (unindexed)**	**2017 £m**	**2017 %**	2016 £m	2016 %
<70%	**263.1**	**52.8**	284.5	54.6
70% - <80%	**160.3**	**32.2**	146.6	28.2
80% - <90%	**74.6**	**15.0**	89.4	17.2
>90%	**-**	**-**	-	-
	498.0	**100.0**	520.5	100.0

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

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 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 2017	**+1% £m**	**+2% £m**	**-1% £m**	**-2% £m**
Next 12 months	**1.3**	**2.6**	**-**	**-**
Next 2 years	**0.5**	**1.0**	**(0.5)**	**(1.0)**
Next 3 years	**1.1**	**2.2**	**(1.1)**	**(2.2)**

At 31 December 2016	+1% £m	+2% £m	-1% £m	-2% £m
Next 12 months	1.5	2.9	(1.5)	(2.9)
Next 2 years	3.0	5.9	(3.0)	(5.9)
Next 3 years	4.1	8.1	(4.1)	(8.1)

The main risk measure used by ALCO is an immediate 200 basis points parallel shift in rates.

Due to the sustained 2017 low interest rate environment, the rate shocks for interest rate reductions communicated to ALCO have remained at -0.10% and -0.20% throughout 2017.

An immediate 2% upward movement in interest rates would increase members' interests by: **£6.4m** (2016: £6.9m).

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
IFRS 9 "Financial Instruments" will replace the current IAS 39 "Financial Instruments" on 1 January 2018. For further details see page 80, IFRS 9 Financial Instruments..

IFRS9 Implementation

IFRS 9 (Financial Instruments) supersedes IAS 39 (Financial Instruments) and first mandatorily applies to the Society and Group from 1 January 2018. Neither the Society nor the Group has elected to early apply IFRS 9.

IFRS 9 introduces fundamental changes to the classification and measurement and calculation of impairment of most financial instruments. See the table on page 81 for detail of which of the Group's assets are in scope of IFRS 9. IFRS 9 also introduces changes to hedge accounting and hedge assessment for non-dynamic hedging activities.

The Group has a long established IFRS 9 steering committee consisting of members of finance, credit risk, balance sheet management, mortgage operations and internal audit. An impairment sub-committee is also in place supported by external experts providing credit risk advice and modelling assistance. Extensive work undertaken throughout 2016 and 2017 to facilitate development of robust, compliant and informative loss provisioning models was concluded in the second half of 2017.

The Group's IFRS 9 project has been considered internally under three distinct streams; classification and measurement, impairment, and hedge accounting. The impact of IFRS 9 to the Group across these streams is as follows:

Classification and measurement

Classification of financial assets is based on the cash flow characteristics of the assets and the business model under which the assets are held. Assets may be classified at amortised cost, fair value through other comprehensive income and fair value through profit or loss. These classifications and their subsequent measurements are broadly analogous to the existing IAS 39 amortised cost, available for sale and fair value through profit or loss classifications.

Amortised cost (AC)

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 effective interest rate method, 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 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.

Fair value through Other Comprehensive Income (FVOCI)

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'.

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

The Group's primary debt security holdings are in covered bonds, residential mortgage backed securities (RMBS) and government gilts. Each attract a rate of interest analogous with a simplified debt instrument (the Society assessing that the interest rate receivable is sufficiently compensating for the time value of money and perceived credit risk inherent in each investment). The Group's current treasury policy ensures that investment in RMBS is at a sufficiently 'senior secured' level to conclude that RMBS cashflows continue to meet the SPPI requirements.

Fair value through profit or loss (FVTPL)

Where the contractual cash flow characteristics of an asset do not reflect SPPI, or where neither of the above business models 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's derivative financial instruments will be classified at fair value through profit or loss, in line with their current IAS 39 classification. The Group has not otherwise elected to hold at fair value through profit or loss financial assets it could otherwise have held at amortised cost or fair value through comprehensive income.

A small number of cash-based financial assets previously held at amortised cost are held at fair value through profit or loss under IFRS 9 due to either the indeterminate timing of cash flows or failing the SPPI requirements.

The Group is therefore broadly unaffected by IFRS 9's classification and unaffected by IFRS 9's measurement requirements as the IAS 39 and IFRS 9 accounting requirements are similar across similar classifications. Where technicalities force an IFRS 9 mapping out of IAS 39 amortised cost and into IFRS 9 fair value through profit and loss, this does not impact the underlying value of the financial assets due to their nature (typically 'physical cash' denominated in Sterling).

IFRS 9 has not altered the classification and measurement of financial liabilities.

The Group's closing IAS 39 balance sheet will consequently open on 1 January 2018 under IFRS 9 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 and amortised cost equivalent in value.
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 31 December 2017 are net of IAS 39 provision. The quantified impact of classification and measurement at 31 December 2017 is £nil.**

Impairment

IFRS 9 replaces 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.

Loss allowances for expected credit losses are to be 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 will be adopted for trade receivables and contract assets.

Loss allowances against in-scope assets are to be 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. Assets can be assessed on an individual or collective basis and assessment should consider forward looking information.

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.

IFRS 9 Financial Instruments (continued)

Scenarios are modelled to determine 12 month and lifetime expected credit losses against assets under said scenarios. Multiple scenarios to allow a probability weighted outcome are expected and while it is not necessary to identify every scenario, and it is advised not to select unlikely scenarios, the International Accounting Standards Board still expect at least one scenario to be included that is 'expecting to default', even if historically or presently there is no indication that a default will occur.

Where an asset has not seen a significant increase in credit risk since its origination ('Stage 1 assets'), 12 month expected credit losses are to be 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 to be 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 to be recognised and interest income is to be calculated against the net carrying amount of the financial asset, rather than the typical gross amount.

IFRS 9 introduces significant forward looking assessments of financial assets requiring loss allowances to be recognised against assets expected to default at any point in their lifetime (or within 12 months for stage 1 assets). IFRS 9's multiple, forward looking scenarios can be expected to bring forward the recognition of loss allowances compared to the existing IAS 39 loss allowance requirements, particularly in the transitional phase through 2018 as the new standard is first applied to substantial pre-existing portfolios 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.

IFRS 9 Qualitative Impairment Impact

Residential and new Buy to Let Mortgages

IFRS 9 has had minimal impact on the Group's mortgage provisions. The Group's core lending, to prime residential and high quality buy to let customers is 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. 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.

Under IFRS 9, the Group's residential and new buy to let provisioning is informed by tailored IFRS 9 provisioning models. The models allow a consistent assessment of mortgage assets, operating as follows:

Staging

- 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.

Default indicators and Probability of default (PD)

The Society has to calculate, 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.

The Society calculates its probability of default 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.

Exposure at default (EAD)

- 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.

Loss given default (LGD)

- 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.

Legacy mortgages

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.

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 is 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 (including legacy Buy-to-Let)	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 (including legacy Buy-to-Let)	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**

IFRS 9 Financial Instruments (continued)

Debt securities

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.

As a result, the Society is not significantly impacted by the IFRS 9 impairment requirements with respect to its debt security exposures.

Trade and other receivables

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 will also be incorporated.

The Society is not significantly impacted by the IFRS 9 impairment requirements with respect to its trade and other receivables.

Impairment Conclusion

The overall quantified impact of IFRS 9 to the Group's provisions compared to the existing IAS 39 provisions is not material.

Hedge Accounting

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

The Society has elected to adopt IFRS 9's hedging requirements for its non-dynamic/'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 2017

1 Statutory percentages

	2017 %	Statutory %
Lending limit	**3.6**	25.00
Funding limit	**15.32**	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:	**2017 %**	Restated 2016 %
Gross capital	**7.36**	8.24
Free capital	**6.26**	7.51
Liquid assets	**23.94**	24.99
Result for the year as a percentage of mean total assets	**0.29**	0.17
Management expenses as a percentage of mean total assets	**1.24**	1.21

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 include 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 2017 and 2016 total assets.

Annual Business Statement for the year ended 31 December 2017 (continued)

Directors at 31 December 2017

	Date of Birth	Date of Appointment	Business Occupation
RJ Bottomley OBE, FCA	**22.05.53**	**22.09.14**	**Financial and Business Consultant** Other Directorships: Newcastle Portland House Limited; Marsden Packaging Limited; MSL Property Care Services Limited; TL Dallas Group Limited; Greggs 1978 Pension Scheme Trustee Limited; The Beckfoot Estate Company Limited; The Craven Family Trust.
DJ Buffham	**13.08.59**	**24.05.10**	**Company Director** Other Directorships: Newcastle Strategic Solutions Limited (appointed 2 January 2018); 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; Echo Financial Services Limited (appointed 16 February 2018).
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
PJ Moorhouse FCCA	**18.01.53**	**31.10.11**	**Company Director** Other Directorships: Newcastle Strategic Solutions Limited; Newcastle Systems Management Limited; MPAC Group PLC.
J Morris BA, FCA	**13.09.56**	**31.10.11**	**Chartered Accountant** Other Directorships: None.
AM Russell BA, FCA, CPA	**18.03.67**	**01.07.10**	**Building Society Deputy Chief Executive & Finance Director** Other Directorships: Newcastle Financial Advisers Limited; Newcastle Mortgage Loans (Jersey) Limited; Newcastle Portland House Limited; The Percy Hedley Foundation.
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; Harrogate and District NHS Foundation Trust.

Documents may be served on any of the above named Directors: "Newcastle Building Society" c/o Addleshaw Goddard LLP (Ref. GAB), Milton Gate, 60 Chiswell Street, London EC1Y 4AG. 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 eighth largest in the UK with assets in excess of c£3.8billion.

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 13 to the Annual Report and Accounts.

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 31 October 2017.

For the year ended 31 December 2017:

- Group total operating income was **£57.9m** (2016: £54.6m), the proportion not arising from UK-based activity is not considered material for the purposes of this disclosure.
- The average number of Group full time equivalent employees was **954.2**, (2016: 873.3) of which **948.9** (2016: 865.9) were employed in the UK and **5.3** (2016: 7.4) in Gibraltar.
- Group profit before tax **£13.1m** (2016: £8.1m) with tax a charge of **£2.2m** (2016: £2.0m). The profit before tax and the tax charged relates to UK-based activity and the UK tax jurisdiction.
- No public subsidies were received by the Group.

Auditors' Report on Country-by-Country Reporting

Independent auditors' report to the Directors of Newcastle Building Society

We have audited the accompanying schedule of Newcastle Building Society for the year ended 31 December 2017 ("the schedule"). The schedule has been prepared by the directors based on the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Directors' Responsibility for the schedule

The directors are responsible for the preparation of the schedule in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013, for the appropriateness of the basis of preparation and the interpretation of the Regulations as they affect the preparation of the schedule, and for such internal control as the directors determine is necessary to enable the preparation of the schedule that is free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the schedule based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the schedule.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the country-by-country information in the schedule as at 31 December 2017 is prepared, in all material respects, in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Basis of Preparation and Restriction on Distribution

Without modifying our opinion, we draw attention to the schedule, which describes the basis of preparation. The schedule is prepared to assist the directors to meet the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013. As a result, the schedule may not be suitable for another purpose.

Our report is intended solely for the benefit of the directors of Newcastle Building Society. We do not accept or assume any responsibility or liability to any other party save where terms are agreed between us in writing.

PRICEWATERHOUSECOOPERS LLP
CHARTERED ACCOUNTANTS
NEWCASTLE UPON TYNE
27 FEBRUARY 2018

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.

IFRS 9 - the accounting standard that establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. Effective from 1 January 2018.

Impaired loans - Loans where an event has occurred which indicates the Group does not expect to collect all the contractual cash flows due, or expects to collect them later than they are contractually due.

Individual Capital Guidance (ICG) - Guidance from the PRA on the minimum level of capital that must be held.

Individual Liquidity Guidance (ILG) - Guidance from the PRA on the minimum quantity of a firm's liquidity resources and the firm's funding profile.

Individually / collectively assessed - Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be incurred.

Interest rate risk - The risk that the value of the Society's net assets or net interest income falls as a result of a change in interest rates.

Internal Capital Adequacy Assessment Process (ICAAP) - The Group's own assessment of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios.

Internal Liquidity Adequacy Assessment Process (ILAAP) - The Group's internal assessment of the liquidity levels needed to meet its regulatory liquidity requirements.

Legacy mortgage portfolios - Mortgage loan books where the Group has ceased new lending and is winding down exposures.

Lending limit - Measures the proportion of business assets not in the form of loans fully secured on residential property.

Leverage ratio - A Basel III ratio which measures Tier 1 capital against total on and off balance sheet assets.

Liquid assets - The total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.

Liquidity Coverage Ratio (LCR) - A Basel III measure of the amount of highly-liquid assets against cash outflows over a 30 day period.

Liquidity risk - The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash inflows and outflows.

Loan-to-value ratio (LTV) - A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates UK residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis) to reflect changes in house prices.

Loans and advances to banks - Treasury investments purchased with banking institutions.

Management expenses - Management expenses represent administrative expense and depreciation. The management expense ratio is management expenses expressed as a percentage of mean total assets.

Market risk - The risk that movements in market risk factors, including re-pricing of assets and liabilities and the imperfect matching of interest rates between different asset and liability types, may adversely impact the Society.

Mean total assets - Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.

Member - A person who has a qualifying share investment or a mortgage loan with the Society.

Net interest income - The difference between interest received on assets and interest paid on liabilities.

Non-Executive Director - A Member of the Society's Board who does not form part of the executive management team. He or she is not an employee of the Society.

Operational risk - The risk of loss arising from inadequate or failed internal processes, people and systems or from external events.

Other lending - Loans and advances secured on traded endowment policies.

Past due - Loans on which payments are overdue including those on which partial payments are being made.

Permanent Interest Bearing Shares (PIBS) - Unsecured, deferred shares that are a form of capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing Members of Newcastle Building Society.

Prime - Prime mortgages are those granted to the most credit worthy category of residential borrowers.

Prudential Regulation Authority (PRA) - Part of the Bank of England and responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.

Renegotiated loans - Loans are classed as renegotiated with the customer's consent, when their terms have changed during the year. Loans and advances are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower.

Repo - Short to medium-term funding agreements which allow a borrower to sell a financial asset, such as Government bonds, as security for cash. As part of the agreement the borrower agrees to repurchase the security at a later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future), it is a reverse repurchase agreement or reverse repo.

Residential mortgage backed securities (RMBS) - Asset backed securities that represent interests in residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and principal).

Residential loans - Residential loans are secured against residential property.

Risk appetite - The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's Members whilst achieving business objectives.

Risk-weighted assets (RWA) - The value of assets, after adjustment under Basel II rules, to reflect the degree of risk they represent. The Society measures RWA using the standardised approach.

Shares - Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.

Shares and borrowings - The total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest.

Solutions - A subsidiary of the Society that offers business to business services through people, process and innovative application of technology. Services include complete systems for smaller societies and white-labelled savings management for a range of banks and building societies.

Solvency ratio - The ratio of total capital to total risk weighted assets.

Subordinated debt / liabilities - A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing Members (other than holders of PIBS).

Tier 1 capital - Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital comprises general reserves from retained profits. Other regulatory adjustments may be made for the purposes of capital adequacy. Under the grandfathering rules of Basel III qualifying capital instruments such as PIBS can be included in other Tier 1 capital (i.e. not Common Equity Tier 1) transferring to Tier 2 over the grandfathering period.

Tier 2 capital - Comprises the Group's qualifying subordinated debt and collective impairment allowance (for exposures treated on a Basel II standardised basis).

Wholesale funding - The total of deposits from banks, amounts owed to other customers and debt securities in issue.

Branch and Financial Advice Centre Directory

Alnwick - 28 Bondgate Within, NE66 1TD	Tel: (01665) 603 344
Ashington - 10 Station Road, NE63 9UJ	Tel: (01670) 815 919
Berwick Upon Tweed - 12 Hide Hill, TD15 1AB	Tel: (01289) 306 417
Carlisle - 2/4 English Street, CA3 8HX	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