SCOTTISH BUILDING SOCIETY

# Annual Report & Accounts

For the year ended 31 January 2017

# Report & Accounts

For the year ended 31 January 2017

"I am delighted to report another healthy set of results, with Profit Before Tax for the year at £1.27million, and mortgage growth of 8.8%."

**MARK L THOMSON**
CHIEF EXECUTIVE

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# Chairman's Report

"We have successfully embedded our loyalty programme which is designed to benefit both mortgage and savings members."

**ROB GOLBOURN**
CHAIRMAN

*"We remain very positive about the future and we thank members for their continued support."*

## FOCUS ON MEMBERS

As a mortgage and savings institution owned by our members, Scottish Building Society places their interests at the focus of everything we do. Our key strategic aim of delivering long term value to members is central to Board discussions, and building on efficient financial management with an appropriate balance of growth and cost control, we have successfully embedded our loyalty programme which is designed to benefit both mortgage and savings members.

A close relationship with our members is of course an essential element of mutuality, and we continue to achieve this through holding our AGM in different locations where our members are based around the country, as well as communicating through our Society magazine, periodic mailings, member forums and our online member panel. The AGM also provides members with the opportunity to ask questions of the Board, whether on the day or by prior submission.

## FINANCIAL OVERVIEW

The Society has a strong capital base and our aim is to generate sufficient profit to maintain this strength. We have no need to maximise annual profits, as is the case with Banks and other companies who must satisfy their shareholders and distribute dividends. Our pre-tax profit of £1.27 million for the past year is within the range we target to maintain financial stability, and is achieved after reducing our margin to provide loyalty benefits to both mortgage borrowers and savers.

Our strategic plans going forward are based on a settled financial structure, including the appropriate level of liquid assets and efficient management of costs, including the cost of maintaining a distribution network of Branches and agents throughout Scotland. Regulatory costs remain high, but we are confident that the Society is soundly based for future progress including the increased use of technology.

## OUR PEOPLE

As we build for the future we are proud of the commitment shown by our management team and staff to the growth and development of the Society. On behalf of the Board I would like to thank all our colleagues and agents throughout the country for their hard work and contribution to our success.

During the year we have seen changes on the Board. Alexa Henderson retired from the Board in November and I would like to take this opportunity to thank her for fifteen years of conscientious service as a Director including four years as Chairman. The Board and management will greatly miss her positive contribution and guidance and we wish her every happiness for the future.

Also during the year, Aileen Brown joined our Board in the role of Finance Director, and I am sure members will join me in wishing Aileen a long and happy association with the Society.

## LOOKING FORWARD

This is a time of some uncertainty following the UK referendum vote to negotiate our departure from the European Union, and indeed the only certainty is that the forecasts from many economic commentators have so far been proved wrong. The UK is showing a strong economic performance to date, although the fall in the world oil price had a negative effect in the Aberdeen area. Bank Rate set by the Bank of England remains at a very low level which is good for borrowers, but difficult for savers, and the Society aims to treat members fairly at all times by consistently providing the best possible rates to both our mortgage and savings members. Overall we remain very positive about the future and we thank members for their continued support.

**ROB GOLBOURN**
CHAIRMAN

29 March 2017

# Chief Executive's Review

"The provision of long-term value to our members is at the very heart of our strategy and cannot be assessed by short-term measures."

**MARK L THOMSON**
CHIEF EXECUTIVE

**£1.27** million pre-tax profit for 2017

**£25.2** million mortgage asset growth

*"Our members generally regard us highly in terms of trust and in the performance of the accounts they maintain with us."*

## OUR PERFORMANCE

When assessing the performance of a financial institution there can be a tendency to focus solely on financial results, which tells only part of the story. Delivering consistently strong financial results is, of course, essential for the security and stability of any business, and I am delighted to report another healthy set of results, with Profit Before Tax for the year at £1.27 million; an achievement which was again directly in line with our five-year plan.

As a mutual institution, owned by its members, it is not our intention to maximise profit, but to simply produce a sufficient return to ensure the Society maintains its already strong capital position. The posting of another year's profits further strengthens the Society's reserves, which along with a solid liquidity coverage ratio, meets our strategic aim of maintaining our financial strength. With a clear strategy to grow our business in a balanced, prudent and controlled manner, our financial strength is expected to increase over the coming years, keeping the Society in an excellent position to withstand any future shocks to the financial system.

The provision of long-term value to our members is at the very heart of our strategy and cannot be assessed by short-term measures. Since the introduction of our Loyalty Promises in the autumn of 2015, the Society has consistently delivered against these, which are designed to provide our members with the reassurance that they will receive long-term value throughout their relationship with us.

Feedback from our members remains very important to us, and I was particularly pleased with the positive results from our various member surveys over 2016, from which we learned that our members generally regard us highly in terms of trust and in the performance of the accounts they maintain with us. We also received very high scores in respect of our customer service, which clearly reflects very well on my colleagues, whose aim is to consistently deliver the best customer proposition we are able to provide to our members.

## MORTGAGES

Over my four-year tenure as Chief Executive my Senior Management Team has been engaged in making regular improvements to the Society's mortgage proposition to ensure we remain a credible provider of homeowner finance to the sectors of the market in which we wish to participate.

An overhaul of our product range and a 'root-and-branch' review of our service proposition are just two of the activities we have undertaken to complement our already successful approach to underwriting, where every mortgage application is assessed on its individual merits by experienced lending professionals.

This desire to treat every applicant (and, indeed, every member) as an individual is particularly important when dealing with potential borrowers who may not fit the automated decision-making systems of the larger lenders, where an applicant's individual circumstances are rarely considered. This has traditionally been the case for those looking to build their own home, or whose special circumstances do not comfortably 'tick all the boxes' of a lender's scorecard. During this past Financial Year we have also seen an increasing number of applications from older borrowers who, despite being totally acceptable in terms of risk, have found difficulties obtaining mortgage finance from mainstream lenders.

Being able to provide suitable and affordable products to these groups of individuals, together with our promise to offer all mortgage borrowers a fair rate throughout the term of their relationship with us, has contributed to a very successful year in terms of the growth of our mortgage assets by some 8.8% to £311 million – a period where the credit quality of our lending portfolio remains high.

# Chief Executive's Review (continued)

## SAVINGS

I'm pleased to report that the harmonisation exercise to simplify our savings product range was completed in November 2016. This three-year exercise had previously seen the simplification of the Society's product range, designed to ensure our products remain fair and transparent and that all savers receive long-term value throughout their relationship with us.

We continue to appreciate that it is difficult for savers to receive a real return on their investments during this sustained low interest rate environment, and we have purposely maintained our savings rates across our product range at a level generally above market rates while we continue to achieve a fair balance between the interests of both our savers and our mortgage borrowers.

Our Loyalty Cash ISA, which was launched in April 2016, is designed to pay a higher rate (over time) on funds deposited with the Society, compared with others available elsewhere in the market. It is just one of the ways we seek to reward our members for their loyalty to the Society.

## THE YEAR AHEAD

During the year ahead we will continue to consider ways to deliver improvements to the way we operate, taking account of the feedback we receive from our members. It is apparent that a number of our members would like to transact with us online, particularly in relation to savings accounts. With this in mind, we are currently considering a number of options, which will allow the Society to offer such functionality, and it is my intention to keep our members updated on progress in this regard through regular updates to our website, and in our magazine, 'Society'.

Our key focus, in addition to maintaining the Society's financial strength, remains the delivery of long-term value to our members throughout the term of their relationship with Scottish Building Society.

**MARK L THOMSON**
CHIEF EXECUTIVE

29 March 2017

# Member Survey Results 2016

**132** Member surveys completed

51% male

37% female

12% did not answer

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**87%** agree or strongly agree that the overall service they receive from the Scottish is EXCELLENT

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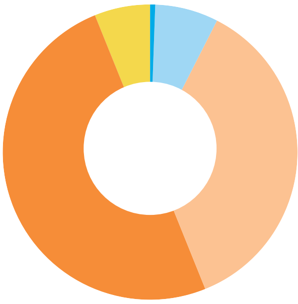
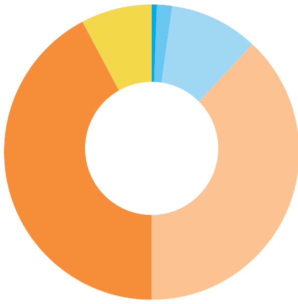
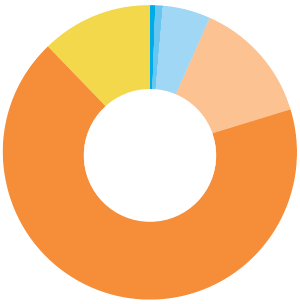


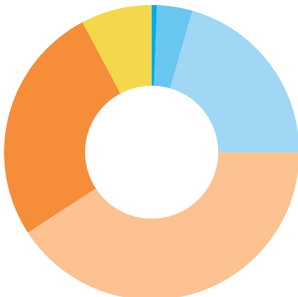
**86%** agree or strongly agree that they **trust the Scottish as a provider of financial products**



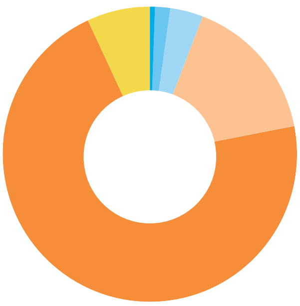
**80%** agree or strongly agree that they **believe the Scottish is financially strong**



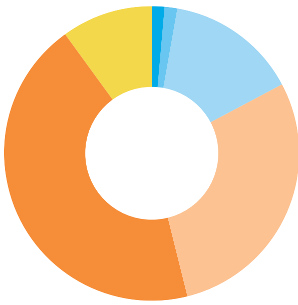
**81%** agree or strongly agree that they **find staff at the Scottish helpful, professional and efficient**



**67%** agree or strongly agree that the **range of products offered is sufficient and comprehensive**



**86%** agree or strongly agree that **communications they receive from the Scottish are clear and easy to understand**



**73%** agree or strongly agree that they **would recommend the Scottish to family or friends in the future**

Strongly Agree | Agree | Neither Disagree or Agree | Disagree | Strongly Disagree | Not answered

## Communication preference

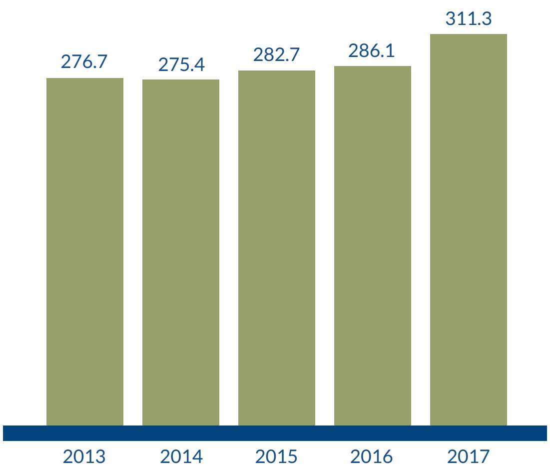
# Group Key Results

As a building society, our principal purpose is to provide mortgages for homeowners funded by savings raised from our members whilst ensuring our financial strength is maintained, as evidenced by strong Capital and Liquidity measures.

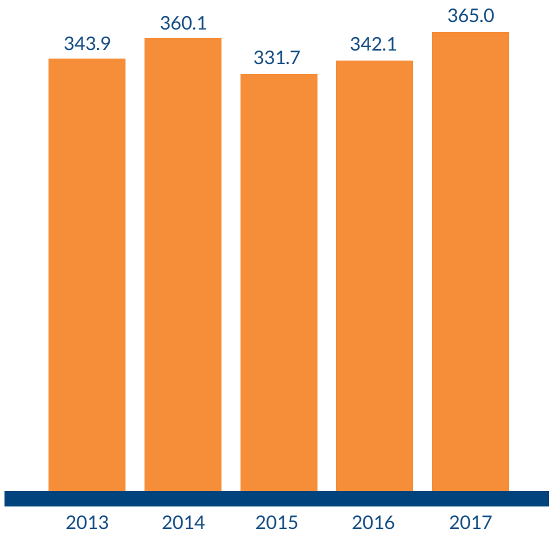
Total Assets
**£409.2 million**

Liquid Assets
**£95.9 million**

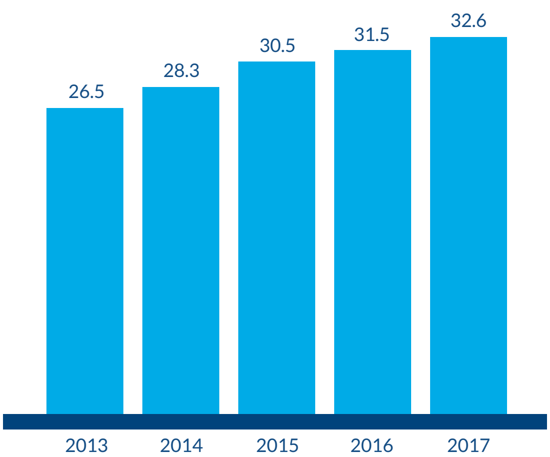
Profit before tax
**£1.27 million**



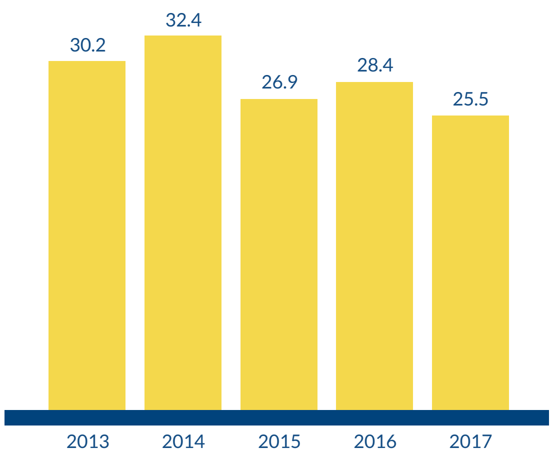
MORTGAGE BALANCES (£m)



SAVINGS BALANCES (£m)



CAPITAL (RESERVES) (£m)



LIQUID ASSETS (as % of Shares & Deposits)

Figures for 2015 and onwards have been prepared under FRS 102, with figures for 2013 and 2014 prepared under UK GAAP.

# Directors' Report

## INTRODUCTION

The Directors present their 168th Annual Report, together with the Annual Accounts and Annual Business Statement, for the year ended 31 January 2017.

## OUR MISSION, VISION AND VALUES STATEMENTS

The Society's Mission Statement is that "we aim to be the Building Society of choice for every stage in life".

Our Vision is "to remain Scottish, independent and mutual, providing a first class service and quality products for all members" and the values of the Society are:

- To provide professional and friendly service and to be clear and straightforward in all our communications with our members, who are both our customers and the owners of our business.
- To operate in accordance with the highest standards of integrity and transparency in all relationships with members, business partners and regulators.
- To earn the respect and trust of our members and to be socially responsible in everything we do.
- To maintain the Society's financial strength and stability and aim to be as cost-effective as possible.

## BUSINESS REVIEW

The Business Review is covered in the Chairman's Report and Chief Executive's Review on pages 2 to 6.

## PROFIT AND CAPITAL

Profit for the year before tax amounted to £1.27million (2016: £1.33million) representing another strong performance with excellent growth in our mortgage book of 8.8% (2016: 1.2%). We have continued to invest in our loyalty initiatives and increased our reserves to provide scope for further innovation in how we serve members.

The Society is required to set out its capital position, risk exposures and risk assessment processes in its Pillar 3 disclosures document which is available on the Society's website or from the Society's Finance Director.

## LIQUIDITY

Total cash and investments at 31 January 2017 amounted to £95.9million which represented 25.5% of total shares and borrowings, managed down from £100.9million (28.4%) at 31 January 2016. The Society's continuing aim is to maintain an appropriate level of liquidity at all times. Funding is invested mainly in mortgage assets with sufficient liquid assets for risk management purposes and in accordance with regulatory requirements.

## INTEREST RATES

The Bank of England base rate reduced to 0.25% on 4 August 2016, this being the first rate change since March 2009. As a result the Society's Standard Variable Rate for mortgages reduced.

When the Bank Rate reduced in August 2016, the Society's savings rates were generally higher than those offered elsewhere in the market, and after careful consideration the decision was made to reduce the variable rates across the entire product range.

The harmonisation exercise to simplify the savings product range completed in November 2016, ensuring products remain fair and transparent and that all savers receive long-term value throughout their relationship with us. The Loyalty Cash ISA was launched in April 2016 and is designed to pay a higher rate, over time, on funds to reward members for their loyalty.

## MORTGAGE ARREARS AND FORBEARANCE

At 31 January 2017 the Group had only nine mortgage accounts in arrears for 12 months or more (2016: eight). The total arrears outstanding on these accounts was £70,264 (2016: £77,051) and the aggregate capital balance was £849,159 (2016: £763,767). Three properties were taken into possession during the year (2016: two).

The Society uses a number of forbearance measures to assist those borrowers who are, or could be, approaching a point of experiencing financial difficulty. Such measures include agreeing a temporary payment concession in order to reduce the borrowers' financial pressures. We expect borrowers to resume normal payments once they become able to do so. As at 31 January 2017 there were 50 cases benefiting from the Society's forbearance measures (2016: 58) with total outstanding capital balances of £3.3million (2016: £4.0million). The Society makes provisions for any expected loss resulting from accounts in arrears in accordance with the Board approved policy.

## KEY PERFORMANCE INDICATORS

The Board and management monitor a range of performance indicators to assess the ongoing health of the Society. The financial indicators are shown in the table below – and some are also shown graphically on page 9. Their significance is explained as:

**Total Assets:** Consisting primarily of Mortgage Assets and Liquid Assets, these have increased by 5.2%.

**Mortgage Assets:** One of the key reasons for the Society's existence is to promote home ownership through mortgage lending. During the past year Mortgage Assets have increased by 8.8%.

**Share Balances:** Another key reason for the Society's existence: to encourage saving and investment. Savings balances have been increased by 6.7% during the past year.

**Reserves:** The accumulated profits of the Society over more than 168 years of operation, which provide the capital which helps to maintain the Society's financial strength. These have increased by £1.1million in the year through the addition of the year's profits after tax.

**Net Interest Margin:** The income generated by the Society from its operations, expressed as a percentage of mean total assets. This has decreased by 0.11 percentage points in the year as we continue to provide long-term value to members.

**Liquidity:** Total cash and investments held by the Society at the year-end, expressed as a percentage of shares and borrowings. This has been managed down by 2.9 percentage points in the year and remains at a level well above regulatory requirements.

**Gross Capital:** This ratio is expressed as a percentage of shares and borrowings and demonstrates the relationship between the Society's capital and its liabilities to investors. It reflects the continuing strength of the Society whilst remaining well within prudent guidelines. This has decreased by 0.2 percentage points during the year, reflecting the growth in mortgage assets.

**Asset Growth/Mortgage Asset Growth:** The annual increase (decrease) in the Society's Total Assets and Mortgage Assets, shown as a percentage.

## GROUP KEY FINANCIAL PERFORMANCE INDICATORS 2013-2017

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| **Total Assets** | £387.8m | £397.2m | £378.2m | £388.9m | £409.2m |
| **Mortgage Assets** | £276.7m | £275.4m | £282.7m | £286.1m | £311.3m |
| **Share Balances** | £343.9m | £360.1m | £331.7m | £342.1m | £365.0m |
| **Reserves** | £26.5m | £28.3m | £30.5m | £31.5m | £32.6m |
| **Net Interest Margin** | 1.65% | 1.71% | 1.70% | 1.68% | 1.57% |
| **Liquidity** | 30.2% | 32.4% | 26.9% | 28.4% | 25.5% |
| **Gross Capital** | 7.4% | 7.7% | 8.8% | 8.9% | 8.7% |
| **Asset Growth** | 13.2% | 2.4% | (4.9%) | 2.8% | 5.2% |
| **Mortgage Asset Growth** | 7.0% | (0.5%) | 2.6% | 1.2% | 8.8% |

Figures for 2015 and onwards have been prepared under FRS 102, with figures for 2013 and 2014 prepared under UK GAAP.

## NON-FINANCIAL KEY PERFORMANCE INDICATORS

The Board also monitors a number of other indicators on a regular basis. Amongst these, it is pleasing to report that:

- More than 85% of mortgage borrowers reaching the end of their initial incentive period have remained with the Society.
- Less than 1.5% of mortgage accounts have arrears greater than 1.5% of their mortgage balance.

# Directors' Report (continued)

## REGULATION AND COMPLIANCE

As has been the case for a number of years, the Society has continued to ensure that it remains compliant with the various changes to regulation affecting the way in which we operate.

Last year's Report referred to implementation of the Mortgage Credit Directive (MCD) and the new Senior Managers & Certification Regime, both of which came into force in March 2016 and work continued throughout the year to ensure that both sets of changes were appropriately embedded. We also ensured that the Society was ready for changes relating to the taxation of savings interest from April 2016; reporting requirements for the Financial Service Compensation Scheme and new rules regarding the way that savings accounts are described in our marketing literature and on our website. The latter changes applied from December 2016.

There are a number of other regulatory changes applying to both mortgages and savings which come into force in 2017 and beyond and the Society will ensure that these are addressed as appropriate. The Society is required to have regard to the principles laid down in the UK Corporate Governance Code. This is covered in more detail in the separate Corporate Governance Report on pages 18 to 22.

## PRINCIPAL RISKS AND UNCERTAINTIES

The Society has a risk-averse strategy and maintains a comprehensive Risk Register reflecting the impact and likelihood of adverse events, which is regularly reviewed by the Board and covers all aspects of the business.

The principal business risks to which the Society is exposed are considered to be:

- **Credit Risk:** This relates to the risk that mortgage borrowers or treasury counterparties, to whom the Society has lent money, default on their obligation to pay. We seek to mitigate credit risk principally through the careful management of our underwriting policy and process, ensuring that all loans meet the criteria laid down in our Lending policy which is reviewed on a rolling basis at least annually and overseen by the Retail Credit Committee. The Society's exposure to treasury counterparties is carefully controlled in accordance with the limits set out in our Liquidity policy.
- **Interest Rate Risk:** This is the risk of the Society's financial position deteriorating as interest rates move over time and the failure to preserve interest rate margins arising from an increase in the cost of funds or a decrease in the earning capacity of assets. We seek to manage interest rate risk by matching the characteristics of mortgage and savings products and through the use of financial instruments within defined parameters set out in our Liquidity and Financial Risk Management policies.
- **Liquidity Risk:** This relates to the Society's ability to meet its financial obligations as they fall due. The Society has policies in place to ensure it maintains sufficient funds in liquid form at all times and stress tests are carried out regularly to confirm that the Society can withstand normal and abnormal cash outflows.
- **Operational Risk:** This is the risk of a loss arising from inadequate or failed internal processes or systems, human error or external events, including cyber risk. Processes and systems are in place to minimise these risks.
- **Strategic and Reputational Risk:** The risk of the Society entering unprofitable markets or offering unprofitable products. The Board has a duty to ensure that the Society makes an adequate amount of profit to maintain capital ratios at a sufficient level to provide long-term financial strength and stability for all members. This also includes risk arising from increased regulation by the financial services regulators.
- **Conduct Risk:** The risk of the Society failing to treat its customers fairly, with resulting detriment to those customers. The Conduct Risk Committee oversees the arrangements in place to ensure that the Society continues to keep the needs of its members at the heart of everything we do.

A further risk stems from the continuing uncertainty inherent in the current economic environment and the impact of the UK's exit from membership of the European Union. The Society has carried out an initial evaluation of the impact of Britain's decision to leave the EU and will continue to monitor developments. The only minor risk currently identified is the possibility of change in the regulatory environment. There are also additional risks arising from (a) the impact of regulatory changes already mentioned and (b) the potential for further contributions to the FSCS levy which would impact upon the Society's capital and ability to compete over a period of time.

The Society will continue to adopt a cautious approach in the coming financial year, seeking moderate managed growth in order to maintain financial stability, whilst providing suitable mortgage and savings products to customers.

## FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Society has a formal policy for the management of financial risk, including the arrangement of appropriate financial instruments to provide a hedge against identified exposures in fixed-rate lending. Particular risks including credit, liquidity and interest rate risk are considered in Note 27 to the Accounts.

As a key component of the Society's management of financial risk, the Management Asset & Liability Committee (MALCO) meets at least monthly to make decisions within Board-prescribed parameters on product pricing, margin policy, hedging strategy and interest rate risk strategy. The MALCO reports to the Board's Asset & Liability Committee (ALCO), which in turn reports to the Board.

## CAPITAL REQUIREMENTS

The Board has reviewed its risk assessment to meet the requirements of Basel III and the associated Capital Requirements Regulations and Directive (CRR/CRD4). The Society is required to conduct an assessment of the adequacy of its capital and resources, known as the Internal Capital Adequacy Assessment Process (ICAAP), which is regularly reviewed and revised to reflect the prevailing economic climate.

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 which came into effect on 1 January 2014 place certain reporting obligations on financial institutions that are within the scope of CRD4. The purpose of the regulations is to provide clarity on the source of the Society's income and the location of its operations. The annual reporting requirements for the Society as at 31 January 2017 are provided in Note 31 to the Accounts.

## GOING CONCERN

As part of the Society's forward planning process, the Directors have considered forecasts showing the Society's capital, liquidity and financial position for the next three years under normal operating conditions. They have also considered the potential effect on the Society's business, financial position, capital and liquidity under stressed operating conditions.

The Directors are satisfied that the Society has adequate resources to continue in business for the foreseeable future. For this reason, the Accounts continue to be prepared on the going concern basis.

## CORPORATE SOCIAL RESPONSIBILITY (CSR)

The Society recognises that CSR is concerned with how businesses take account of the social, environmental and economic impacts of their operations. We seek to be a good corporate citizen in all aspects of our operations and activities and aim to be recognised as a socially responsible business by our members, our staff and the communities in which we operate. This is articulated in our Corporate Social Responsibility policy and regularly monitored by the Board.

### Customer Service and Conduct of Business

The Society is committed to treating its members fairly and to acting with honesty and integrity in its relationships with members, regulators and the wider community. Continuous review and improvement is used to build on the high level of service throughout the Society and the many positive aspects already in place.

### Donations and Community Support

The Society continues to provide support for local events in areas around its branches, as well as supporting designated charities in each of its six area offices during the past year, as voted for by the local membership. New charities are in place for 2017, again chosen by local members. These are:

***Ravelrig Riding for the Disabled (Edinburgh and East Scotland)***

Founded in 1986, Ravelrig RDA provides life changing therapy, achievement and enjoyment to people with disabilities through horse riding.

***St Margaret Hospice (Glasgow and West Scotland)***

Since 1950, St Margaret Hospice has touched the lives of thousands of patients with advanced life-limiting illness, their families and friends.

***Irvine & Troon Cancer Care (South West)***

Irvine and Troon Cancer Care offers support to those facing cancer by providing a patient transport service and information about locally available services.

***Elsie Normington Foundation (North Scotland)***

Elsie Normington Foundation is raising funds to build a specialist play centre, respite wing, community coffee shop and supported housing for children and young adults with learning disabilities in Inverness.

***Rowan Boland Trust (Borders)***

The Trust offers financial assistance to young people living in the Borders with proven ability to further their sporting careers, whatever their chosen support.

# Directors' Report (continued)

In addition to the designated charities, we have also provided local sponsorship throughout the year, including acting as a collection point for the Cash for Kids Mission Christmas Appeal.

The Society makes charitable donations to reflect and encourage members' participation in the Society's Annual General Meetings each year. £1,250 was donated in 2016 to the Lavender Touch charity in Galashiels for postal and online votes received and for members who attended the AGM in person at Abbotsford, Sir Walter Scott's former home near Galashiels. This year's AGM will be held at Surgeons' Hall, Edinburgh on 31 May and a donation will be made to Ravelrig Riding for the Disabled (Edinburgh and East Scotland), made up of £2 for every voting member attending and 50p for every postal and online vote received.

The Society does not make donations for political purposes.

**Environmental issues**

The Society aims to minimise the environmental impacts of all our operations by striving to reduce unnecessary consumption, to re-use and recycle where possible, to manage energy usage wisely and to promote the control of environmental issues at all levels. We continue to use paper from sources approved by the Forestry Stewardship Council wherever possible, to recycle waste paper and other materials and to encourage our staff to be environmentally aware at all times. Our vehicle replacement policy includes a maximum $CO_2$ emissions limit of 130g/km.

Following the successful introduction of online voting facilities, we also intend to reduce our impact on the environment in the future by allowing members to opt to receive future AGM packs electronically.

**Employee Policies**

The Society aims to create an environment in which all staff feel valued, where discriminatory behaviour is not tolerated and all employees are encouraged to enhance their skills through personal development and training programmes linked closely to their specific role and annual performance review.

## DIRECTORS

The following individuals were Directors of the Society during the year to 31 January 2017:

**Non-Executive Directors**

| | |
|---|---|
| **Robert Golbourn MBA FCIBS** | Chairman |
| **Raymond J Abbott CA** | Vice-Chairman, Senior Independent Director and Chairman of Nomination & Remuneration Committee |
| **David Peebles MSc DipM FCIBS MCT** | Chairman of Audit Committee |
| **Alexa H Henderson BSc CA** | Retired 30 November 2016 |
| **John C Ogston FCIBS** | Chairman of Retail Credit Committee |
| **Simon M Pashby BA FCA** | Chairman of Operational Risk Committee |
| **James Coyle BAcc CA FCIBS** | Chairman of Asset & Liability Committee |

**Executive Directors**

| | |
|---|---|
| **Mark L Thomson FCIBS** | Chief Executive<br>Chairman of Conduct Risk Committee |
| **Aileen Brown BA CA** | Finance Director (appointed 1 August 2016) |

None of the Directors had any beneficial interest in the Society's subsidiary undertaking, SBS Mortgages Limited, as at the year end. The Society maintains liability insurance cover for Directors and Officers as permitted by the Building Societies Act 1986.

## ELECTION OF DIRECTORS

The following Directors are standing for election/re-election:

- **Robert (Rob) Golbourn** is retiring under Rule 24(1)(j), having passed the age of 70 and having been approved as eligible for re-election by resolution of the Board. The Board acknowledges his extensive experience and continuing valuable contribution as a Non-Executive Director and as Chairman in coming to that decision.
- **Aileen Brown** has joined the Board since the 2016 Annual General Meeting and is retiring in accordance with Rule 25(4).
- **John (Jack) Ogston** and **Mark Thomson** are retiring under Rule 26, which requires a proportion of the remaining Directors to retire from office by rotation each year.

All of the above, being eligible under the Rules, offer themselves for election/re-election at the Annual General Meeting to be held on 31 May 2017.

Biographies of all current Directors, including those seeking election/re-election, appear on pages 16 & 17.

## STAFF AND AGENTS

The Directors recognise the contribution that staff at all levels make to the continuing success of the Society and would once again like to record their appreciation for the efforts made by everyone, particularly in what has been another very busy and challenging year.

The Directors also wish to acknowledge the assistance provided by our agency network that enables the Society to offer a counter service to members throughout Scotland, particularly in rural areas.

## POST BALANCE SHEET EVENTS

The Directors do not consider that there have been any events since the year-end that have a material effect on the financial position of the Society.

## SUPPLIER PAYMENT POLICY

The Society's continuing policy concerning the payment of its trade creditors is to pay within the agreed terms of credit, once the supplier has discharged their contractual obligations. The average number of days' credit taken to pay suppliers during the year ended 31 January 2017 was eighteen (2016: ten).

## AUDITOR

Our auditor, KPMG LLP, is willing to continue in office and the Board is happy to recommend their re-appointment as auditor. A resolution to that effect will be proposed for consideration at the Annual General Meeting to be held on 31 May 2017.

By order of the Board

**AILEEN E ROSE**
SECRETARY 29 March 2017

# Board of Directors

**Robert (Rob) Golbourn** is a Fellow and former Member of Council of the Chartered Institute of Bankers in Scotland. He spent 30 years with Clydesdale Bank, in various management positions and later in senior roles including Regional Manager, Treasurer and Head of Credit. In 1994 he joined Scottish Widows, then an independent mutual, to set up a new banking subsidiary which grew to become a well-established operator in the direct and intermediary markets. He retired as Managing Director of Scottish Widows Bank in 2003. Rob keeps well up to date with financial sector issues through a wide network of contacts established throughout his career. He joined the Board in 2006 and was appointed Society Chairman in June 2015, having previously been Vice-Chairman, Senior Independent Director and Chairman of the Nomination & Remuneration Committee and of the Audit Committee.

**Raymond Abbott** is a Chartered Accountant by profession and has worked in private equity and investment for over twenty years. As the former managing director of Alliance Trust Equity Partners he was responsible for strategic development. Previously he founded the UK venture investor Albany Ventures and prior to that was Director of Investment at British Linen Bank. Raymond also serves as Chairman of Foresight 3 plc. He therefore brings a wealth of financial experience to the Board. Raymond joined the Board in June 2013 and is currently Vice-Chairman, Senior Independent Director and Chairman of the Nomination & Remuneration Committee.

**David Peebles** joined the Board in 2006 and is currently Chairman of the Audit Committee (having previously chaired the Asset & Liability Committee). He is a Fellow of the Chartered Institute of Bankers in Scotland and a Chartered Banker. He has a Postgraduate Diploma and a Masters Degree in Marketing and is also a Fellow of the Association of Corporate Treasurers. As a former bank Treasurer he has an in-depth knowledge of Risk and Balance Sheet management. David is Managing Director of XM International Associates Ltd which provides treasury consultancy advice to a diverse group of financial services organisations worldwide.

**John (Jack) Ogston** joined the Board in July 2013 and chairs the Retail Credit Committee. Jack is a Fellow of the Chartered Institute of Bankers in Scotland, having spent 36 years with Clydesdale Bank, including a number of management positions and latterly as Head of Corporate & Structured Finance in Scotland. He has significant board and lending experience and is currently a non-executive director of Vehicle Professionals Ltd, Constant Progress Ltd, Equator Capital Ltd and Toward Technology Ltd.

**Simon Pashby** is a Chartered Accountant with almost 30 years' experience working in financial services, with 15 years as an audit partner responsible for signing audit opinions for regulated firms. He has experience of advising a wide range of organisations on risk, regulation and controls. Simon retired from KPMG in 2012 and now works as an independent non-executive director, and maintains his current financial knowledge as a Fellow of the Institute of Chartered Accountants. He is Vice Chairman of the Medical Protection Society, a members' mutual fund which provides indemnity services to the medical profession, where he chairs the audit and risk committee. Simon is also a non-executive director of the Shepherds Friendly Society Limited where he chairs the audit committee. Simon joined the Board in October 2014 and currently chairs the Operational Risk Committee.

**James (Jim) Coyle** was appointed to the Board in March 2015 and currently chairs the Asset & Liability Committee (ALCO). Jim is a non-executive director of HSBC Bank plc and Marks & Spencer Financial Services plc, Chairman of HSBC Trust Company (UK) Limited, Chairman of the Audit Committee of Honeycomb Investment Trust plc and a member of the Board of Scottish Water. He is a Fellow of the Chartered Institute of Bankers in Scotland, on the Council of the Institute of Chartered Accountants of Scotland and a member of the Financial Reporting Council's Financial Reporting Review Panel and Monitoring Committee. Jim retired from Lloyds Banking Group in mid-2015, where he had been Group Financial Controller and previously a Divisional Finance Director and a Director of Scottish Financial Enterprise and Chairman of the Audit Committee of Vocalink plc.

**Mark Thomson** was appointed as Chief Executive on 1 May 2013, having joined the Society in April 2012 in the role of Chief Operating Officer and been appointed to the Board in October 2012. He is a Fellow of the Chartered Institute of Bankers in Scotland and a Chartered Banker. During his career of 30-plus years, Mark has worked in a variety of roles in retail banking, including 16 years at Scottish Widows Bank, where his responsibilities included credit risk management and compliance, as well as a wide range of operational activities. Mark was appointed to the Board of Scottish Widows Bank in January 2006 as Credit Director – a position he held until joining the Society. Mark currently chairs the Society's Conduct Risk Committee.

**Aileen Brown** joined the Board as Finance Director in August 2016. A Chartered Accountant, Aileen brings broad experience at board and senior management level to the role. Most recently she was Interim Finance Director at Scottish Friendly and prior to that was Group Chief Financial Officer and Company Secretary with Braveheart Investment Group plc. Aileen has held Board level positions in a variety of sectors and worked in corporate finance and professional services including five years with Ernst & Young. Aileen currently chairs the Society's Management Asset & Liability Committee.

# Corporate Governance Report

The Directors are responsible for the governance of the Society, on behalf of the members, and are committed to good practice in Corporate Governance. They have regard to the principles of the UK Corporate Governance Code for listed companies issued in September 2014 ('the Code') as it applies to building societies, in accordance with the expectation of the regulators.

## THE ROLE OF THE BOARD

The principal functions of the Board are to set the Society's strategy, as articulated in the Corporate Plan and annual business plans agreed by the Board, to ensure that the necessary financial and human resources are in place for the Society to meet its objectives, and to review management performance. The Board is responsible for succession planning for both Executive and Non-Executive Director positions. As part of its annual evaluation process, the Board considers the balance of skills and experience it requires, the requirements of the business, and recommends change where appropriate.

The full Board meets regularly with additional meetings as required. In 2016-17 there were eleven Board meetings, including a specific meeting to consider future strategy and the Corporate Plan. A table showing details of Directors' attendance during the year in relation to Board and Committee meetings appears on page 21 as part of this report.

There is a schedule of matters reserved for Board decision and the Board has delegated certain responsibilities to the Committees described below, all of which report to the Board. Minutes of each Committee's meetings are distributed to all Board members and the Chairman of each Committee provides a report at the Board meeting following any meeting of that Committee. The terms of reference for all Committees are available on the Society's website and the membership of committees is reviewed annually. The Society maintains liability insurance cover for Directors and Officers.

**Audit Committee:** This Committee met on four occasions during the year and is chaired by an independent Director. The Committee considers regulatory compliance matters and adequacy of internal controls. It also reviews audit reports, monitors the effectiveness of the internal audit function and agrees the annual internal audit plan. It considers and recommends to the Board (for approval by the members) the appointment or re-appointment of the external auditors, and the policy on the engagement of the external auditors for non-audit services and approval of their fees. The Committee also monitors the external auditors' independence, objectivity, competence and effectiveness. It also ensures that the systems of accounting, business control and management of information are adequate for the Society's needs. At least annually the Committee meets with the external auditors without members of the Management team being present. As required by the Code, the Committee provides advice to the Board confirming that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the Society's performance, business model and strategy.

The Committee comprises three Non-Executive Directors who all have relevant financial experience. David Peebles chairs the Committee; other members during the year were Raymond Abbott and Simon Pashby. The Society Chairman and members of senior management attend by invitation, together with representatives from the internal and external auditors.

**Asset & Liability Committee (ALCO):** This Committee held nine meetings during the year and its remit includes monitoring capital and liquidity, balance sheet structure, financial risk management, pricing of new and existing products, and monitoring of treasury activities – including counterparties, interest rate risk and basis risk and performance against the Society's overall Financial Risk Appetite. It also oversees the work of the Management Asset & Liability Committee, which meets monthly.

The Committee comprises three Non-Executive Directors, together with the Chief Executive, Finance Director (from August 2016) and Head of Finance. The Committee was chaired by Jim Coyle; other Non-Executive members during the year were Alexa Henderson (until the end of November 2016) and David Peebles. Other members of senior management and the Finance team attend by invitation.

**Retail Credit Committee:** This Committee provides Board oversight of retail credit risk. Membership currently consists of two Non-Executive Directors (Jack Ogston and Rob Golbourn), the Chief Executive and Head of Lending. Meetings are attended by other relevant staff as necessary. Jack Ogston chairs the Committee.

The Committee held six meetings during the year and its remit includes reviewing lending policies, monitoring of mortgage market conditions from a credit risk perspective, reviewing the credit quality and risk profile of the mortgage book, assessing credit risks associated with new and existing mortgage products, overviewing lending decisions, monitoring arrears and reviewing specific and general loss provisions and general oversight of performance against the Society's Credit Risk Appetite. Any recommendations for changes to policies are referred to the Board for approval.

**Nomination & Remuneration Committee:** This Committee reviews Board constitution, skills, performance, succession plans and Director elections and is responsible for remuneration policy for all Directors and for making recommendations to the Board regarding general remuneration and contractual arrangements. It also supervises the process for appointment of new Directors. All the Non-Executive Directors are members of the Committee, which is chaired by the Senior Independent Director (Raymond Abbott). The Chief Executive attends by invitation but takes no part in any discussion of his own remuneration. There were six meetings during the year.

**Conduct Risk Committee:** This Committee has been established by the Board to provide assurance that members (or potential members) are being treated fairly and consistently and that Conduct Risks are being appropriately managed by monitoring performance against the Society's Conduct Risk Appetite. The Committee is chaired by the Chief Executive, and consists of one Non-Executive Director (Rob Golbourn), the Finance Director (from August 2016), the Chief Operating Officer, the Head of Lending, the Secretary & Head of Compliance (until 30 November 2016), the Head of Marketing and Communications and the Head of Strategic Development. Other members of the Management team attend as required. The Committee held five meetings during the year.

**Operational Risk Committee:** This Committee's primary role is to monitor performance against the Society's Operational Risk Appetite and the Committee met on five occasions during the year. It is chaired by a Non-Executive Director, Simon Pashby, and its membership includes the Chief Executive, the Chief Operating Officer, the Finance Director (from August 2016), the Head of Finance, the Head of Lending, the Head of Sales and the Secretary & Head of Compliance (until November 2016). Other managers attend as required.

## DIVISION OF RESPONSIBILITIES: CHAIRMAN AND CHIEF EXECUTIVE

The offices of Chief Executive and Chairman are distinct and held by different people. The Chief Executive is responsible for managing the Society's business within the parameters set by the Board. The Chairman sets the direction and culture of the Board, facilitating effective contribution from Directors, maintaining constructive relations between Executive and Non-Executive Directors and ensuring that Directors receive accurate, timely and clear advice and information. The current Chairman (Rob Golbourn) was considered independent on his appointment in May 2016, having demonstrated clear commitment, experience, and capability since joining the Board in October 2006.

## NON-EXECUTIVE DIRECTORS

Non-Executive Directors are required to have a full understanding of the risks in the business; to show commercial leadership within a framework of prudent and effective risk management controls; to provide an independent perspective, monitoring performance and resources; and to constructively challenge strategic proposals, whilst supporting the Executive management. The Non-Executive Directors meet regularly without the Chief Executive present. The Board has appointed a Senior Independent Director, Raymond Abbott, to provide support for the Chairman and an alternative route for communication from members and Society colleagues. His main responsibilities are to chair the Nomination & Remuneration Committee and to carry out the appraisal of the Chairman, taking into account the views of the other Directors.

# Corporate Governance Report (continued)

## THE COMPOSITION OF THE BOARD

The Board currently consists of six Non-Executive Directors plus the Chief Executive and the Finance Director, providing a balance of skills and experience appropriate for the requirements of the business. The Board is satisfied that in terms of independence of character, judgement and robustness of challenge to the Society's Management, each Non-Executive Director is considered independent. Factors taken into account when assessing independence include length of service, material business relationships and whether the Director has recently been an employee of the Society.

Although Rob Golbourn and David Peebles have been Non-Executive Directors for more than nine years, the Board is satisfied that their length of service does not impair their independence and that they both continue to bring valuable knowledge and experience to the Society.

There are no current business relationships between the Society and firms connected with Directors. No ex-employees are or have been Non-Executive Directors.

## APPOINTMENTS TO THE BOARD

The Society values all aspects of diversity, including gender, and ensures that Non-Executive Director appointments are made on merit, based on the specific skills and experience required. Vacancies are advertised within the Society's membership and more widely where appropriate. Members have the right under the Society's Rules to nominate candidates for election to the Board. The Nomination & Remuneration Committee leads the recruitment process, although the final decision rests with the Board as a whole.

All Directors must meet the requirements of fitness and propriety and are subject to the Conduct Rules laid down by the regulators. Directors who are to hold certain roles e.g. Board Chairman and Chairman of the Audit Committee are subject to formal regulatory approval.

## COMMITMENT

The Nomination & Remuneration Committee evaluates the ability of Non-Executive Directors to commit the time required for their role, prior to appointment. The letter of appointment sets out the expected time commitment and Directors undertake that they have sufficient time to meet those expectations. The formal appraisal process carried out by the Chairman each year also assesses whether Directors have demonstrated this ability during the year.

The attendance record of Board and Committee members during the year is set out opposite. This table does not reflect Directors' attendance at additional ad hoc meetings, seminars, conferences and courses during the year or time spent on preparation for meetings etc. Generally each Non-Executive Director spends a minimum of 2-3 days each month on Society business and the Chairman's time commitment is considerably more.

## DEVELOPMENT

All new Directors receive induction training, and ongoing training is provided by attendance at courses and seminars organised by outside bodies, in particular the Building Societies Association. Training and development needs are identified as part of the annual appraisal of the Board's and individual Director's performance and effectiveness. The Secretary has specific responsibility for ensuring that Directors are provided with appropriate information and training.

## INFORMATION AND SUPPORT

The Chairman ensures that the Board receives sufficient information to enable it to discharge its responsibilities. The quality and content of management information provided to the Board and Committees is constantly reviewed by Directors and management. The Secretary provides support on corporate governance matters and the Board has access to independent professional advice if required.

## DIRECTORS' ATTENDANCE 2016-17

The table below shows the number of Board meetings attended by each Director and, for each of the Board Committees, the number of meetings and attendance by individuals as members of those Committees. The figures in brackets denote the number of meetings each Director was eligible to attend.

| | Board | Audit Committee | Asset & Liability Committee | Retail Credit Committee | Operational Risk Committee | Conduct Risk Committee | Nomination & Remuneration Committee |
|---|---|---|---|---|---|---|---|
| **R Golbourn** | 11(11) | - | - | 5(6) | - | 5(5) | 6(6) |
| **R J Abbott** | 11(11) | 4(4) | - | - | - | - | 6(6) |
| **A H Henderson** | 9(9) | - | 7(7) | - | - | - | 5(5) |
| **D Peebles** | 11(11) | 4(4) | 9(9) | - | - | - | 6(6) |
| **J C Ogston** | 10(11) | - | - | 6(6) | - | - | 6(6) |
| **S M Pashby** | 11(11) | 4(4) | - | - | 5(5) | - | 6(6) |
| **J Coyle** | 11(11) | - | 9(9) | - | - | - | 6(6) |
| **M L Thomson** | 10(11) | - | 8(9) | 5(6) | 5(5) | 5(5) | - |
| **A Brown** | 5(5) | - | 4(4) | - | 1(1) | 1(2) | - |

## EVALUATION

The Chairman & Vice-Chairman review the performance of the Chief Executive annually. Non-Executive Directors are evaluated by the Chairman using questions based on the FRC Guidance on Board Effectiveness. The Chairman is evaluated by the Senior Independent Director, taking into account the views of the other Directors. The Board evaluates its overall performance and that of each Committee. This process is used to improve the effectiveness of Directors and the Board collectively.

## RE-ELECTION

The Society's Rules require that Directors are submitted for election at the Annual General Meeting (AGM) following their appointment to the Board. All Directors are required by the Society's Rules to seek re-election if they have not been elected at either of the two previous AGMs. Directors may also submit themselves for re-election voluntarily. The Nomination & Remuneration Committee considers and makes a recommendation to the Board whether each Non-Executive Director should be submitted for re-election, bearing in mind that Director's continued independence and contribution to Board deliberations. The UK Corporate Governance Code specifies that any Director serving for longer than nine years should be subject to annual re-election by the members. The Board considers that annual re-election is not appropriate for the Society, as compliance with the requirements under the Society's Rules has tended to mean Directors standing for re-election every two years.

## FINANCIAL AND BUSINESS REPORTING

The Statement of Directors' Responsibilities on page 25 sets out the Board's responsibilities in relation to the Society's Annual Report and Accounts and the Directors' Report includes a statement regarding the Society's position as a going concern on page 13.

# Corporate Governance Report (continued)

### RISK MANAGEMENT AND INTERNAL CONTROL

The Board is collectively responsible for determining strategies for risk management and control. Senior management are responsible for designing, operating and monitoring risk management and internal control processes through the respective risk management committees that report directly to the Board each month. The Board reviews the adequacy of these processes and the Internal Audit function provides independent and objective assurance that the processes are appropriate and effectively applied. The Society has a strong compliance culture and the Board is satisfied that the Society's systems are effective and appropriate to the scale and complexity of the Society's business.

### REMUNERATION

The Directors' Remuneration Report on pages 23 & 24 sets out the remuneration policies for Executive and Non-Executive Directors and explains how this meets the requirements of the UK Corporate Governance Code.

### DIALOGUE WITH SHAREHOLDERS

As a mutual organisation the Society does not have 'shareholders' as referred to in the Code, and the Society's saving and borrowing customers are also its members. The Society seeks the views of its members through membership surveys, members' forums, the Society newsletter and the AGM.

### CONSTRUCTIVE USE OF THE ANNUAL GENERAL MEETING (AGM)

Each year the Society sends details of the AGM to those members who are eligible to vote. The AGM is held in a different location each year to encourage member attendance and participation. Resolutions include the election of Directors and a separate advisory vote on the Directors' Remuneration Report.

Members are encouraged to exercise their right to vote and a donation to charity is made for each vote cast either in person or by proxy. Members are provided with forms and prepaid envelopes which enable them to appoint a proxy to vote on their behalf if they are unable to attend in person. Proxy voting can also be conducted via a secure website. The proxy form and website provide the opportunity to formally abstain in respect of any resolutions, should the member so wish. The receipt and counting of proxy votes is conducted by independent scrutineers.

At the AGM a poll is called in relation to each resolution and the proxy votes cast are included in the result. The results are subsequently disclosed on the Society's website. Members who cannot attend the meeting are encouraged to submit questions in writing.

**ROB GOLBOURN**
CHAIRMAN

29 March 2017

# Directors' Remuneration Report

The purpose of this report is to inform members of the Society, in line with the relevant provisions of the UK Corporate Governance Code, of the policy for determining the remuneration of Executive and Non-Executive Directors. The Society has adopted a Remuneration Policy which meets the applicable requirements of the Remuneration Code issued by the financial services regulators.

A statement of all Directors' Remuneration is included within this report and also appears in the Annual Review & Summary Financial Statement issued annually to all members. An advisory vote on Directors' Remuneration is included in the AGM agenda.

As a mutual organisation, the Society has no share option scheme and none of the Directors has any beneficial interest in, or any rights to subscribe for, shares in or debentures of any connected undertaking of the Society.

## PROCEDURE FOR DEVELOPING POLICY ON EXECUTIVE & INDIVIDUAL DIRECTOR REMUNERATION

The Board has overall responsibility for overseeing arrangements for remuneration. This is done through the Nomination & Remuneration Committee, which is chaired by the Senior Independent Director. All Non-Executive Directors are members of the Committee and the Chief Executive attends meetings and acts as secretary of the Committee but takes no part in discussions on his own remuneration.

The Committee reviews remuneration for Directors and staff annually, using data from comparable organisations and taking advice from external consultants when appropriate.

## NON-EXECUTIVE DIRECTORS

The level of fees payable to Non-Executive Directors is assessed annually using market information and data from comparable organisations. The fees payable to the Chairman and Vice-Chairman reflect the additional responsibilities of these positions.

Fees for Non-Executive Directors are non-pensionable and Non-Executive Directors do not participate in any bonus or incentive schemes or receive any other benefits apart from reimbursement of expenses incurred in the execution of their duties as Directors.

## EXECUTIVE DIRECTORS

The basic salaries of the Chief Executive and Finance Director are reviewed annually by reference to jobs carrying similar responsibilities in comparable organisations and by reference to market conditions and personal performance.

Their contracts with the Society include a non-pensionable executive bonus scheme which is payable dependent on the Society's performance and the individual's personal performance measured against a number of specific objectives, including strategy, business performance, risk management and corporate governance. No single factor can therefore unduly influence the amount of bonus payable. Bonus payments are not guaranteed and are reviewed each year.

The Society makes a minimum contribution of 20% of salary to the Executive Directors' private pension arrangements and they also receive a further taxable benefit comprising a Society car, or car allowance.

## SERVICE CONTRACTS

Executive Directors have service contracts with the Society which can be terminated by either side giving six months' notice.

Non-Executive Directors do not have service contracts but serve under letters of appointment subject to election by the Society's members.

# Directors' Remuneration Report (continued)

## NON-EXECUTIVE DIRECTORS

**Fees only**

| | To 31 January 2017 | To 31 January 2016 |
|---|---|---|
| R J Abbott | £25,583 | £23,083 |
| J Coyle | £21,583 | £19,050 |
| R Golbourn | £34,583 | £30,033 |
| A H Henderson | £17,917 | £26,275 |
| J C Ogston | £21,393 | £20,480 |
| S M Pashby | £21,583 | £20,750 |
| D Peebles | £22,750 | £20,750 |
| **Total** | **£165,392** | **£160,421** |

## EXECUTIVE DIRECTORS

**To 31 January 2017**

| | Salary | Bonus | Pension Contributions | Taxable Benefits | Total |
|---|---|---|---|---|---|
| M L Thomson | £141,103 | £26,598 | £28,221 | £6,001 | £201,923 |
| A Brown | £68,929 | – | £13,786 | £3,225 | £85,940 |
| **Total** | **£210,032** | **£26,598** | **£42,007** | **£9,226** | **£287,863** |

**To 31 January 2016**

| | Salary | Bonus | Pension Contributions | Taxable Benefits | Total |
|---|---|---|---|---|---|
| M L Thomson | £132,990 | £26,000 | £26,598 | £4,726 | £190,314 |

All pension contributions paid by the Society were in respect of money-purchase pension schemes.

**RAYMOND ABBOTT**
CHAIRMAN, NOMINATION & REMUNERATION COMMITTEE

29 March 2017

# Statement of Directors' Responsibilities

### DIRECTORS' RESPONSIBILITIES FOR PREPARING THE ANNUAL REPORT, THE ANNUAL BUSINESS STATEMENT, THE DIRECTORS' REPORT AND THE ANNUAL ACCOUNTS

The Directors are responsible for preparing the Annual Report, Annual Business Statement, Directors' Report and the Annual Accounts in accordance with applicable 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 that law they are required to prepare the Group and Society Annual Accounts in accordance with UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland.

The Group and Society Annual Accounts are required by law and International Financial Reporting Standards (IFRS) as adopted in the EU to give a true and fair view of the state of affairs of the Group and of the Society; the Building Societies Act 1986 provides in relation to such Annual Accounts that references in the relevant part of that Act to Annual Accounts giving a true and fair view are references to their achieving a fair presentation.

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

- select suitable accounting policies and then apply them consistently;
- make adjustments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with UK Accounting Standards;
- prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group and Society will continue in business.

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

### DIRECTORS' RESPONSIBILITIES FOR ACCOUNTING RECORDS AND INTERNAL CONTROLS

The Directors are responsible for ensuring that the Group:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act; and
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by both the Prudential Regulation Authority and the Financial Conduct Authority under the Financial Services and Markets Act 2000 (as amended).

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the UK governing the preparation and dissemination of Annual Accounts may differ from legislation in other jurisdictions.

### DIRECTORS' RESPONSIBILITIES IN RELATION TO THE COUNTRY-BY-COUNTRY REPORTING (CBCR) INFORMATION

The CBCR information comprises the information discussed below.

The Directors of the Society are responsible for preparing the CBCR information for the year ended 31 January 2017 in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013. In preparing the CBCR information, the Directors are responsible for:

- interpreting the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013;
- determining the acceptability of the basis of preparation of the CBRC information set out in Note 31;
- making judgements and estimates that are reasonable and prudent; and
- establishing such internal control as the Directors determine is necessary to enable the preparation of CBCR information that is free from material misstatement, whether due to fraud or error.

# Independent Auditor's Report to the Members of Scottish Building Society

We have audited the Group and Society Annual Accounts of Scottish Building Society for the year ended 31 January 2017 set out on pages 28 to 66. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland.

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

## RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

As explained more fully in the Directors' Responsibilities Statement set out on page 25, the Directors are responsible for the preparation of Annual Accounts which give a true and fair view. Our responsibility is to audit, and express an opinion on, the Annual Accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## SCOPE OF THE AUDIT OF THE ANNUAL ACCOUNTS

A description of the scope of an audit of annual accounts is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

## OPINION ON ANNUAL ACCOUNTS

In our opinion the Annual Accounts:

- give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of affairs of the Group and of the Society as at 31 January 2017 and of the income and expenditure of the Group and of the Society for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it.

## OPINION ON OTHER MATTERS PRESCRIBED BY THE BUILDING SOCIETIES ACT 1986

In our opinion:

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

## MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

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

**CATHERINE BURNET (SENIOR STATUTORY AUDITOR)**
**FOR AND ON BEHALF OF KPMG LLP, STATUTORY AUDITOR**
CHARTERED ACCOUNTANTS
20 CASTLE TERRACE
EDINBURGH

29 March 2017

# Accounts

For the year ended 31 January 2017

# Income Statement

| | Notes | Group 2017 £000 | Group 2016 £000 | Society 2017 £000 | Society 2016 £000 |
|---|---|---|---|---|---|
| Interest receivable and similar income | 2 | **11,034** | 11,756 | **10,994** | 11,699 |
| Interest payable and similar charges | 3 | **(4,776)** | (5,326) | **(4,776)** | (5,326) |
| **Net interest income** | | **6,258** | 6,430 | **6,218** | 6,373 |
| Fees and commissions receivable | | **74** | 80 | **74** | 80 |
| Fees and commissions payable | | **(25)** | (34) | **(25)** | (34) |
| Net gains from derivative financial instruments | 4 | **5** | 46 | **5** | 46 |
| **Total Net Income** | | **6,312** | 6,522 | **6,272** | 6,465 |
| Administrative expenses | 5 | **(4,950)** | (4,633) | **(4,910)** | (4,578) |
| Depreciation and amortisation | 15, 16 | **(271)** | (293) | **(271)** | (293) |
| **Operating Profit before movement in acquired assets, impairment losses and provisions** | | **1,091** | 1,596 | **1,091** | 1,594 |
| Net increase in value of acquired assets | 13 | **199** | 18 | **199** | 18 |
| Impairment gains/(losses) on loans and advances | 12 | **44** | (116) | **44** | (116) |
| Provisions for liabilities - FSCS levy | 24 | **(59)** | (164) | **(59)** | (164) |
| **Operating Profit** | | **1,275** | 1,334 | **1,275** | 1,332 |
| Distribution of reserves from subsidiary entity | 14 | **-** | - | **1,561** | - |
| **Profit before tax** | | **1,275** | 1,334 | **2,836** | 1,332 |
| Tax expense | 8 | **(211)** | (223) | **(211)** | (223) |
| **Profit for the financial year** | 25 | **1,064** | 1,111 | **2,625** | 1,109 |

Profit for the financial year arises from continuing operations. Both the profit for the financial year and total comprehensive income for the period are attributable to the members of the Society.

*The accompanying notes form an integral part of the financial statements.*

# Other Comprehensive Income

| | | Group | | Society | |
|---|---|---|---|---|---|
| | *Notes* | **2017 £000** | 2016 £000 | **2017 £000** | 2016 £000 |
| Profit for the financial year | | **1,064** | 1,111 | **2,625** | 1,109 |
| Valuation gains/(losses) taken to reserves | *26* | **53** | (67) | **53** | (67) |
| Income tax on other comprehensive income | *26* | **(10)** | 14 | **(10)** | 14 |
| **Total comprehensive income for the year** | | **1,107** | 1,058 | **2,668** | 1,056 |

*The accompanying notes form an integral part of the financial statements.*

# Statement of Financial Position

| | Notes | Group 2017 £000 | Group 2016 £000 | Society 2017 £000 | Society 2016 £000 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Liquid Assets: | | | | | |
| Cash in hand and balances with Bank of England | | **46,150** | 40,141 | **46,150** | 40,141 |
| Loans and advances to credit institutions | *9* | **23,096** | 20,959 | **23,096** | 20,959 |
| Debt securities | *10* | **26,610** | 39,785 | **26,610** | 39,785 |
| Derivative financial instruments | *21* | **58** | - | **58** | - |
| Loans and advances to customers | *11* | **311,313** | 286,051 | **311,313** | 285,024 |
| Investment in subsidiary undertaking | *14* | **-** | - | **-** | 10 |
| Tangible fixed assets | *15* | **1,625** | 1,634 | **1,625** | 1,634 |
| Intangible assets | *16* | **123** | 130 | **123** | 130 |
| Other assets | *17* | **257** | 222 | **257** | 222 |
| **TOTAL ASSETS** | | **409,232** | 388,922 | **409,232** | 387,905 |
| **LIABILITIES** | | | | | |
| Shares | *18* | **365,007** | 342,072 | **365,007** | 342,072 |
| Amounts owed to credit institutions | *19* | **-** | - | **-** | - |
| Amounts owed to other customers | *20* | **10,490** | 13,483 | **10,490** | 13,483 |
| Derivative financial instruments | *21* | **89** | 362 | **89** | 362 |
| Other liabilities and accruals | *22* | **933** | 1,362 | **933** | 1,906 |
| Deferred tax liability | *23* | **62** | 62 | **62** | 62 |
| Provisions for liabilities | *24* | **58** | 95 | **58** | 95 |
| **TOTAL LIABILITIES** | | **376,639** | 357,436 | **376,639** | 357,980 |
| **RESERVES** | | | | | |
| General reserves | *25* | **32,596** | 31,532 | **32,596** | 29,971 |
| Available-for-sale reserves | *26* | **(3)** | (46) | **(3)** | (46) |
| **Total reserves attributable to members of the Society** | | **32,593** | 31,486 | **32,593** | 29,925 |
| **TOTAL RESERVES AND LIABILITIES** | | **409,232** | 388,922 | **409,232** | 387,905 |

These accounts were approved by the Board of Directors on 29 March 2017 and were signed on its behalf by :

**ROB GOLBOURN**
CHAIRMAN

**RAYMOND ABBOTT**
VICE CHAIRMAN

**MARK L THOMSON**
CHIEF EXECUTIVE

*The accompanying notes form an integral part of the financial statements.*

# Consolidated Statement of Changes in Members' Interests

| Group | General reserves 2017 £000 | Available -for-sale reserves 2017 £000 | Total 2017 £000 | General reserves 2016 £000 | Available -for-sale reserves 2016 £000 | Total 2016 £000 |
|---|---|---|---|---|---|---|
| **As at 1 February 2016** | **31,532** | **(46)** | **31,486** | 30,421 | 7 | 30,428 |
| **Total Comprehensive income for the year** | | | | | | |
| Profit for year | **1,064** | **-** | **1,064** | 1,111 | - | 1,111 |
| Other comprehensive income *(see Note 26)* | **-** | **43** | **43** | - | (53) | (53) |
| Total Comprehensive income for the year | **1,064** | **43** | **1,107** | 1,111 | (53) | 1,058 |
| **As at 31 January 2017** | **32,596** | **(3)** | **32,593** | 31,532 | (46) | 31,486 |

| Society | General reserves 2017 £000 | Available -for-sale reserves 2017 £000 | Total 2017 £000 | General reserves 2016 £000 | Available -for-sale reserves 2016 £000 | Total 2016 £000 |
|---|---|---|---|---|---|---|
| **As at 1 February 2016** | **29,971** | **(46)** | **29,925** | 28,862 | 7 | 28,869 |
| **Total Comprehensive income for the year** | | | | | | |
| Profit for year | **2,625** | **-** | **2,625** | 1,109 | - | 1,109 |
| Other comprehensive income *(see Note 26)* | **-** | **43** | **43** | - | (53) | (53) |
| Total Comprehensive income for the year | **2,625** | **43** | **2,668** | 1,109 | (53) | 1,056 |
| **As at 31 January 2017** | **32,596** | **(3)** | **32,593** | 29,971 | (46) | 29,925 |

*The accompanying notes form an integral part of the financial statements.*

# Group Cash Flow Statement

| | 2017 £000 | 2016 £000 |
|---|---|---|
| **Cash flows from operating activities** | | |
| **Profit before tax** | **1,275** | 1,334 |
| *Adjustments for* | | |
| Depreciation and amortisation | **271** | 293 |
| Loss on disposal of fixed assets | **-** | 1 |
| (Decrease)/increase in impairment of loans and advances | **(168)** | 116 |
| **Total** | **1,378** | 1,744 |
| **Changes in operating assets and liabilities** | | |
| Increase/(decrease) in prepayments, accrued income and other assets | **(72)** | 31 |
| (Decrease) in accruals, deferred income and other liabilities | **(757)** | (68) |
| (Increase) in loans and advances to customers | **(25,094)** | (3,435) |
| Increase in shares | **23,014** | 10,302 |
| (Decrease) in amounts owed to credit institutions and other customers | **(2,987)** | (654) |
| (Increase) in loans and advances to credit institutions | **(2,000)** | (12,000) |
| Taxation paid | **(288)** | (118) |
| **Net cash flows from operating activities** | **(8,184)** | (5,942) |
| **Cash flows from investing activities** | | |
| Purchase of debt securities | **(27,016)** | (63,126) |
| Sale and maturity of debt securities | **40,205** | 55,906 |
| Purchase of tangible fixed assets | **(190)** | (28) |
| Disposal of tangible fixed assets | **12** | - |
| Purchase of intangible assets | **(77)** | (23) |
| **Net cash flows from investing activities** | **12,934** | (7,271) |
| **Net increase/(decrease) in cash and cash equivalents** | **6,128** | (11,469) |

| **Cash and cash equivalents** | **2016 £000** | **Cash Flow** | **2017 £000** |
|---|---|---|---|
| Cash in hand and balances with the Bank of England | **40,141** | **6,009** | **46,150** |
| Loans and advances to credit institutions - repayable on demand | **2,895** | **119** | **3,014** |
| | **43,036** | **6,128** | **49,164** |

| | 2015 £000 | Cash Flow | 2016 £000 |
|---|---|---|---|
| Cash in hand and balances with the Bank of England | 52,145 | (12,004) | 40,141 |
| Loans and advances to credit institutions - repayable on demand | 2,360 | 535 | 2,895 |
| | 54,505 | (11,469) | 43,036 |

*The accompanying notes form an integral part of the financial statements.*

## 1. PRINCIPAL ACCOUNTING POLICIES

### Basis of preparation

The Accounts have been prepared in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations 1998 and Financial Reporting Standard 102 *The Financial Reporting Standard* applicable in the UK and Republic of Ireland ("FRS 102"), as issued in September 2015, including the recognition and measurement provisions of International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (as adopted for use in the European Union), as permitted by section 11 of FRS 102.

The parent Society is included in the consolidated annual accounts, and is considered to be a qualifying entity under FRS 102 paragraphs 1.8 to 1.12. The following exemptions available under FRS 102 in respect of certain disclosures for the parent Society annual accounts have been applied:

- No separate parent Society Cash Flow Statement with related notes is included

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these annual accounts.

Judgements made by the Directors in the application of these accounting policies that have significant effect on the annual accounts and estimates, with a significant risk of material adjustment in the next year, are discussed in *Note 1*.

### Accounting convention

The annual accounts are prepared under the historical cost convention as modified by the fair value revaluation of available-for-sale assets, derivatives and hedged items.

### Basis of consolidation

The Group Accounts include the accounts of the Society and its subsidiary undertaking made up to 31 January each year. The investment in subsidiary undertaking is carried at cost less provision for impairment. Merger accounting has been applied in relation to the transfer of SBS Mortgages Ltd assets to the Society. (Further detail is available in *Note 14*.)

### Interest

Interest income and expense is recognised in the income statement and other comprehensive income using the effective interest method. The 'effective interest rate' is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate, a shorter period), to the carrying amount of the financial asset or financial liability.

When calculating the effective interest rate, the Group estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes transaction costs and fees paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Interest income and expense presented in the income statement and other comprehensive income includes:

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- interest on available-for-sale investment securities calculated on an effective interest basis;
- the effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of interest rate risk.

### Fees and commission

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or financial liability, such as arrangement fees, are included in the measurement of the effective interest rate above.

Other fees and commission income, such as transaction charges, are recognised as the related services are performed.

### Leases

Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, determined at the inception of the lease. The corresponding liability to the lessor is included in the Statement of Financial Position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised immediately in the income statement.

Rental charges under "operating leases" are charged to the income statement evenly over the life of the lease.

Assets held by the Group for use in operating leases are included as tangible fixed assets. Rents receivable under operating leases are recognised in the income statement as they fall due.

## Taxation

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised directly in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the period end, and any adjustment to tax payable in respect of previous years.

Provision for deferred tax is made, using the liability method, on a non-discounted basis for taxation at the relevant rate in respect of all items where there is a timing difference between their treatment for accounts and taxation purposes except where, in the opinion of the Directors, it is likely that tax assets would not be recoverable in the foreseeable future.

## Financial instruments

### Recognition

The Group initially recognises loans and advances, deposits, and debt securities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Group becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

### Classification

*Financial assets*

The Group classifies its financial assets into one of the following categories:

- *Loans and receivables*

'Loans and advances' are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term.

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

- *Available-for-sale*

'Available-for-sale investments' are non-derivative investments that are designated as available-for-sale or are not classified as another category of financial assets. Available-for-sale investments comprises debt securities. Unquoted equity securities whose fair value cannot be measured reliably are carried at cost. All other available-for-sale investments are measured at fair value after initial recognition.

Interest income is recognised in profit or loss using the effective interest method. Impairment losses are recognised in profit or loss.

Other fair value changes, other than impairment losses, are recognised in other comprehensive income and presented in the available-for-sale reserve within equity. When the investment is sold, the gain or loss accumulated in equity is reclassified to profit or loss.

- *At fair value through profit and loss*

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

On initial designation of the hedge, the Group formally documents the relationship between the hedging instrument(s) and hedged item(s), including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at inception of the hedge relationship and on an ongoing basis, of whether the hedging instrument(s) is(are) expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged item(s) during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125%.

- *Held to maturity*

There are no financial assets held to maturity.

*Fair value hedges*

Where a derivative financial instrument is designated as a hedge of the variability in fair value of a recognised asset or liability or an unrecognised firm commitment, all changes in the fair value of the derivative are recognised immediately in profit or loss. The carrying value of the hedged item is adjusted by the change in fair value that is attributable to the risk being hedged (even if it is normally carried at cost or amortised cost) and any gains or losses on remeasurement are recognised immediately in the income statement (even if those gains would normally be recognised directly in reserves). If hedge accounting is discontinued and the hedged financial asset or liability has not been derecognised, any adjustments to the carrying amount of the hedged item are amortised into profit or loss using the effective interest method over the remaining life of the hedged item.

*Financial liabilities*

The Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or fair value through profit or loss.

### Derecognition

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

### Measurement

*Amortised cost measurement*

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

*Fair value measurement*

'Fair value' is the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

When available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an on-going basis.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Group determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

### Identification and measurement of impairment

At each reporting date, the Group assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is 'impaired' when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired includes:

a. significant financial difficulty of the borrower or issuer;

b. default or delinquency by a borrower;

c. the restructuring of a loan or advance by the Group on terms that the Group would not consider otherwise;

d. indications that a borrower or issuer will enter bankruptcy;

e. the disappearance of an active market for a security; or

f. observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

The Group considers evidence of impairment for loans and advances at both a specific asset and a collective level. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances that are not individually significant are collectively assessed for impairment by grouping together loans and advances with similar risk characteristics.

A collective provision is made against a group of loans and advances where there is objective evidence based on the Group's experience that credit losses have been incurred, but not yet identified, at the reporting date. Where certain emerging impairment characteristics are considered significant but have not been included as part of the impairment calculation, management may elect to apply an overlay to the calculated impairment provision to ensure that the Group has sufficient impairment provisions at the Statement of Financial Position date.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

Interest on impaired financial assets is recognised at the effective interest rate for the relevant loan. To the extent that interest is not expected to be recovered, an allowance for this is included in the provisions for impairment losses.

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised. If the cash flows of the renegotiated asset are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and the new financial asset is recognised at fair value.

A range of forbearance options are available to support customers who are in financial difficulty. The purpose of forbearance is to support customers who have temporary financial difficulties and help them get back on track.

The main options offered by the Group include:

- Temporary payment reductions;
- Payment plans;
- Capitalisations; and
- Mortgage term extensions.

Customers requesting a forbearance option will need to provide information to support the request which is likely to include a budget planner, statement of assets and liabilities, bank/credit card statements, payslips etc. in order that the request can be properly assessed. If the forbearance request is granted the account is monitored in accordance with our policy and procedures. At the appropriate time the forbearance option that has been implemented is cancelled, with the exception of capitalisation of arrears, and the customer's normal contractual payment is restored.

Loans that are subject to restructuring may only be classified as restructured and up-to-date once a specified number and/or amount of qualifying payments have been received. These qualifying payments are set at a level appropriate to the nature of the loan and the customer's ability to make the repayment going forward. Typically the receipt of twelve months' of qualifying payments is required. Loans that have been restructured and would otherwise have been past due or impaired are classified as renegotiated.

Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and receivables. Interest on the impaired assets continues to be recognised through the unwinding of the discount. If an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through profit or loss.

### Cash and cash equivalents

For the purposes of the Cash Flow Statement, cash comprises cash in hand and unrestricted loans and advances to credit institutions repayable on demand. Cash equivalents comprise highly liquid unrestricted investments that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than three months.

The Cash Flow Statement has been prepared using the indirect method.

### Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is charged to the profit and loss account on a straight-line basis over the estimated useful lives of each part of an item of tangible fixed assets. Assets held under finance leases are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated. The estimated useful lives are as follows:

- Buildings – 50 years
- Plant and equipment – 5 years
- Fixtures and fitting – 10 years
- Motor vehicles – 3-4 years

### Intangible assets

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and less accumulated impairment losses.

Amortisation starts when the asset becomes available for operational use and is charged to the income statement on a straight-line basis over 4 years. The assets and the amortisation period are reviewed annually for impairment.

Computer software costs have been classified as intangible assets under FRS 102.

### Pension costs

The Society operates defined contribution pension schemes administered by two British life companies, the funds of which are separate from those of the Society. Contributions are charged to revenue in the year in which they are made and are included in management expenses.

### Provisions

A provision is recognised in the Statement of Financial Position when the entity has a present legal or constructive obligation as a result of a past event, that can be reliably measured and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are recognised at the best estimate of the amount required to settle the obligation at the reporting date.

Where the parent Society enters into financial guarantee contracts to guarantee the indebtedness of other companies within its group, the Society treats the guarantee contract as a contingent liability in its individual annual accounts until such time as it becomes probable that the Society will be required to make a payment under the guarantee.

### Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ending 31 January 2017 is set out below:

a. *Impairment losses on loans and advances to customers* – the Group reviews its mortgage portfolio regularly to assess impairment. In determining whether an impairment loss should be recorded, the Group is required to exercise a degree of judgement. Impairment provisions are calculated using arrears experience, credit risk characteristics and expected cashflows. Estimates are applied to determine prevailing market conditions and customer behaviour. To the extent that default rates differ from that estimated by 10%, the impairment provisions on loans and advances would change by an estimated £6,000.

b. *Expected mortgage life* – in determining the expected life of mortgage assets, the Group uses historical and forecast redemption data as well as management judgement. The accuracy of the provision would therefore be affected by unexpected changes to these assumptions. A 10% increase in the total mortgage life would result in an increase in the value of loans on the Statement of Financial Position by approximately £597,000.

c. *Fair value of derivatives and financial assets* – the Group employs the following techniques in determining the fair value of its derivatives and financial assets:

- Derivative financial instruments – calculated by discounted cashflow models using yield curves that are based on observable market data
- Available-for-sale investments – measured at fair value using market prices

A change in the yield curve of 1% would change the total net fair value of derivative financial instruments by £460,000.

## 2. INTEREST RECEIVABLE AND SIMILAR INCOME

| | Group | | Society | |
|---|---|---|---|---|
| | **2017 £000** | 2016 £000 | **2017 £000** | 2016 £000 |
| On loans fully secured on residential property | **10,141** | 10,717 | **10,101** | 10,660 |
| On other loans | **632** | 695 | **632** | 695 |
| Net expense on financial instruments | **(326)** | (335) | **(326)** | (335) |
| On debt securities: | | | | |
| - interest and other income | **259** | 369 | **259** | 369 |
| On other liquid assets: | | | | |
| - interest and other income | **328** | 310 | **328** | 310 |
| | **11,034** | 11,756 | **10,994** | 11,699 |

Included within loans fully secured on residential property is £7,500 (2016: £23,000) in respect of interest income on impaired loans.

## 3. INTEREST PAYABLE AND SIMILAR CHARGES

| **Group & Society** | **2017 £000** | 2016 £000 |
|---|---|---|
| On shares held by individuals | **4,705** | 5,232 |
| On other shares | **7** | 8 |
| On deposits and other borrowings | **64** | 86 |
| | **4,776** | 5,326 |

## 4. NET GAINS FROM DERIVATIVE FINANCIAL INSTRUMENTS

| **Group & Society** | **2017 £000** | 2016 £000 |
|---|---|---|
| Derivatives in designated fair value hedge relationships | **331** | 175 |
| Adjustment to hedged items in fair value hedge accounting relationships | **(326)** | (129) |
| Derivatives not in designated fair value hedge relationships | **-** | - |
| | **5** | 46 |

## 5. ADMINISTRATIVE EXPENSES

| | Group | | Society | |
|---|---|---|---|---|
| | **2017 £000** | 2016 £000 | **2017 £000** | 2016 £000 |
| Staff costs *(Note 6)* | **2,991** | 2,635 | **2,991** | 2,635 |
| Other expenses | **1,959** | 1,998 | **1,919** | 1,943 |
| | **4,950** | 4,633 | **4,910** | 4,578 |
| Included in other expenses are the following charges: | | | | |
| - property leasing costs | **77** | 79 | **77** | 79 |
| - remuneration of auditors (excl. VAT): | | | | |
| audit of the Annual Accounts under FRS 102 | **51** | 63 | **50** | 62 |
| other services | **8** | 5 | **8** | **5** |

Audit fees for 2016 included additional fees in relation to the transition from UK GAAP to FRS 102.

## 6. STAFF NUMBERS AND COSTS

The average number of persons employed by the Group and Society (including Executive Directors) during the year was as follows:

| | Full time | | Part time | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| Head Office | **36** | 29 | **6** | 6 |
| Branch offices | **18** | 23 | **14** | 13 |
| | **54** | 52 | **20** | 19 |

The aggregate costs of employment of these persons were as follows:

| | **2017 £000** | 2016 £000 |
|---|---|---|
| Wages and salaries | **2,475** | 2,173 |
| Social security costs | **240** | 211 |
| Pension costs | **276** | 251 |
| | **2,991** | 2,635 |

# Notes to the Accounts (continued)

### 7. DIRECTORS' REMUNERATION

Individual Directors' remuneration of £453,000 (2016: £351,000) is detailed in the Directors' Remuneration Report on pages 23 & 24.

### 8. TAX EXPENSE

| | Group | | Society | |
|---|---|---|---|---|
| | **2017 £000** | 2016 £000 | **2017 £000** | 2016 £000 |
| Current Tax | | | | |
| Corporation tax charge for the year at 20% (2016: 20.16%) | **216** | 297 | **216** | 297 |
| Adjustment in respect of prior year | **(1)** | - | **(1)** | - |
| Total current tax charge for the year | **215** | 297 | **215** | 297 |
| Deferred tax | | | | |
| Deferred tax charge/(credit) for the year (*Note 23*) | **(4)** | (74) | **(4)** | (74) |
| Total tax charge for the year | **211** | 223 | **211** | 223 |

The main rate of UK corporation tax is 20% from 1 April 2015. Further reductions to 19% from 1 April 2017 and 17% from 1 April 2020 were substantively enacted on 26 October 2015 and 6 September 2016 respectively. The substantive enactment of these rate reductions has been reflected in the computation of the net deferred tax liability recognised by the Society with account taken of the tax rates that will apply when the various timing differences are expected to reverse.

The tax assessed for the year differs from the statutory rate of corporation tax in the UK of 20%; the differences are explained below:

| | Group 2017 | Group 2016 | Society 2017 | Society 2016 |
|---|---|---|---|---|
| Profit on ordinary activities before taxation | **1,275** | 1,334 | **2,835** | 1,332 |
| Profit on ordinary activities multiplied by the statutory rate of corporation tax of 20% (2016: 20.16%) | **255** | 269 | **567** | 269 |
| Effects of: | | | | |
| Expenses not deductible for corporation tax purposes | **11** | 10 | **11** | 10 |
| Income not taxable | **-** | - | **(312)** | - |
| Effect of change of tax rate on deferred tax | **(11)** | 1 | **(11)** | 1 |
| Loss relief arising from merger with Century Building Society | **(43)** | (57) | **(43)** | (57) |
| Adjustment in respect of prior year | **(1)** | - | **(1)** | - |
| Total tax charge for the year | **211** | 223 | **211** | 223 |

## 8. TAX EXPENSE (continued)

The total tax charge is recognised as shown in the following tables:

| Group | Current tax 2017 £000 | Deferred tax 2017 £000 | Total tax 2017 £000 | Current tax 2016 £000 | Deferred tax 2016 £000 | Total tax 2016 £000 |
|---|---|---|---|---|---|---|
| Recognised in income statement | 215 | (4) | 211 | 297 | (74) | 223 |
| Recognised in other comprehensive income | 6 | 4 | 10 | (14) | - | (14) |
| **Total Tax** | 221 | - | 221 | 283 | (74) | 209 |

| Society | Current tax 2017 £000 | Deferred tax 2017 £000 | Total tax 2017 £000 | Current tax 2016 £000 | Deferred tax 2016 £000 | Total tax 2016 £000 |
|---|---|---|---|---|---|---|
| Recognised in income statement | 215 | (4) | 211 | 297 | (74) | 223 |
| Recognised in other comprehensive income | 6 | 4 | 10 | (14) | - | (14) |
| **Total Tax** | 221 | - | 221 | 283 | (74) | 209 |

## 9. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

| Group & Society | 2017 £000 | 2016 £000 |
|---|---|---|
| Accrued Interest | 82 | 64 |
| Repayable on demand | 3,014 | 2,895 |
| In not more than three months | 11,000 | 10,000 |
| In more than three months but not more than one year | 9,000 | 8,000 |
| | 23,096 | 20,959 |

## 10. DEBT SECURITIES

| Group & Society | 2017 £000 | 2016 £000 |
|---|---|---|
| Treasury bills | - | 5,982 |
| Certificates of deposit | 23,094 | 30,307 |
| Floating rate notes | 3,516 | 3,496 |
| | 26,610 | 39,785 |
| Debt securities have remaining maturities as follows: | | |
| Accrued interest | 85 | 124 |
| In not more than one year | 23,006 | 36,189 |
| In more than one year | 3,525 | 3,533 |
| | 26,616 | 39,846 |
| Transferable debt securities (excluding accrued interest) comprise: | | |
| Listed | 3,500 | 3,500 |
| Unlisted | 23,000 | 36,184 |
| Unamortised premia | 32 | 38 |
| | 26,532 | 39,722 |
| Market Value of listed debt securities | 3,516 | 3,497 |
| Movements during the year of debt securities: | | |
| At 1 February 2016 | 39,671 | 32,511 |
| Additions | 27,016 | 63,126 |
| Disposals and maturities | (40,206) | (55,906) |
| Net (losses) from changes in fair value recognised in other comprehensive income | (7) | (60) |
| **As at 31 January 2017** | 26,474 | 39,671 |

## 11. LOANS AND ADVANCES TO CUSTOMERS

| | Group | | Society | |
|---|---|---|---|---|
| | **2017 £000** | 2016 £000 | **2017 £000** | 2016 £000 |
| Loans fully secured on residential property | **296,849** | 270,405 | **296,849** | 269,378 |
| Loans fully secured on land | **14,437** | 15,293 | **14,437** | 15,293 |
| Fair value adjustment for hedged risk | **27** | 353 | **27** | 353 |
| | **311,313** | 286,051 | **311,313** | 285,024 |

*Maturity Analysis*

The remaining maturity of loans and advances to customers as at the date of the balance sheet is as follows:

| | Group | | Society | |
|---|---|---|---|---|
| | **2017 £000** | 2016 £000 | **2017 £000** | 2016 £000 |
| On call and at short notice | **930** | 439 | **930** | 439 |
| In not more than three months | **3,025** | 2,781 | **3,025** | 2,741 |
| In more than three months but not more than one year | **9,513** | 8,569 | **9,513** | 8,534 |
| In more than one year but not more than five years | **59,198** | 54,564 | **59,198** | 54,328 |
| In more than five years | **239,007** | 220,226 | **239,007** | 219,510 |
| | **311,673** | 286,579 | **311,673** | 285,552 |
| Less allowance for impairment *(Note 12)* | **(360)** | (528) | **(360)** | (528) |
| | **311,313** | 286,051 | **311,313** | 285,024 |

The maturity analysis above is based on contractual maturity not expected redemption levels.

## 12. ALLOWANCE FOR IMPAIRMENT

| Group & Society | Individual Impairment £000 | Collective Impairment £000 | Total £000 |
|---|---|---|---|
| Loans fully secured on residential property: | | | |
| At 1 February 2016 | 228 | 300 | 528 |
| Amounts written off during the year, net of recoveries | (124) | - | (124) |
| Charge/(credit) for the year | (44) | - | (44) |
| As at January 2017 | **60** | **300** | **360** |
| Loans fully secured on residential property: | | | |
| At 1 February 2015 | 262 | 150 | 412 |
| Amounts written off during the year, net of recoveries | - | - | - |
| Charge/(credit) for the year | (34) | 150 | 116 |
| As at January 2016 | 228 | 300 | 528 |

## 13. MOVEMENTS IN VALUES OF ACQUIRED ASSETS

| Group & Society | **2017 £000** | 2016 £000 |
|---|---|---|
| Further impairment of acquired assets | **(8)** | (18) |
| Increase in value of acquired assets | **207** | 36 |
| | **199** | 18 |

## 14. INVESTMENT IN SUBSIDIARY UNDERTAKING

During the year, the Society had a 100% holding of the ordinary share capital in its sole subsidiary, SBS Mortgages Ltd, a company incorporated in Scotland under the Companies Act. The company's principal activity was mortgage lending.

On 27 October 2016, the Directors of SBS Mortgages Ltd agreed to sell the remaining mortgage assets to the Society at book value and to settle the intercompany loan via a dividend payment. As at the end of the financial year, SBS Mortgages Ltd had Share Capital of £1 following a reduction in Share Capital of 9,999 £1 shares.

The investment by the Society in its subsidiary during the year was as follows:

| | Shares £000 | Loan £000 | **Total £000** |
|---|---|---|---|
| Cost at 1 February 2016 | 10 | (544) | **(534)** |
| Management charge due to Society from subsidiary | - | 40 | **40** |
| Subsidiary mortgage repayments received by the Society | - | (98) | **(98)** |
| Purchase of SBS Mortgages Ltd mortgages | - | (969) | **(969)** |
| Dividend issued & impairment of Share Capital | (10) | 1,571 | **1,561** |
| **Cost at 31 January 2017** | - | - | - |

The Society received mortgage repayments on behalf of its subsidiary, and these repayments were then ultimately owed by the Society to the subsidiary. The inter-company creditor balance of £544,000 as at 1 February 2016 is shown under Other Liabilities and Accruals *(Note 22)*.

### 15. TANGIBLE FIXED ASSETS

| Group & Society | Lands & Buildings Freehold £000 | Lands & Buildings Short Leasehold £000 | Office Equipment £000 | Motor Vehicles £000 | Total £000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| As at 1 February 2016 | 1,634 | 178 | 909 | 159 | 2,880 |
| Additions | - | - | 181 | 9 | 190 |
| Disposals | - | - | (22) | (20) | (42) |
| As at 31 January 2017 | 1,634 | 178 | 1,068 | 149 | 3,028 |
| **Depreciation** | | | | | |
| As at 1 February 2016 | 350 | 167 | 630 | 99 | 1,246 |
| Charged in year | 33 | 6 | 116 | 32 | 187 |
| Disposals | - | - | (17) | (13) | (30) |
| As at 31 January 2017 | 383 | 173 | 729 | 118 | 1,403 |
| **Net book value** | | | | | |
| **As at 31 January 2017** | **1,251** | **5** | **339** | **31** | **1,625** |
| As at 31 January 2016 | 1,284 | 11 | 279 | 60 | 1,634 |

The net book value of freehold and leasehold property occupied by the Group and Society for its own activities was as follows:

| | **2017 £000** | 2016 £000 |
|---|---|---|
| As at 31 January | **1,256** | 1,295 |

The net book value of motor vehicles includes an amount of £9,000 (2016: £Nil) in respect of assets held under finance leases. Depreciation charged in the year on these assets amounted to £Nil (2016: £Nil).

## 16. INTANGIBLE ASSETS

| Group & Society | Computer Software £000 |
|---|---|
| **Cost** | |
| As at 1 February 2016 | 571 |
| Additions | 77 |
| Disposals | (5) |
| As at 31 January 2017 | 643 |
| **Amortisation** | |
| As at 1 February 2016 | 441 |
| Charged in year | 84 |
| Disposals | (5) |
| As at 31 January 2017 | 520 |
| **Net book value** | |
| **As at 31 January 2017** | **123** |
| As at 31 January 2016 | 130 |

## 17. OTHER ASSETS

| Group & Society | **2017 £000** | 2016 £000 |
|---|---|---|
| Prepayments and accrued income | **226** | 199 |
| Other debtors | **31** | 23 |
| | **257** | 222 |

### 18. SHARES

| Group & Society | 2017 £000 | 2016 £000 |
|---|---|---|
| a) Held by individuals | **364,217** | 341,473 |
| Other shares | **790** | 599 |
| | **365,007** | 342,072 |
| b) Repayable from the date of the Financial Statements in the ordinary course of business as follows: | | |
| Accrued interest | **2,368** | 2,447 |
| On demand | **312,196** | 288,035 |
| In not more than three months | **6,315** | 5,473 |
| In more than three months but not more than one year | **25,936** | 26,484 |
| In more than one year but not more than five years | **18,192** | 19,633 |
| | **365,007** | 342,072 |

### 19. AMOUNTS OWED TO CREDIT INSTITUTIONS

| Group & Society | 2017 £000 | 2016 £000 |
|---|---|---|
| Repayable from the date of the Financial Statements in the ordinary course of business as follows: | | |
| Accrued interest | - | - |
| In not more than three months | - | - |
| In more than three months but not more than one year | - | - |
| | - | - |

### 20. AMOUNTS OWED TO OTHER CUSTOMERS

| Group & Society | 2017 £000 | 2016 £000 |
|---|---|---|
| Repayable from the date of the Financial Statements in the ordinary course of business as follows: | | |
| Accrued interest | **23** | 29 |
| Repayable on demand | **7,467** | 12,390 |
| In not more than three months | **3,000** | 1,064 |
| In more than three months but not more than one year | - | - |
| | **10,490** | 13,483 |

## 21. DERIVATIVE FINANCIAL INSTRUMENTS

| Group & Society | **Positive Market value 2017 £000** | **Negative Market value 2017 £000** | Positive Market value 2016 £000 | Negative Market value 2016 £000 |
|---|---|---|---|---|
| Derivatives designated as fair value hedges: | | | | |
| Interest rate swaps | **(58)** | **89** | - | 362 |
| **As at 31 January 2017** | **(58)** | **89** | - | 362 |

## 22. OTHER LIABILITIES AND ACCRUALS

| | Group | | Society | |
|---|---|---|---|---|
| | **2017 £000** | 2016 £000 | **2017 £000** | 2016 £000 |
| Other Liabilities | | | | |
| Corporation tax | **101** | 168 | **101** | 168 |
| Income tax | **-** | 311 | **-** | 311 |
| Amounts due to subsidiary *(Note 14)* | **-** | - | **-** | 544 |
| Finance leases *(Note 29)* | **9** | - | **9** | - |
| Other creditors | **118** | 135 | **118** | 135 |
| Accruals and deferred income | **705** | 748 | **705** | 748 |
| | **933** | 1,362 | **933** | 1,906 |

## 23. DEFERRED TAX

| | Group | | Society | |
|---|---|---|---|---|
| | **2017 £000** | 2016 £000 | **2017 £000** | 2016 £000 |
| Provided: | | | | |
| Timing differences between capital allowances and depreciation | **63** | 69 | **63** | 69 |
| FRS 102 transitional adjustments | **(8)** | (9) | **(8)** | (9) |
| Recognised in other comprehensive income | **7** | 2 | **7** | 2 |
| | **62** | 62 | **62** | 62 |
| As at 1 February 2016 | **62** | 136 | **62** | 136 |
| Deferred tax charge/(credit) for the financial year *(Note 8)*: - income statement | **(4)** | (74) | **(4)** | (74) |
| Deferred tax charge/(credit) for the financial year *(Note 8)*: - other comprehensive income | **4** | - | **4** | - |
| **As at 31 January 2017** | **62** | 62 | **62** | 62 |

A deferred tax asset amounting to £44,000 in relation to tax losses incurred by Century Building Society (CBS) as at 31 January 2013 (date of transfer of engagements) has not been recognised due to uncertainty that there will be future notional taxable profits in CBS available for offset.

## 24. PROVISIONS FOR LIABILITIES

**Financial Services Compensation Scheme**

| **Group & Society** | **2017 £000** | 2016 £000 |
|---|---|---|
| As at 1 February 2016 | **95** | 151 |
| Paid in year | **(96)** | (220) |
| Charge for the year | **59** | 164 |
| **As at 31 January 2017** | **58** | 95 |

**Financial Services Compensation Scheme**

As a regulated UK deposit-taker, the Society, in common with all regulated UK deposit-takers, pays levies based on its share of deposits protected by the Financial Services Compensation Scheme (FSCS) to enable the scheme to meet claims against it. There are two FSCS levies – a management expenses levy ("MEL") and a compensation costs levy ("CCL"). The MEL covers the running costs of the scheme and the CCL covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it.

In September 2008 a claim was triggered against the FSCS by the transfer of Bradford & Bingley plc's retail deposit business to Abbey National plc. In October 2008 a further claim was triggered against the FSCS by the transfer of Kaupthing Singer and Friedlander's (KSF) internet deposit business (Kaupthing Edge) and Heritable Bank's (a subsidiary of Landsbanki hf) deposit business to ING Direct. The FSCS will also be liable to claims from depositors of Landsbanki hf and KSF whose balances have not been transferred to ING Direct but are covered by the FSCS. Additional claims arose relating to the default of London Scottish Bank plc in 2008 and Dunfermline Building Society in 2009.

In May 2013, the International Accounting Standards Board issued an interpretation to clarify the accounting treatment for levies in the financial statements of an entity subject to such levies. The interpretation explains that there is no obligation to recognise the liability for a levy until the activity that triggers payment occurs. Applying the interpretation to the FSCS levies, the liability should only be recognised after the trigger date of 1 April. As at the Statement of Financial Position date, the CCL liability accrued relates to the twelve month period to 31 March 2017 triggered at 1 April 2016. No liability for the levies is recognised for scheme years beyond March 2017. The charge for the current year for the Group and Society is £59,000 (2016: £164,000).

### 25. GENERAL RESERVES

| | Group | | Society | |
|---|---|---|---|---|
| | **2017 £000** | 2016 £000 | **2017 £000** | 2016 £000 |
| As at 1 February 2016 | **31,532** | 30,421 | **29,971** | 28,862 |
| Profit for the year | **1,064** | 1,111 | **2,625** | 1,109 |
| **As at 31 January 2017** | **32,596** | 31,532 | **32,596** | 29,971 |

### 26. AVAILABLE-FOR-SALE RESERVES

| **Group & Society** | **2017 £000** | 2016 £000 |
|---|---|---|
| As at 1 February 2016 | **(46)** | 7 |
| Valuation gains/(losses) recognised directly in other comprehensive income | **43** | (53) |
| **As at 31 January 2017** | **(3)** | (46) |

When an investment is sold, the gain or loss accumulated in equity is reclassified to profit or loss.

### 27. FINANCIAL INSTRUMENTS

The Group uses financial instruments to invest liquid asset balances and raise wholesale funding. The Group also uses derivative financial instruments (derivatives) to manage the risks arising from its operations.

The Group uses derivatives for economic hedging purposes only. The Group does not run a trading book.

The Group's core business is to provide its members with financial products appropriate to their needs. The Group uses wholesale financial instruments to invest in liquid assets and to raise funds from wholesale money markets in support of its retail savings operations. These instruments also allow it to manage the financial risks arising from these business activities.

The Group has a well-established formal structure for managing financial risks which includes formal risk policies, risk limits, reporting structures, mandates and control procedures. This structure begins with the Board of Directors and its Asset & Liability Committee.

Financial instruments used by the Group for risk management purposes include derivative instruments. In accordance with the Building Societies Act 1986 such instruments are only used to limit the extent to which the Group will be affected by changes in interest rates.

As part of its responsibilities, the Board approves the use of specified instruments within approved limits and business activities. The Group does not undertake transactions for trading or speculative purposes.

## 27. FINANCIAL INSTRUMENTS (continued)

The Board approves the use of interest rate swaps in order to manage the Group's balance sheet risk exposures. These instruments are used to protect the Group from exposures arising principally from fixed-rate mortgage lending, and they could also be used against exposures arising from fixed-rate savings products and deposit funding if the need arose. The duration of the contracts is generally short to medium-term and their maturity profile reflects the nature of exposures arising from underlying business activities.

The notional principal of these instruments reflects the extent of the Group's involvement in the instruments, but does not represent its exposure to credit risk which is assessed by reference to the fair value.

**Categories of financial assets and liabilities**

Financial assets and liabilities are measured on an on-going basis either at fair value or at amortised cost. *Note 1* 'Financial instruments' describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The tables below analyse the Group's assets and liabilities by financial classification:

| **Carrying values by category as at 31 January 2017** | Held at amortised cost | | Held at fair value | | | |
|---|---|---|---|---|---|---|
| | Loans and receivables £000 | Financial assets and liabilities at amortised cost £000 | Available-for-sale £000 | Derivatives designated as fair value hedges £000 | Unmatched derivatives £000 | Total £000 |
| **Financial assets** | | | | | | |
| Cash in hand and with Bank of England | - | 46,150 | - | - | - | 46,150 |
| Loans and advances to credit institutions | 23,096 | - | - | - | - | 23,096 |
| Debt securities | - | - | 26,610 | - | - | 26,610 |
| Derivative financial instruments | - | - | - | 58 | - | 58 |
| Loans and advances to customers | 311,313 | - | - | - | - | 311,313 |
| Other assets | - | 2,005 | - | - | - | 2,005 |
| | **334,409** | **48,155** | **26,610** | **58** | **-** | **409,232** |
| **Financial liabilities** | | | | | | |
| Shares | - | 365,007 | - | - | - | 365,007 |
| Amounts owed to credit institutions | - | - | - | - | - | - |
| Amounts owed to other customers | - | 10,490 | - | - | - | 10,490 |
| Derivative financial instruments | - | - | - | 89 | - | 89 |
| Other liabilities | - | 1,053 | - | - | - | 1,053 |
| Reserves | - | 32,593 | - | - | - | 32,593 |
| | **-** | **409,143** | **-** | **89** | **-** | **409,232** |

*There is no material difference between the above figures for the Group and those for the Society.*

### 27. FINANCIAL INSTRUMENTS (continued)

**Carrying values by category as at 31 January 2016**

| | Held at amortised cost | | Held at fair value | | | |
|---|---|---|---|---|---|---|
| | Loans and receivables £000 | Financial assets and liabilities at amortised cost £000 | Available-for-sale £000 | Derivatives designated as fair value hedges £000 | Unmatched derivatives £000 | Total £000 |
| **Financial assets** | | | | | | |
| Cash in hand and with Bank of England | - | 40,141 | - | - | - | 40,141 |
| Loans and advances to credit institutions | 20,959 | - | - | - | - | 20,959 |
| Debt securities | - | - | 39,785 | - | - | 39,785 |
| Loans and advances to customers | 286,051 | - | - | - | - | 286,051 |
| Other assets | - | 1,986 | - | - | - | 1,986 |
| | **307,010** | **42,127** | **39,785** | **-** | **-** | **388,922** |
| **Financial liabilities** | | | | | | |
| Shares | - | 342,072 | - | - | - | 342,072 |
| Amounts owed to credit institutions | - | - | - | - | - | - |
| Amounts owed to other customers | - | 13,483 | - | - | - | 13,483 |
| Derivative financial instruments | - | - | - | 362 | - | 362 |
| Other liabilities | - | 1,519 | - | - | - | 1,519 |
| Reserves | - | 31,486 | - | - | - | 31,486 |
| | **-** | **388,560** | **-** | **362** | **-** | **388,922** |

*There is no material difference between the above figures for the Group and those for the Society.*

Loans and advances to customers in the above tables includes an amount of £27,000 (2016: £353,000) in relation to fair value adjustments in respect of hedged fixed-rate mortgages.

At the year end, the Group has loan commitments to customers of £16.2m (2016: £20.7m) measured at cost less impairment.

## 27. FINANCIAL INSTRUMENTS (continued)

**Valuation of financial instruments carried at fair value**

The Group holds certain financial assets and liabilities at fair value, grouped into Levels 1 to 3 of the fair value hierarchy (see below).

***Valuation techniques***

Fair values are determined using the following fair value hierarchy that reflects the significance of the inputs in measuring fair value:

Level 1 The most reliable fair values of financial instruments are quoted market prices in an actively traded market. The Group's Level 1 portfolio comprises debt securities for which traded prices are readily available.

Level 2 These are valuation techniques for which all significant inputs are taken from observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed when no active market exists and quoted prices are available for similar instruments in active markets. The Group's Level 2 portfolio comprises interest rate swaps. The valuation of interest rate swaps is based on the 'present value' method. Expected interest cash flows are discounted using the prevailing LIBOR yield curves. The LIBOR yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the interest cash flows and maturities of the instruments.

Level 3 These are valuation techniques for which one or more significant input is not based on observable market data. The Group currently does not hold any Level 3 instruments.

The table below summarises the fair values of the Group's financial assets and liabilities that are accounted for at fair value, analysed by the valuation methodology used by the Group to derive the financial instruments fair value:

| **Group & Society** | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
|---|---|---|---|---|
| **31 January 2017** | | | | |
| **Financial assets** | | | | |
| Debt securities | **26,610** | **-** | **-** | **26,610** |
| Derivative financial instruments | **-** | **58** | **-** | **58** |
| | **26,610** | **58** | **-** | **26,668** |
| **Financial liabilities** | | | | |
| Derivative financial instruments | **-** | **89** | **-** | **89** |
| | **-** | **89** | **-** | **89** |
| **31 January 2016** | | | | |
| **Financial assets** | | | | |
| Debt securities | 39,785 | - | - | 39,785 |
| | 39,785 | - | - | 39,785 |
| **Financial liabilities** | | | | |
| Derivative financial instruments | - | 362 | - | 362 |
| | - | 362 | - | 362 |

## 27. FINANCIAL INSTRUMENTS (continued)

### Credit Risk

Credit risk is the risk that a borrower or counterparty will cause a financial loss for the Group by failing to discharge an obligation.

All loan applications are assessed with reference to the Group's lending policy. Changes to policy are recommended by the Retail Credit Committee and approved by the Board and loan applications are approved in accordance with delegated lending authorities. The Asset & Liability Committee is responsible for approving treasury counterparties.

The Group's maximum credit risk exposure is detailed in the table below:

| Group & Society | 2017 £000 | 2016 £000 |
|---|---|---|
| Cash in hand and with Bank of England | 46,150 | 40,141 |
| Loans and advances to credit institutions | 23,096 | 20,959 |
| Debt securities | 26,610 | 39,785 |
| Derivative financial instruments | 58 | - |
| Loans and advances to customers | 311,313 | 286,051 |
| Total Statement of Financial Position exposure | 407,227 | 386,936 |
| Statement of Financial Position exposure commitments | 16,188 | 20,660 |

## 27. FINANCIAL INSTRUMENTS (continued)

**Credit Risk** (continued)

***Credit quality analysis of loans and advances to customers***

The tables below set out information about the credit quality of financial assets and the allowance for impairment/loss held by the Group against those assets.

| **Group and Society** | **2017** | | | 2016 | | |
|---|---|---|---|---|---|---|
| | **Loans fully secured on residential property** | **Loans fully secured on land** | **Other loans** | Loans fully secured on residential property | Loans fully secured on land | Other loans |
| | **£000** | **£000** | **£000** | £000 | £000 | £000 |
| Neither past due nor impaired | **290,786** | **14,095** | **-** | 263,499 | 14,747 | - |
| Past due but not impaired | | | | | | |
| 30 - 60 days | **3,089** | **148** | **-** | 4,294 | 433 | - |
| 60 - 90 days | **484** | **-** | **-** | 901 | - | - |
| 90 - 180 days | **1,772** | **-** | **-** | 1,322 | - | - |
| 180 days+ | **1,214** | **194** | **-** | 831 | 113 | - |
| | **6,559** | **342** | **-** | 7,348 | 546 | - |
| Individually impaired | | | | | | |
| Not past due | **46** | **-** | **-** | - | - | - |
| 30 - 60 days | **-** | **-** | **-** | - | - | - |
| 60 - 90 days | **-** | **-** | **-** | - | - | - |
| 90 - 180 days | **-** | **-** | **-** | - | - | - |
| 180 days+ | **45** | **-** | **-** | 439 | - | - |
| Possession | **96** | **-** | **-** | - | - | - |
| | **187** | **-** | **-** | 439 | - | - |
| Allowance for impairment | | | | | | |
| Individual | **(60)** | **-** | **-** | (228) | - | - |
| Collective | **(300)** | **-** | **-** | (300) | - | - |
| Total allowance for impairment | **(360)** | **-** | **-** | (528) | - | - |

## 27. FINANCIAL INSTRUMENTS (continued)

**Credit Risk** (continued)

Individual assessments are made of all mortgage loans where objective evidence indicates that losses are likely (for example when loans are past due) or the property is in possession, or where fraud or negligence has been identified. Further consideration is given in *Note 1* to the Accounts.

The table below stratifies credit exposures from mortgage loans and advances to retail customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan – or the amount committed for loan commitments – to the value of the collateral. The gross amounts exclude any impairment allowance. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination updated based on changes in house price indices.

| **Group & Society** | **2017 £000** | 2016 £000 |
|---|---|---|
| LTV | | |
| Less than 50% | **123,929** | 105,693 |
| 51%-70% | **114,045** | 115,340 |
| 71%-90% | **70,827** | 61,122 |
| 91%-100% | **2,588** | 3,756 |
| More than 100% | **284** | 668 |
| **As at 31 January 2017** | **311,673** | 286,579 |

## 27. FINANCIAL INSTRUMENTS (continued)

**Credit Risk** (continued)

***Forbearance***

All temporary payment reductions are agreed for periods relevant to the borrower's circumstances. The arrangement will be subject to regular review with the aim of the borrower re-commencing the contractual monthly payment, together with repayment of the payment shortfall as soon as they are in a position to do so.

Payment plans are agreed to enable borrowers to reduce their arrears balances by an agreed amount per month which is paid in addition to their standard monthly repayment.

Capitalisation occurs where arrears are added to the capital balance outstanding for the purposes of re-structuring the loan.

The term of the mortgage is extended in order to reduce payments to a level which is affordable to the borrower based on their current financial circumstances.

All forbearance arrangements are formally discussed with the borrower and reviewed by management prior to acceptance of the forbearance arrangement. By offering borrowers in financial difficulty the option of forbearance the group potentially exposes itself to an increased level of risk through prolonging the period of non-contractual payment and/or potentially placing the borrower into a detrimental position at the end of the forbearance period.

Regular monitoring of the level of and different types of forbearance activity are reported to the Retail Credit Committee on a quarterly basis. In addition, all forbearance arrangements are reviewed and discussed with the borrower on a regular basis to assess the on-going potential risk to the Group and the suitability of the arrangement for the borrower.

The table below details the number of forbearance cases applied as at the year-end:

| **Group & Society** | **2017**<br>**£000** | 2016<br>£000 |
|---|---|---|
| Temporary payment reductions | **2** | 4 |
| Payment plans | **48** | 54 |
| Capitalisations | **-** | - |
| Mortgage term extensions | **-** | - |
| | **50** | 58 |

## 27. FINANCIAL INSTRUMENTS (continued)

### Liquidity Risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

The Group's policy is to maintain sufficient funds in a liquid form at all times to ensure that the Group can meet its liabilities as they fall due. The objective of liquidity is to help smooth mis-matches between maturing assets and liabilities and to provide a degree of protection against any unexpected developments that might arise.

***Maturity analysis for financial assets and financial liabilities***

The tables below set out the remaining contractual maturities of the Group's financial liabilities and financial assets. In practice, contractual maturities are not always reflected in actual experience. For example, loans and advances to customers tend to repay ahead of contractual maturity and customer deposits (for example shares) are likely to be repaid later than on the earliest date on which repayment can be required.

| **Group as at 31 January 2017** | On demand £000 | Not more than three months £000 | More than three months but not more than one year £000 | More than one year but not more than five years £000 | More than five years £000 | Non-defined maturity £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| Cash in hand and with Bank of England | 46,135 | - | - | - | - | 15 | 46,150 |
| Loans and advances to credit institutions | 3,014 | 11,000 | 9,000 | - | - | 82 | 23,096 |
| Debt securities | - | 3,000 | 20,000 | 3,525 | - | 85 | 26,610 |
| Derivative financial instruments | - | - | - | - | - | 58 | 58 |
| Loans and advances to customers | 930 | 3,025 | 9,513 | 59,198 | 238,647 | - | 311,313 |
| Other assets | - | - | - | - | - | 2,005 | 2,005 |
| | **50,079** | **17,025** | **38,513** | **62,723** | **238,647** | **2,245** | **409,232** |
| **Financial liabilities** | | | | | | | |
| Shares | 312,196 | 6,315 | - | 25,936 | 18,192 | 2,368 | 365,007 |
| Amounts owed to credit institutions | - | - | - | - | - | - | - |
| Amounts owed to other customers | 7,467 | 3,000 | - | - | - | 23 | 10,490 |
| Derivative financial instruments | - | - | - | - | - | 89 | 89 |
| Other liabilities | - | - | - | - | - | 1,053 | 1,053 |
| Reserves | - | - | - | - | - | 32,593 | 32,593 |
| | **319,663** | **9,315** | **-** | **25,936** | **18,192** | **36,126** | **409,232** |

*There is no material difference between the above figures for the Group and those for the Society.*

## 27. FINANCIAL INSTRUMENTS (continued)

**Liquidity Risk** (continued)

| **Group as at 31 January 2016** | On demand £000 | Not more than three months £000 | More than three months but not more than one year £000 | More than one year but not more than five years £000 | More than five years £000 | Non-defined maturity £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| Cash in hand and with Bank of England | 40,132 | - | - | - | - | 9 | 40,141 |
| Loans and advances to credit institutions | 2,895 | 10,000 | 8,000 | - | - | 64 | 20,959 |
| Debt securities | - | 9,168 | 27,003 | 3,490 | - | 124 | 39,785 |
| Loans and advances to customers | 439 | 2,781 | 8,569 | 54,564 | 219,698 | - | 286,051 |
| Other assets | - | - | - | - | - | 1,986 | 1,986 |
| | **43,466** | **21,949** | **43,572** | **58,054** | **219,698** | **2,183** | **388,922** |
| **Financial liabilities** | | | | | | | |
| Shares | 288,035 | 5,473 | 26,484 | 19,633 | - | 2,447 | 342,072 |
| Amounts owed to credit institutions | - | - | - | - | - | - | - |
| Amounts owed to other customers | - | 13,454 | - | - | - | 29 | 13,483 |
| Derivative financial instruments | - | - | - | - | - | 362 | 362 |
| Other liabilities | - | - | - | - | - | 1,519 | 1,519 |
| Reserves | - | - | - | - | - | 31,486 | 31,486 |
| | **288,035** | **18,927** | **26,484** | **19,633** | **-** | **35,843** | **388,922** |

*There is no material difference between the above figures for the Group and those for the Society.*

**27. FINANCIAL INSTRUMENTS** (continued)

**Liquidity Risk** (continued)

The tables below show the Group's gross contractual cash flows payable under financial liabilities:

| **Group as at 31 January 2017** | On demand £000 | Not more than three months £000 | More than three months but not more than one year £000 | More than one year but not more than five years £000 | More than five years £000 | Total £000 |
|---|---|---|---|---|---|---|
| **Financial liabilities** | | | | | | |
| Shares | 314,235 | 6,356 | 26,105 | 18,311 | - | 365,007 |
| Amounts owed to credit institutions | - | - | - | - | - | - |
| Amounts owed to other customers | - | 10,490 | - | - | - | 10,490 |
| | **314,235** | **16,846** | **26,105** | **18,311** | **-** | **375,497** |

| **Group as at 31 January 2016** | On demand £000 | Not more than three months £000 | More than three months but not more than one year £000 | More than one year but not more than five years £000 | More than five years £000 | Total £000 |
|---|---|---|---|---|---|---|
| **Financial liabilities** | | | | | | |
| Shares | 289,979 | 5,565 | 26,691 | 19,837 | - | 342,072 |
| Amounts owed to credit institutions | - | - | - | - | - | - |
| Amounts owed to other customers | - | 13,483 | - | - | - | 13,483 |
| | **289,979** | **19,048** | **26,691** | **19,837** | **-** | **355,555** |

*There is no material difference between the above figures for the Group and those for the Society.*

The analysis of gross contractual cash flows differs from the maturity analysis above due to the inclusion of accrued interest.

## 27. FINANCIAL INSTRUMENTS (continued)

**Market Risk**

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices.

The Group is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature. The Group manages this exposure through the use of financial instruments within defined parameters to provide a hedge against identified exposure in fixed-rate lending.

The table below summarises these re-pricing mismatches as at 31 January 2017. Items are allocated to time bands by reference to the earlier of the next interest rate re-pricing date and the maturity date.

| **Group as at 31 January 2017** | Three months or less | More than three months but not more than six months | More than six months less than one year | More than one year but not less than five years | More than five years | Non-interest bearing | Total |
|---|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| **Financial assets** | | | | | | | |
| Liquid assets | 49,149 | 14,000 | 29,000 | 3,525 | - | 182 | 95,856 |
| Derivative financial instruments | - | - | - | - | - | 58 | 58 |
| Loans and advances to customers | 245,839 | 17,108 | 8,691 | 39,675 | - | - | 311,313 |
| Tangible fixed assets | - | - | - | - | - | 1,625 | 1,625 |
| Intangible assets | - | - | - | - | - | 123 | 123 |
| Other debtors | - | - | - | - | - | 257 | 257 |
| | **294,988** | **31,108** | **37,691** | **43,200** | **-** | **2,245** | **409,232** |
| **Financial liabilities** | | | | | | | |
| Shares | 312,196 | 6,315 | 25,936 | 18,192 | - | 2,368 | 365,007 |
| Amounts owed to credit institutions | - | - | - | - | - | - | - |
| Amounts owed to other customers | 7,467 | 3,000 | - | - | - | 23 | 10,490 |
| Derivative financial instruments | - | - | - | - | - | 89 | 89 |
| Other liabilities and accruals | - | - | - | - | - | 933 | 933 |
| Deferred tax liability | - | - | - | - | - | 62 | 62 |
| Provision for liabilities | - | - | - | - | - | 58 | 58 |
| Reserves | - | - | - | - | - | 32,593 | 32,593 |
| | **319,663** | **9,315** | **25,936** | **18,192** | **-** | **36,126** | **409,232** |
| Notional amount of interest rate swaps | 40,000 | (5,500) | (8,000) | (26,500) | - | - | - |
| Interest rate sensitivity gap | 15,325 | 16,293 | 3,755 | (1,492) | - | (33,881) | - |
| Cumulative Gap | 15,325 | 31,618 | 35,373 | 33,881 | 33,881 | - | |

*There is no material difference between the above figures for the Group and those for the Society.*

## 27. FINANCIAL INSTRUMENTS (continued)

**Market Risk** (continued)

| **Group as at 31 January 2016** | Three months or less £000 | More than three months but not more than six months £000 | More than six months less than one year £000 | More than one year but not less than five years £000 | More than five years £000 | Non-interest bearing £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| Liquid assets | 89,083 | 8,000 | 3,533 | - | - | 269 | 100,885 |
| Loans and advances to customers | 223,700 | 2,098 | 14,096 | 46,157 | - | - | 286,051 |
| Tangible fixed assets | - | - | - | - | - | 1,634 | 1,634 |
| Intangible assets | - | - | - | - | - | 130 | 130 |
| Other debtors | - | - | - | - | - | 222 | 222 |
| | **312,783** | **10,098** | **17,629** | **46,157** | **-** | **2,255** | **388,922** |
| **Financial liabilities** | | | | | | | |
| Shares | 288,035 | 5,473 | 26,484 | 19,633 | - | 2,447 | 342,072 |
| Amounts owed to credit institutions | - | - | - | - | - | - | - |
| Amounts owed to other customers | 13,454 | - | - | - | - | 29 | 13,483 |
| Derivative financial instruments | - | - | - | - | - | 362 | 362 |
| Other liabilities and accruals | - | - | - | - | - | 1,362 | 1,362 |
| Deferred tax liability | - | - | - | - | - | 62 | 62 |
| Provision for liabilities | - | - | - | - | - | 95 | 95 |
| Reserves | - | - | - | - | - | 31,486 | 31,486 |
| | **301,489** | **5,473** | **26,484** | **19,633** | **-** | **35,843** | **388,922** |
| Notional amount of interest rate swaps | 39,000 | - | (11,000) | (28,000) | - | - | - |
| Interest rate sensitivity gap | 50,294 | 4,625 | (19,855) | (1,476) | - | (33,588) | - |
| Cumulative Gap | 50,294 | 54,919 | 35,064 | 33,588 | 33,588 | - | |

*There is no material difference between the above figures for the Group and those for the Society.*

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and financial liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a monthly basis include a 100-basis point parallel fall or rise in the yield curve in a 12-month period. A 1% rate change will result in a net interest income change of £256,300 for one year (2016: £205,000).

## 28. CAPITAL STRUCTURE

The Group's policy is to maintain a strong capital base to maintain member, creditor and market confidence and to sustain future development of the business. The formal ICAAP (Internal Capital Adequacy Assessment Process) assists the Board with management of capital. Through its annual Corporate Plan the Board monitors the Group's capital position to assess whether adequate capital is held to mitigate the risks faced in the course of the Group's business activities. The Group's actual capital position is reviewed against stated risk appetite which aims to maintain capital at a specific level above its Internal Capital Guidance (ICG).

The Group's capital requirements are set and monitored by the Prudential Regulation Authority (PRA).

There were no reported breaches of capital requirements during the year.

## 29. GUARANTEES AND OTHER FINANCIAL COMMITMENTS

a) Section 22 of the Building Societies Act 1986 was repealed with effect from 11 June 1996 and the Society therefore has no obligation to stand by its subsidiary in respect of liabilities incurred after this date. However it is the intention of the Board to continue to support fully its subsidiary undertaking.

b) At 31 January 2017, non-cancellable operating lease payments for land and buildings were:

| **Group & Society** | **2017 £000** | 2016 £000 |
|---|---|---|
| Within one year | **65** | 76 |
| Between one and five years | **137** | 182 |
| More than five years | **-** | 6 |
| | **202** | 264 |

c) At 31 January 2017, amounts payable under finance leases were:

| **Group & Society** | **2017 £000** | 2016 £000 |
|---|---|---|
| Within one year | **3** | - |
| Between one and five years | **6** | - |
| More than five years | **-** | - |
| | **9** | - |

# Notes to the Accounts (continued)

## 30. RELATED PARTIES

***Transactions with key management personnel***

| | 2017 Number | £000 | 2016 Number | £000 |
|---|---|---|---|---|
| Loans and advances to customers | **1** | **151** | 1 | 151 |
| Deposits and share accounts | **13** | **244** | 15 | 133 |

The aggregate amount outstanding at 31 January 2017 in respect of loans, transactions and arrangements made by the Society to Directors or persons connected with a Director was £150,818 and comprised one secured mortgage to one Director (2016: £150,745 comprising one secured mortgage to one Director) at normal commercial rates and on the Society's standard terms and conditions.

A Register of loans and transactions subsisting between the Society and its Directors (and connected persons) is maintained. This Register is available for inspection by any member of the Society at the Society's Head Office for a period of fifteen days prior to the Annual General Meeting and at the Annual General Meeting.

## 31. COUNTRY BY COUNTRY REPORTING

Scottish Building Society and its subsidiary are both UK-registered entities, with 100% of their activities within the UK.

The Society's total operating income, profit before tax, tax paid, public subsidies received and the number of full time equivalent employees during the year to 31 January 2017 were:

| **Group & Society** | **2017 £000** | 2016 £000 |
|---|---|---|
| Total operating income | **6,311** | 6,522 |
| Profit before tax | **1,275** | 1,334 |
| Tax paid in year | **288** | 118 |
| Public subsidies received | **Nil** | Nil |
| Average number of employees on FTE basis | **63** | 60 |

The Country-by-Country information has been prepared on the following basis:

- Total operating income represents Total Net Income for the Group as disclosed in the Income Statement.
- Profit before tax represents Operating Profit and Profit before tax for the Group as disclosed in the Income Statement.
- Tax paid in year represents actual corporation tax payments made during the year as disclosed in the Group Cash Flow Statement.
- Number of employees on an FTE basis is representative of the average number of persons employed by the Group as disclosed in *Note 6* to the Accounts.

## 32. REGISTERED OFFICE

The address of the Society's registered office, which is also the head office, is:

Scottish Building Society
SBS House
193 Dalry Road
Edinburgh
EH11 2EF

## 1. STATUTORY PERCENTAGES

| | % | Statutory Limit % |
|---|---|---|
| a) Lending limit | 4.74 | 25.0 |
| b) Funding limit | 3.00 | 50.0 |

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986. The Lending limit measures the proportion of business assets not in the form of loans fully secured on residential property and the Funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals.

The statutory limits are prescribed in building society legislation and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

## 2. OTHER PERCENTAGES

| | **2017 %** | 2016 % |
|---|---|---|
| As a percentage of shares and borrowings: | | |
| a) Gross capital | **8.68** | 8.87 |
| b) Free capital | **8.33** | 8.46 |
| c) Liquid assets | **25.53** | 28.37 |
| Profit after tax as a percentage of mean total assets | **0.27** | 0.29 |
| Profit after tax (excluding movement in acquired assets and FSCS levy after tax) as a percentage of mean total assets | **0.23** | 0.31 |
| Management expenses as a percentage of mean total assets | **1.31** | 1.28 |

**Explanation of terms**

All of the above percentages are based on Group figures.

Shares and borrowings represents the total of shares, amounts owed to credit institutions and amounts owed to other customers (all including accrued interest).

Gross capital is the general reserves as shown in the balance sheet.

Free capital represents gross capital and collective impairment loss less tangible fixed assets and intangible assets.

Mean total assets represents the average of total assets shown in the relevant balance sheets. These amounted to £383,558k for 2016, increasing to £399,077k for 2017.

Management expenses represents the aggregate of administrative expenses and depreciation and amortisation.

## 3. DIRECTORS AND OTHER OFFICERS AS AT 31 JANUARY 2017

### Directors

| Name and Business Occupation | Date of Birth | Date of Appointment | Other Directorships |
|---|---|---|---|
| **Raymond J Abbott**<br>Company Director | 02.03.59 | 01.06.13 | SBS Mortgages Limited<br>Foresight 3 VCT PLC |
| **James Coyle**<br>Company Director | 25.08.56 | 01.03.15 | HSBC Trust Company (UK) Limited<br>HSBC Bank PLC<br>Marks & Spencer Financial Services PLC<br>Honeycomb Investment Trust PLC<br>Scottish Water |
| **Robert Golbourn**<br>Banker | 08.06.45 | 25.10.06 | None |
| **John C Ogston**<br>Chartered Banker | 28.04.57 | 01.07.13 | Vehicle Professionals Limited<br>Constant Progress Limited<br>Equator Capital Limited<br>Toward Technology Limited |
| **Simon M Pashby**<br>Chartered Accountant | 16.04.58 | 15.10.14 | The Medical Protection Society Limited<br>MPI (London) Limited<br>Shepherds Friendly Society Limited |
| **David Peebles**<br>Company Director | 14.02.62 | 25.10.06 | XM International Associates Limited |
| **Mark L Thomson**<br>Building Society Chief Executive | 22.04.66 | 12.10.12 | SBS Mortgages Limited |
| **Aileen Brown**<br>Building Society Finance Director | 16.07.66 | 01.08.16 | None |

Documents may be served on any of the above-named Directors c/o KPMG LLP at the following address:
Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EG

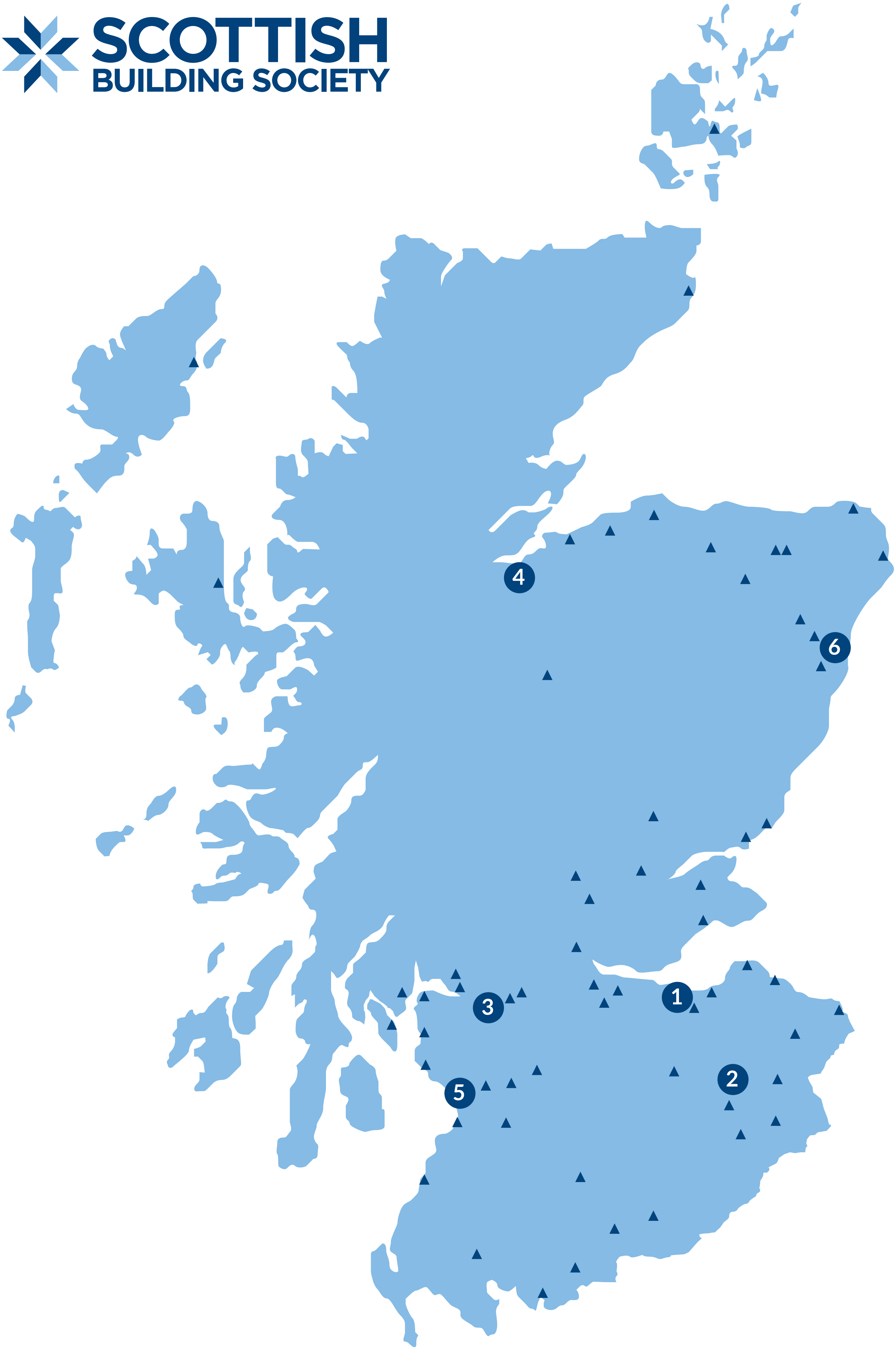
### Executive Directors' Service Contracts

Mr Thomson and Mrs Brown have rolling service contracts with the Society dated 6 March 2017 and 28 February 2017 respectively, which can be terminated by either party giving six months' notice.

### Officers

| Name | Business Occupation | Other Directorships |
|---|---|---|
| **Aileen Rose** | Society Secretary | None |
| **Alan Searl** | Chief Operating Officer | None |
| **Alison I Quilter** | Head of IT | None |
| **Andrew Moses** | Head of Lending | None |
| **Emily F Dixon** | Head of Human Resources | None |
| **Graeme L Chandler** | Head of Finance | None |
| **John H Lloyd** | Head of Sales | None |
| **Kerra McKinnie** | Head of Marketing & Communications | Burgh After School Club |
| **Kenny Mearns** | Head of Risk | None |

SCOTTISH
BUILDING SOCIETY



# Our Area Offices


**1 EDINBURGH AND EAST**
SBS House
193 Dalry Road
Edinburgh
EH11 2EF

Tel: 0131 313 7755

**2 GALASHIELS AND BORDERS**
48 Bank Street
Galashiels
TD1 1EP

Tel: 01896 753682

**3 GLASGOW AND WEST**
18 Waterloo Street
Glasgow
G2 6DB

Tel: 0141 248 6111

**4 INVERNESS AND NORTH**
71 Queensgate
Inverness
IV1 1DG

Tel: 01463 234423

**5 TROON AND SOUTH WEST**
27 Ayr Street
Troon
KA10 6EB

Tel: 01292 315506

**6 ABERDEEN MORTGAGE OFFICE**
6-10 Thistle Street,
Aberdeen
AB10 1XZ

Tel: 01224 622900


# Plus agency offices

▲ For a list of agency offices across Scotland, please call us or visit our website:

**0131 313 7700**
**scottishbs.co.uk**

# OUR Loyalty Promises

**We promise** to provide you with access to ***member only products*** and exclusive offers from time to time, whether you are an existing saver or a borrower.

**We promise** to make products available that will ***reward your loyalty*** to us.

**We promise** only to offer products and services that are fair and are designed to provide you with ***long-term value.***

**We promise** to offer our ***best available rates*** to you throughout the term of your relationship with us.

**We promise** to always allow you a say in what ***local charities*** the Society supports.

**We promise** to ***treat you as an individual,*** both at the commencement of your relationship with us, and throughout.

Head Office: SBS House, 193 Dalry Road, Edinburgh EH11 2EF.