ANNUAL REPORT & ACCOUNTS

2017

Manchester
BUILDING SOCIETY

Manchester
BUILDING SOCIETY

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CHAIRMAN'S STATEMENT

In the twelve months ended 31 December 2017 the Society and its subsidiaries (the "Group") recorded an operating profit before impairments and provisions of £1.6m compared with £0.5m in the preceding twelve months. There was a modest increase in net interest income despite the continued reduction in the size of the loan book which fell 13% from £289m to £251m. There was a corresponding reduction in funding from £340m to £265m.

Administrative expenses (including depreciation) of £8.0m were lower than the £8.7m in the previous year. This total included £2.5m (2016: £1.0m) for legal costs associated with the claim against Grant Thornton, the Society's previous auditors, concerning matters which were fully described in the Group's 2012 Annual Report and Accounts. The resulting trial commenced in January 2018; judgment is not expected for some months.

The Society's €58m Spanish Lifetime portfolio originated between 2008 and 2010 required a further provision of £2.8m in the year (2016: £1.6m) owing to adverse external factors, including exchange rates and forecast house prices in Spain. Impairment provisions on the remainder of the portfolio were lower than in the previous year at £0.4m credit (2016: £1.8m charge).

The Group recorded a post-tax loss of £0.8m (2016: loss £3.4m). At 31 December 2017, the Group had negative accounting reserves of £10.0m (2016: negative £9.2m). The Society complied with all regulatory requirements throughout the year in total capital terms but did not meet the qualitative standards for the level of CET 1 regulatory capital. As a result, the Society was prohibited by Capital Requirements Directive IV ("CRD IV") from paying the coupons on Permanent Interest Bearing Shares ("PIBS") in 2017. The Board considers that there continues to be uncertainty over the Society's ability to make coupon payments in the short- to medium-term. In the longer-term, there remains material uncertainty about the Group's prospects as set out in Note 1 to the financial statements on page 25.

The Group continues to hold high levels of liquidity to meet liabilities as they fall due and within the low risk appetite as set by the Board. Of the Group's retail deposits, 99% are covered under the Government's Financial Services Compensation Scheme.

On 31 December 2017, Mr John Allen retired from the Board after 8 years' service and on behalf of the Board I should like to express our thanks for his support and wise counsel and wish him a long and happy retirement.

D.A. Harding
Chairman
12 March 2018

STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017

Introduction

The directors present their 95th Annual Report together with the financial statements and Annual Business Statement for the Group for the year ended 31 December 2017.

The Group consists of the Society and its two wholly owned subsidiaries: MBS (Mortgages) Limited and MBS (Property) Limited; further, under the terms of *IFRS 10 Consolidated Financial Statements*, this set of Financial Statements includes the consolidated position of NMB Mortgage Acquisition Company Limited (in liquidation) ("NMB MAC"), where the Group exerts control notwithstanding that it holds no shares in that entity.

The Group's strategy and results for the year are covered in detail in the sections that follow, along with the principal risks and uncertainties that the Group faces.

Strategy

The Society is owned by its members. The means by which its value is preserved is by providing products that meet the financial needs of both existing and potential members.

The Group's strategy since 2013 has been to reduce its risks and conserve its regulatory capital. This strategy was necessary because of events, fully disclosed in the Annual Report and Accounts for the year ended 31 December 2012, that led to a material write-down of the Group's reserves following a change in the accounting treatment of certain financial assets.

Risk reduction has been achieved via the disposal of almost all of the Group's non-strategic UK lifetime mortgage assets. Further reduction has been sought by investigating the potential for disposals of other mortgage assets. The Board's strategic aim in this regard has been to move the Group's risk profile away from those legacy asset positions that carried higher risks and higher regulatory capital risk weightings.

During 2017 the Group significantly concluded a project to ensure regulatory compliance of two acquired second charge loan portfolios, NMB MAC and The Consumer Loans Company Limited ("CLC"), the administration of which is now in house. Discussions with relevant interested parties to acquire these loans in the future will continue.

Regulatory capital conservation has continued to be a priority. The Group continues to have headroom above its Internal Capital Guidance ("ICG") in total capital terms as set by the PRA, but did not meet the qualitative standards for the level of CET 1 regulatory capital. Consequently, the Society did not pay the coupons on PIBS as, in order to conserve capital, such a distribution is prohibited under CRD IV article 141.

The Group has continued to explore ways in which the CET 1 regulatory capital position could be improved and an updated Capital Conservation Plan was submitted to the PRA in April and September 2017. These options include improving the CET 1 regulatory capital position through a capital restructuring exercise. In addition, owing to the financial position and challenges faced by the business, there is a risk that the Group will not meet the regulatory requirement to hold 4.5% of CET 1 capital against risk weighted assets in the future, though based on present projections this is not the case.

The Board continued to take legal advice regarding the Group's claim for damages against the previous external auditors, Grant Thornton UK LLP and as at the date of signing these financial statements the trial verdict is still awaited.

Against this background the Board is currently reviewing the strategic direction of the Group and continues to hold discussions on a regular basis with the PRA; the uncertainties which exist regarding the longer term prospects of the Group are disclosed in Note 1 on page 25.

Business Model

The principal activities of the Group remain the provision of competitive facilities for personal savings and for servicing its existing mortgage finance book, which primarily supports owner occupation of residential property. The Group does not presently engage in further lending.

Key performance indicators

Key performance indicators ("KPIs") monitored by the Board include the following:

- Capital
- Liquid assets
- Retail balances
- Mortgages and other loans
- Administration expenses
- Profit on ordinary activities before tax

The KPIs are considered in more detail in the sections that follow below, with indications as to why each metric is considered to be of importance in assessing financial performance.

STRATEGIC REPORT

FOR THE YEAR ENDED 31 DECEMBER 2017

Review of business performance

In 2017 the Group reported a loss for the financial year of £0.8m (2016: loss of £3.4m).

In the year the Group reported operating profit before impairments and provisions of £1.6m (2016: profit of £0.5m).

A reconciliation of operating profit before impairments and provisions to loss on ordinary activities before taxation and the loss for the financial year is set out below:

The £1.1m increase in operating profit before impairments and provisions from 2016 is a result of:

- Net interest income in the year being £0.5m higher than in 2016. This reflects a £0.5m release of provision for remediation on the NMB MAC & CLC portfolios. Reduced income from loans has been offset by reduced funding costs.
- Lower fee and commission income of £0.1m (2016: £0.2m).
- Administrative expenses decreased by £0.7m. This was a result of £2m cost savings relating to legal fees in 2016 associated with the proposed merger with another mutual society and the preparation of a Capital Conservation Plan. This was offset in 2017 by a £1.5m increase in professional fees associated with the legal claim against Grant Thornton UK LLP. Further cost reductions were experienced through other business efficiencies following a review of cost areas.

Additional net impairment provisions of £2.4m were incurred, as explained more fully on page 5.

In 2017 management undertook a revaluation exercise of the Group's head office property which is recorded within MBS (Property) Limited and consolidated within the Group. Accordingly the value has been increased by £0.4m to reflect its updated fair value.

The Group did not meet the qualitative standards for the level of CET 1 regulatory capital as at 31 December 2017 and, in order to conserve capital, a distribution to PIBS holders in April 2018 may remain prohibited under CRD IV article 141.

PROFITABILITY

Result for the year: The Group reported a loss for the financial year of £0.8m (2016: loss of £3.4m) and a loss on ordinary activities before taxation for the year of £0.8m (2016: loss of £3.0m).The movements in loss are shown in the Statement of Changes in Equity on page 22.

FINANCIAL POSITION

Liquid Assets: The Group's liquid assets are deposited with the Bank of England and with UK clearing bank counterparties in instantly accessible bank accounts. Of the Group's total liquid funds at 31 December 2017, £32.9m was deposited with the Bank of England (2016: £67.4m) following a planned reduction of excess liquidity. Investment securities of £0.04m were held at 31 December 2017 (2016: £0.3m).

Mortgages and Other Loans: Group mortgage balances, after provisions, were £250.8m (2016: £289.5m), representing a year on year decrease of 13.4% (2016: 12.4% decrease). To improve its regulatory capital position, the Society made no advances during the year (2016: £nil).

Overall, the performance of the core mortgage book continues to be in line with expectations. The Group has continued in its efforts to minimise mortgage arrears and to help borrowers in difficulties, taking a consultative approach with borrowers who experience payment difficulties and applying forbearance as appropriate. At 31 December 2017, excluding the second charge portfolio, there were 14 mortgage accounts (2016: 19) where payments were 12 or more months in arrears. Outstanding balances on these accounts amounted to £6.2m (2016: £7.3m) representing 2.3% of total gross mortgage balances (2016: 2.3%), with total arrears of £0.9m (2016: £1.0m). The percentage of accounts 12 months or more in arrears remained stable despite the declining level of total mortgage assets in the year and the absence of new lending. The underlying arrears performance has also remained stable.

There were 9 properties in possession at the end of the year (2016: 12). These figures exclude the NMB MAC portfolio, where the Group only has a beneficial interest in the mortgage assets, and CLC portfolio. As insufficient reliable data exists, arrears banding information is not presented for these second charge portfolios.

Provisions for potential mortgage losses have been calculated by assessing impairment indicators, arrears and forbearance positions and historic loss experience. Mortgage accounts in arrears by 3 months or more are reviewed regularly, as are impairment provision requirements.

Further information is given in Note 1.

Investment property: At the year end the Group held a small number of residential properties as a result of the settlement of impaired mortgage assets. The properties are being held, pending their eventual sale, and have a fair value of £0.7m (2016: £0.8m).

Other Assets: Included within Other Assets is a sum of £1.4m (2016: £3.1m) relating to collateral deposited in the form of cash under credit support annex agreements ("CSA") with the Group's counterparty providers of foreign exchange swaps.

Retail Balances: Retail balances reduced to £247.6m (2016: £315.4m) in line with the overall reduction in the balance sheet. The range of savings products available during the year was carefully managed in order to ensure that a suitable level of funding was held and that the rates offered were appropriately competitive.

Capital: The purpose of the Group's capital is to support its mortgage book and to absorb any losses that may arise, thereby offering members protection as a regulated deposit taker.

The Board manages capital within the regulatory limits set by the PRA. For regulatory capital purposes the Group is made up of the Society, MBS (Mortgages) Limited and, MBS (Property) Limited, with the regulatory capital positions at 31 December 2017 and 31 December 2016 being:

	Group 31 Dec 16	Movement in 2017	Group 31 Dec 17	Regulatory Movement for 2018	Group 1 Jan 18
Tier 1 Capital	£000	£000	£000	£000	£000
Accumulated losses	(9,243)	(780)	(10,023)	-	(10,023)
Deductions	-	-	-	-	-
Profit Participating Deferred Shares	17,461	-	17,461	-	17,461
Total CET1 Capital	8,218	(780)	7,438	-	7,438
Permanent Interest Bearing Shares					
Nominal balance	14,788	-	14,788	-	14,788
Amortisation	(5,915)	(1,479)	(7,394)	(1,479)	(8,873)
Net Permanent Interest Bearing Shares	8,873	(1,479)	7,394	(1,479)	5,915
Total Tier 1 Capital	**17,091**	**(2,259)**	**14,832**	**(1,479)**	**13,353**
Tier 2 Capital					
Subordinated Debt					
Nominal balance	14,200	-	14,200	-	14,200
Amortisation	(2,000)	(1,399)	(3,399)	(500)	(3,899)
Net Subordinated Debt	12,200	(1,399)	10,801	(500)	10,301
Collective Provisions	1,923	(1,492)	431	-	431
Permanent Interest Bearing Shares	5,915	1,479	7,394	1,479	8,873
Total Tier 2 Capital	**20,038**	**(1,412)**	**18,626**	**979**	**19,605**
Total Regulatory Capital	**37,129**	**(3,671)**	**33,458**	**(500)**	**32,958**

Since the start of 2017 Total Regulatory Capital under CRD IV has decreased by £3,671k made up as follows:

- the retained loss of the regulatory capital group for the year of £780k;
- the continued grandfathering of Subordinated debt out of Tier 2 capital over a 9 year period, amounting to £500k in the year;
- Amortisation of Subordinated debt over a 5 year period, amounting to £899k in the year;
- A reduction in the allowed collectively identified provisions of £1,492k.

Under the CRD IV rules applicable from 1 January 2018, Total Regulatory Capital is reduced by £500k compared to the position at 31 December 2017. This is due to Tier 2 Regulatory Capital being reduced by a further £500k in respect of continuing Subordinated debt grandfathering.

As at 31 December 2017 the Group continues to have headroom above its ICG in total capital terms as set by the PRA, but did not meet the qualitative standards for the level of CET 1 regulatory capital. The Group has continued to explore ways in which the CET 1 regulatory capital position could be improved and an updated Capital Conservation Plan was submitted to the PRA in April and September 2017. These options include improving the CET 1 regulatory capital position through a capital restructuring exercise. In addition, owing to the financial position and challenges faced by the business there is a risk that the Society will not meet the regulatory requirement to hold 4.5% of CET 1 capital against risk weighted assets in the future, though based on present projectionss this is not the case. This risk is monitored and under constant review in ongoing discussions with the PRA.

As a result of the shortfall against qualitative standards for the level of CET 1 regulatory capital, under CRD IV article 141, in order to conserve capital, the Society may remain prohibited from making the PIBS coupon payments due in April 2018. The Board considers that there continues to be uncertainty over the Society's ability to make coupon payments thereafter.

The Group's gross capital increased to 13.7% at 31 December 2017 (2016: 10.9%). The free capital at 31 December 2017 was 18.1% (2016: 13.6%). Definitions of gross capital and free capital may be found in the Annual Business Statement on page 65.

The Group is adopting the requirements of *IFRS 9 – Financial instruments* from 1 January 2018. The capital impact of this adoption will be mitigated by transitional arrangements which the Group has confirmed it will be adopting. The regulatory capital reduction due to adoption of IFRS 9 will be restricted to 5% of the provision increase in 2018, increasing to 15% in 2019, 30% in 2020, 50% in 2021, 75% in 2022 and 100% in 2023.

Financial Risk Management Objectives

The Group offers mortgage and savings products. It undertakes limited interaction with the wholesale money market for cash flow and liquidity management purposes. There are formal structures in place to monitor, report and manage the risks associated with the Group's operations. The Board seeks to manage the risks that the Group faces through a suite of regularly reviewed and approved policies covering: Credit, Liquidity, Financial Risk Management and Operational Risk.

Principal Risks and Uncertainties

Given the CET 1 regulatory capital shortfall against qualitative standards for the level of CET 1, the requirement for an increase in CET 1 capital in order to return to lending, and the assessed prospects for the business and its capital position without such a return to lending, there is a material uncertainty to the Society's profitability and capital position arising from the continued run-off of the balance sheet. The Board is assessing a number of options to secure the long-term future of the Group. The immediate focus is on measures to improve the capital position of the Group in discussion with the PRA.

In June 2016 the UK voted in a referendum to leave the European Union ("EU"). The medium to long-term impact of this on UK government policy, the financial markets and the wider UK economy is unknown. The Group's Spanish lifetime portfolio introduces additional uncertainty and risk which the Board is monitoring; in particular there is added risk and uncertainty in relation to foreign exchange volatility, property values for the Spanish lifetime portfolio and the behavioral impact on Spanish lifetime mortgage borrowers.

During 2017 the Group carried out work to prepare for the implementation of *IFRS 9 – Financial instruments* effective on 1 January 2018. The most significant impact on the Group is in respect of the measurement of impairment of financial assets. Under IFRS 9, impairment will be based on expected credit losses ("ECL") rather than incurred credit losses which is the methodology the Group currently adopts under IAS 39. At initial recognition, an ECL provision is required for default events in the next 12 months, whilst following a significant increase in credit risk, a lifetime ECL is required. The review of credit risk and the calculation of ECL are required to be unbiased and probability weighted, and should include all available relevant information, with assessments of current conditions and forecasts of future economic conditions. As a result the recognition and measurement of impairment is more forward looking than is the case under IAS 39. Consequently, it is likely to lead to an increase in the Group's total level of provision. At present, based on an initial assessment, management estimate that the reduction to reserves in 2018 will be in the range of £0.2m to £0.4m.

Every business faces risks as part of its day-to-day operation. The Society has a low appetite for risk and the Board's risk management objectives are to minimise the risks that the Group faces by deploying a range of risk management policies and procedures within an appropriate control environment.

Summarised below are the Group's other key risks and uncertainties:

Credit Risk: The Group is exposed to the risk that it may not receive back in full any sum that has been loaned (in relation to loans and advances) or any sum that it has deposited with a banking counterparty (in relation to liquid assets) when such amounts fall due. The Board monitors credit risk, underlying security values and the level of impairment provisions on a regular basis. Credit risk is more of a consideration in relation to loans and advances than in relation to the Group's liquid assets; the former involve relationships with individuals or small businesses, whilst the latter are far fewer in number, being restricted to either the Bank of England or UK High Street banks, where credit risk is assessed as being very low.

The Group's management of credit risk in respect of loans and advances recognises that as the portfolio runs off it is likely that a greater part of the residual assets will have a higher credit risk profile.

The assessment of credit risk and the related impairment provisioning is a critical accounting estimate, impacted by judgments relating to customer affordability and economic circumstances, including the level of interest rates. Prior to the current strategy of no new lending, credit risk was mitigated by appropriate mortgage underwriting and by limiting the Group's exposure to particular market sectors or loans exhibiting particular attributes. Since the cessation of new lending credit risk has been mitigated through the monitoring of management information, assessment of arrears and forbearance cases, and regular loan provision reviews. The Group holds a beneficial interest in NMB MAC, a portfolio of mortgage assets, some of which are regulated by the Mortgage Conduct of Business regulations ("MCOB"). The legal title of these loans remains with a third party business currently in liquidation, over which the Group exerts control. A further smaller portfolio, CLC, which is now legally owned by the Group, has similarly MCOB regulated mortgage assets. An assessment has been made of the estimated discounted future cash flows expected to arise from both these portfolios of loans which forms the basis for the impairment provision. Sensitivities in respect of the impairment provision required for these portfolios are given on page 43.

Insurance Risk: Impairment assessments incorporate the insurance risk attaching to the Group's lifetime mortgage contracts, which are euro-denominated. The risk arises from a contractual term within the relevant mortgage contracts which in certain circumstances precludes the Group from pursuing the borrower or his estate for any shortfall on redemption. This risk is managed through oversight of the portfolio, including monitoring valuations, the assessment of redemptions and provisioning policy. The insurance provision is a critical accounting estimate, as its assessment is based on expected future outcomes relating to the date on which an account redeems, expected to be on the death of the borrower, a move into care or through non-health related voluntary pre-payment. It is also affected by the assumptions made in relation to house price appreciation and depreciation. This means that the insurance risk provision can move by a material amount dependent upon these assumptions and market conditions.

Liquidity Risk: The Group's strategy is to maintain sufficient funds in unencumbered liquid form at all times to ensure that its liabilities can be met as they fall due. Regular stress testing of liquidity is undertaken by separately using 20 week and 3 month time horizons. The Group operates within closely monitored Board-approved liquidity policy limits, which are reviewed on a daily basis by the Group's Finance and Treasury departments, reported to the Treasury Committee each week and considered by the Board each month. During 2017, the Group continued to have a significant proportion of its liquid assets deposited with the Bank of England.

Capital Risk: In order to conserve capital, the Group has continued to curtail new lending. The Group has also continued to explore ways in which the regulatory capital position could be improved, including the sale of assets. As explained on page 4 as at 31 December 2017 the Group continues to have headroom above its ICG in total capital terms as set by the PRA, but did not meet the qualitative standards for the level of CET 1 regulatory capital. The Group has continued to explore ways in which the CET 1 regulatory capital position could be improved and an updated Capital Conservation Plan was submitted to the PRA in April and September 2017. These options include improving the CET 1 regulatory capital position through a capital restructuring exercise. In addition, owing to the financial position and challenges faced by the business there is a risk that the Group will not meet the regulatory requirement to hold 4.5% of CET 1 capital against risk weighted assets in the future, though based on present projectionss this is not the case. As a result of the shortfall against qualitative standards for the level of CET 1 regulatory capital, under CRD IV article 141, in order to conserve capital, the Group may remain prohibited from making the PIBS coupon payments due in April 2018. The Board considers that there continues to be uncertainty over the Group's ability to make coupon payments thereafter.

Interest Rate Risk: The Group's mortgage and savings products have different interest rate types and differing maturity profiles. This means that the Group is exposed to movements in interest rates. A movement in an external interest rate (e.g. Bank of England Base Rate or LIBOR) does not always affect every mortgage and savings product that the Group holds. The Group has more fixed rate mortgage products (notably its lifetime mortgages) than it has fixed rate savings products. Presently, there are no interest rate swaps in place to mitigate the risk. The interest rate risk position is monitored by the Risk Committee and the Board and is managed via the setting of internal policy limits and through the holding of an ascribed level of regulatory capital to mitigate the risk of interest rate movement. The Board has considered this risk by its review of financial projections under differing interest rate scenarios over the long-term. The Group has a natural partial hedge provided by fixed coupons on capital and some savings products.

The Board does not intend to hedge its fixed rate mortgages using interest rate swaps at this time; this position is monitored regularly. A rise in interest rates gives rise to a risk of decreasing margins as a greater portion of the mortgage portfolio than the deposit portfolio is based on fixed rates. Liquidity risk can also be managed through changes in the interest rate of the deposit book.

Currency Risk: The Group faces currency movement risks on its Euro-denominated mortgage balances which represent 17% of total mortgage assets as at 31 December 2017. The exchange rate risk arising on these balances is managed and mitigated by transacting foreign exchange forwards. The exchange rate risk position is reported to the Asset and Liability Committee (ALCO) and Board each month.

Economic Risk: The Group faces the risk that its interest margin can become subjected to the pressure that is brought to bear from being an institution that is primarily funded through retail deposits. Within this market, there is great competition for attracting retail deposits at sustainable rates of interest. Market rates offered by retail institutions reduced following the launch of the Bank of England's Funding for Lending and Term Funding Schemes; however, there is a risk that as repayments are required under these schemes there may be upward pressure on rates to prevent savings outflows.

The Group is also exposed to movements in the value of residential and commercial property in both its mortgage impairment provision requirements and those property assets held at fair value; the Group's investment property and the Group's head office building.

Regulatory Risk: As a regulated entity, the Group is exposed to risks arising from a failure to adhere to relevant regulation. In order to minimise this risk, the Group has deployed a number of risk management policies and procedures. In January 2017 the Risk Committee and Board approved a revised Risk Management Framework ("RMF"), which is designed around the present needs of the Group. The RMF includes the responsibilities of the Board, the Risk Committee, the Conduct Committee and Management as to how the Group meets, monitors and reports on its regulatory requirements. Oversight of Regulatory Risk is the responsibility of the Compliance function and is led by the Compliance Manager.

The majority of the regulatory requirements that the Group faces are laid down by the PRA and the Financial Conduct Authority ("FCA"). The Group monitors developments in all relevant aspects of financial service regulation and undertakes assessments of the present and future impacts of such. Appropriate actions are taken to strengthen controls and amend the Group's strategy to meet changing regulatory requirements.

In addition to considering the impact of any non-compliance on the recoverability of loan balances and thus impairment provisioning, the Group considers the conduct risk which arises from having originated regulated loans and having acquired regulated loan portfolios. As is the case for all financial institutions there is a risk that aspects of current or historic business might be considered as not being conducted in accordance with all relevant regulation, or the fair and reasonable treatment of customers.

Certain activities of the Group, particularly the NMB MAC and CLC second charge loan portfolios carry greater levels of conduct risk. The administration of the NMB MAC and CLC portfolios was brought in-house in December 2015 and following that transfer the historic conduct of these portfolios was reviewed in detail by management.

Following this review, and having incorporated legal advice received during 2017, the Group has remediated those loans identified as impacted with redress being paid where the Group has been able to contact the customer. As at 31 December 2017 the redress provision was £0.1m (2016: £1.7m) to provide for instances of non-compliance with the CCA within the NMB MAC and CLC portfolios. The provision includes an estimate of the potential cost of interest refunds during periods of non-compliance and other costs associated with a customer redress exercise. Full details of the customer redress provision are set out in Note 29.

Although a detailed review of these portfolios has been carried out, there is no judicial certainty in the legal position and there is a risk that further conduct issues or cases of non-compliance with regulations could be identified in the future. As a result the actual results could differ from our estimates.

Provision has been made where the Group is aware of a specific conduct or regulatory issue and can estimate its impact. Further details in respect of the Group's consideration of other potential conduct and regulatory issues are provided in the contingent liabilities Note 30.

Diversity Matters

Gender Analysis: Below is a table summarising permanent, employed members of staff and directors by gender at 31 December 2017, with comparative positions for the previous year end:

	31 December 2017		31 December 2016	
	Male	**Female**	**Male**	**Female**
Directors	5	1	5	1
Staff	19	29	24	26
Total	24	30	29	27

Given the size and scale of the Group's operations and its headcount, it does not have any members of staff that would be considered for separate disclosure as "Senior Managers" in the above table.

Social, Community and Human Rights Issues

Stakeholders: The Group's members, staff and other stakeholders are key to its success and it is committed to its policy of ensuring that all are treated fairly and equally at all times.

Employees: The Group's policies ensure that discrimination on the grounds of race, colour, religion, belief, nationality, ethnic origin, sex, sexual orientation, marital status, age, part time status and membership (or otherwise) of a trade union is not tolerated. Further, the Group also holds to its policy on disability. This is achieved via a wider policy approach to equal opportunity in the workplace. Training and development opportunities are presented to staff to allow them to acquire relevant professional qualifications, which, in turn, assist the Group in achieving its goals.

Outlook

The medium to long-term impact of the UK vote to leave the EU on UK government policy, the financial markets and the wider UK economy is unknown and this introduces additional uncertainty and risk which the Board will continue to monitor, in particular with regard to the Group's Spanish lifetime portfolio.

The remediation of the NMB MAC and CLC portfolios in 2017 was completed and provides the Group with a greater understanding of and more information on the loan books to enable the Group to take steps toward either a disposal of those assets or a corporate transaction for the Group.

The Board continued to take legal advice regarding the Group's claim for damages against the previous external auditors, Grant Thornton UK LLP throughout 2017 which they believe is in the best interests of members. At the time of signing these financial statements the hearing has concluded but judgment is awaited.

The Group will continue to be managed in run-off for the foreseeable future pending the trial outcome and will carry on discussions with the PRA with regard to the Capital Conservation Plan and the long-term future of the Group. The capital position of the Group, in particular the shortfall against the qualitative standards for the level of CET 1 regulatory capital and the risk of not meeting the regulatory requirement of holding 4.5% CET 1 capital against risk weighted assets, will remain a focus for the Board.

D.A. Harding
Chairman
12 March 2018

DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017

Information presented in other sections of the Annual Report and Accounts

Certain information which is required to be included in the Directors' Report has been included in the separate Strategic Report. This information is deemed to form part of the Directors' Report:

- The Group's profitability and financial position
- The principal risks and uncertainties facing the business
- Outlook for the business
- Detailed financial risk management disclosures are provided in Note 1.

Directors

J.P. Allen (retired 31 December 2017)	Non-executive director
H.F. Baines	Vice Chairman
I.A. Dewar	Non-executive director
D.A. Harding	Chairman
P.A. Lynch	Interim Chief Executive
F.B. Smith	Non-executive director

At the Annual General Meeting Mr Harding, Mr Baines and Mr Lynch will retire by rotation and being eligible, will offer themselves for re-election.

At the year-end no director had an interest in any shares or debentures of the Society or its connected undertakings.

Other matters

Charitable & political donations

The Society made charitable donations totalling £5k (2016: £1k) during the year. No contributions were made for political purposes.

Pillar 3 Disclosure

The Society's Pillar 3 disclosure is available to read on its website at https://www.themanchester.co.uk/Main/FinancialInformation

Supplier payment policy & practice

The Group's policy concerning the payment of its trade creditors is as follows:

a) to agree the terms of payment with a supplier;
b) to ensure that suppliers are aware of the terms of payment;
c) to pay invoices in conformity with the Group's contractual and other legal obligations.

Trade creditors at 31 December 2017 amounted to 27 days of average supplies (2016: 19 days).

Going Concern

The directors consider that it is appropriate for the financial statements to be prepared on a going concern basis of accounting as fully explained in Note 1 on page 25, which sets out the risks and uncertainties assessed as part of the preparation of the financial statements.

Independent Auditors

In accordance with Section 77 of the Building Societies Act 1986 a resolution for the re-appointment of PricewaterhouseCoopers LLP will be proposed at the Annual General Meeting.

On behalf of the Board of Directors
D.A. Harding
Chairman
12 March 2018

CORPORATE GOVERNANCE

The Board is responsible for setting strategy and providing leadership within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board is mindful that ownership of the Society rests with its members and that the provision of appropriate savings and mortgage products is its key aim.

In order to ensure that, as a mutual organisation, it is appropriately governed, the Society has regard to the principles of the UK Corporate Governance Code ("the Code"), which is issued by the Financial Reporting Council ("the FRC") (located at: www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx). In April 2016, the FRC published its revision of the Code which is effective for accounting periods commencing on or after 17 June 2016.

Whilst the Code is more directly relevant to listed companies, its provisions can be adopted by a mutual organisation. The Society has been mindful of the revised Code to the extent deemed reasonable and appropriate by the Board.

At 31 December 2017 the Board consisted of one executive director and five non-executive directors. Two different individuals hold the roles of Chairman and Chief Executive.

All non-executive directors are considered to be independent, except for the Chairman who, by the nature of the role that he holds, is not considered to be wholly independent. Harry Baines was nominated by the Board as the Senior Independent Director. The role of the Senior Independent Director includes being available to members, where contact through the normal channels has failed or where such contact is inappropriate.

On matters where Board approval is required, each director has a single vote; there is a majority of non-executive directors on the Board.

APPOINTMENTS TO THE BOARD

There were no new director appointments during 2017. The Remuneration and Nominations Committee's appointment process focuses on members of the business community in order to identify suitable candidates with specific relevant skills and experience.

On joining the Board, each director is provided with an induction which includes reading material and meetings with the executive director and certain managers. Through a programme of self-managed continuing personal development, each director ensures that they maintain a level of knowledge and skill commensurate with his or her role within the Group.

During the year, all Executive and Non-Executive Directors received training on IFRS 9.

FINANCIAL AND BUSINESS REPORTING

The respective responsibilities of the directors and the Independent Auditors for preparing and reporting on the Annual Report and Accounts are contained within the Statement of Directors' Responsibilities and the Independent Auditors' Report.

REMUNERATION

During 2017 the Remuneration and Nominations committee considered and approved a bonus payment as set out in Note 7, to the Interim Chief Executive for his work and diligence in running the Society and ensuring critical projects were delivered within scope and on time.

No director is involved in the discussion of, or Board voting activity, that relates to his or her own remuneration.

The remuneration policy for directors is contained within the Remuneration Report and service contract details may be found in the Annual Business Statement. Details of directors' remuneration are contained in Note 7 to the financial statements.

INTERACTION WITH SHAREHOLDERS

The "shareholders" of the Group are its borrowing and investing members. Unlike a PLC, each member can only have one vote and as a result there are no "major" or "significant" shareholders whose views can be canvassed for the Board. There are few opportunities for the Group to consult with its members. The Annual General Meeting ("AGM") provides one such opportunity and all Board members are available at this Meeting in order to discuss Society matters with any attending members.

Details of the AGM are sent out to every member; all are encouraged to vote, either in person or by proxy.

THE BOARD AND ITS COMMITTEES

In order to execute its responsibilities in an efficient manner, the Board has constituted seven Committees, of which four (Audit, Remuneration & Nominations, Disclosure and Risk) are oversight Committees and three (Assets and Liabilities Committee ("ALCO"), Conduct and Credit) are executive Committees. The Board retains responsibility for the setting of strategy and the approval of all policy matters. The four oversight Committees are responsible for a more detailed review of matters in their specialist areas, making recommendations to the Board as appropriate. The focus of the three executive Committees is on more day-to-day operational matters, operating within the Board-approved policy framework. Operational matters are delegated to the executive director and staff, within specified mandates, in order to ensure that timely decisions can be taken in support of the Board's strategy and policy limits. In addition, the non-executive directors meet periodically to assess all aspects of governance, board responsibility and board performance.

Assets and Liabilities Committee ("ALCO")

ALCO meets monthly to consider matters relating to liquidity and treasury management, including interest rate risk, treasury counterparty risk, exchange rate risk and interest margin management.

Membership as at 31 December 2017: P.Lynch (Chairman), J. Lincoln*, M.A. Winterbottom*, D. Callaghan*.

(not a director)*

Audit Committee

The Committee's membership includes directors who are considered to be independent and its Chairman has experience in accounting and auditing matters. The Committee receives reports from the Group's internal and external auditors and from the Compliance function; its focus is in relation to compliance with statutory and regulatory requirements and system and control matters, including assessing the effectiveness of risk systems delivered via a rolling Internal Audit Plan which is approved on an annual basis and covers elements of the control environment.

The Committee monitors and approves the non-audit work undertaken by the external auditors, which relates to seeking professional advice on accounting and tax matters. The Audit Committee is satisfied that this non-audit work does not impair PwC's independence. The Committee monitors the financial reporting process, the statutory audit and reviews all financial information that is disclosed externally.

Membership as at 31 December 2017: I.A. Dewar (Chairman) and F.B. Smith.

(* *not a director*)

During the year the committee's focus and key responsibilities consisted of the following:

Review of Financial Reporting matters including:

- Monitoring the integrity of the Group's financial statements and reviewing critical accounting policies, judgments and estimates.
- Reviewing the appropriateness of the going concern basis for preparing the financial statements.
- Providing advice to the Board on whether the Annual Report and Accounts give a true, fair and balanced view and are understandable to the members and other external interested stakeholders.

Within the key judgment areas the committee reviewed and considered the following areas as being the most significant for the Group.

- Loan loss provisions and the assumptions used to determine the level of provisions required for all portfolios including the Spanish lifetime book and NMB MAC loans.
- Going concern accounting given the material uncertainty as disclosed in Note 1a.
- Transition to IFRS 9 and the related disclosure under IAS 8

External Audit oversight and review including:

- Reviewing the objectivity and independence of external audit and assessing the level and appropriateness of non-audit services.
- Considering the appointment, removal, performance and remuneration of the external audit firm
- Considering the planning, scope and findings of the external audit, the receipt of, and responses to the auditors' management letter and reviewing the degree of discussion and cooperation with internal audit.
- Approving any non-audit services to be provided by the external auditors.

Internal Controls and Risk Management including:

- Reviewing the adequacy and effectiveness of the Group's internal controls and risk management systems in conjunction with reviewing reports produced by internal and external audit.
- Reviewing the statements to be included in the Annual Report concerning internal controls and risk management

Reviewing Internal Audit findings including:

- Considering and approving the strategic and annual plans of audit and compliance work.
- Considering management responses to recommendations and ensuring the prompt action of those responses.
- Considering the appointment, removal, performance and remuneration of the internal audit function.
- Considering the internal controls supporting the business operations.

The committee performs an internal self-assessment of its obligations and concluded that it had discharged its duties appropriately and in line with its Terms of Reference.

Conduct Committee

The Committee meets monthly and considers matters relating to the fair treatment of customers.

Membership as at 31 December 2017: P.A. Lynch (Chairman), J.P. Allen, R. Mervill*, V. Smith*

(not a director)*

Credit Committee

The Committee meets monthly to consider all lending policy matters, loan book profile, arrears management and provisioning matters. On a return to lending it would consider lending product development.

Membership as at 31 December 2017: P.A. Lynch (Chairman), D. Callaghan*, J. Lincoln *, D. Spencer*, M.A. Winterbottom*.

(not a director)*

Disclosure Committee

The Committee meets as often as is required to monitor inside information and arrange for its release to the market. In any event, the Committee will meet at least once each year to undertake a review of the Group's systems and procedures relative to the discovery, disclosure and control of inside, regulatory and other sensitive information.

The scope of the Committee responsibilities includes the Group, its subsidiaries and associate companies, enterprises and special purpose vehicles.

Membership as at 31 December 2017: D.A. Harding (Chairman), C.W. Gee *, J. Lincoln*and P.A. Lynch.

(not a director)*

Remuneration and Nominations Committee

The Committee is responsible for making recommendations to the Board in relation to the appointment of new directors, keeping under review the mix of skills and experience of the Board, and also in relation to the levels of remuneration for all Board members and certain managers, as well as policy matters affecting other employees of the Group.

Membership as at 31 December 2017: H.F. Baines (Chairman), D.A. Harding, F.B. Smith.

Risk Committee

In its oversight capacity, the Committee assesses, monitors and manages significant risks faced by the Group and considers strategic issues affecting all areas of risk. Throughout the year, the Committee advised the Board on treasury, balance sheet and operational risk issues.

Membership as at 31 December 2017: I.A. Dewar (Chairman), J.P. Alln, J. Lincoln*, P.A. Lynch, F.B. Smith.

(not a director)*

Board and Committee attendance records for 2017

Attendance at full meetings of the Board and its Committees throughout 2017 is scheduled below. Figures displayed in brackets represent the number of meetings that any individual director was entitled to attend.

Board	Board	ALCO	Audit	Conduct	Credit	Disclosure	Remuneration & Nominations	Risk
J.P. Allen (Retired 31 December 2017)	12 (12)	-	4 (4)	-	-	-	-	5 (5)
H.F. Baines	12 (12)	-	-	-	-	-	4 (4)	-
I.A. Dewar	12 (12)	-	4 (4)	-	-	-	-	5 (5)
D.A. Harding	12 (12)	-	-	-	-	4(8)	4 (4)	-
P.A. Lynch	12 (12)	11 (12)	-	3 (4)	11 (11)	8(8)	-	5 (5)
F.B. Smith	12 (12)	-	3 (4)	-	-	-	4 (4)	5 (5)

The above figures exclude instances where directors have chosen to attend a meeting where they were not a member of that Committee and at which his or her attendance was not strictly required. Also excluded from the above are ad hoc Board and Committee meetings called at short notice and where the agenda items considered were very restricted in nature.

Internal Control

The Board is responsible for ensuring the effectiveness of the Group's systems of risk management and internal control, which are designed to identify, monitor and manage the Group's risks, rather than to eliminate them completely. Through various policies, procedures and appetite statements and with the implementation of a variety of operational control processes, the Board ensures that the Group's risks are managed appropriately and proportionately.

The Group's Risk Committee assesses, monitors and manages the significant risks faced by the Group, overseeing the promotion of a risk based approach to the Group's activities in line with the approved risk appetite for areas of operations.

Directed by the Audit Committee, Internal Audit reviews the control environment throughout the year and reports its findings to the Audit Committee regularly.

Following its annual review of all control activities undertaken in the year by management , internal and external auditors and the Compliance function, the Audit Committee has satisfied itself that, commensurate with the size and risk profile of the current operations of the Group, its systems are effective.

Evaluation

The non-executive directors, led by the senior independent director, are responsible for assessing the performance of the Chairman. The Chief Executive attends the Chairman's appraisal in order for executive views to be taken into consideration.

On an annual basis, the Board and its Committees undertake a process of assessing and formally documenting their performance during the year using a checklist that covers all areas of operation. Contributions are sought from both Board and Committee members and other relevant parties. The Board reviews and approves the written assessments undertaken by all Committees and where required, amendments are made to the Board Procedures as a result of the assessment processes.

DIRECTORS' REMUNERATION REPORT

Introduction

The purpose of this report is to provide details of the Group's policy on the remuneration of its executive and non-executive directors and to explain the process for setting the level of directors' remuneration.

Remuneration and Nominations Committee

The Remuneration and Nominations Committee is responsible for the remuneration policy for all of the directors; it also reviews the remuneration of certain managers. All recommendations made by the Remuneration and Nominations Committee are considered by the full Board. The Committee has regard to best practice as set out in the UK Corporate Governance Code and with the PRA Remuneration Code to the extent that it is relevant to the Group, given that the Society is a mutual institution.

Executive director

Remuneration levels are set for the executive director so as to reward and retain the skills and commitment necessary to manage the development of the Group within a competitive and challenging business sector. In accordance with best practice, the Remuneration and Nominations Committee reviews the remuneration arrangements for the executive director on a periodic basis and compares his or her range of benefits to those available within similar organisations. The Committee's objective is to promote suitable risk management arrangements, avoiding remuneration structures that promote excessive risk taking.

The executives' remuneration arrangements include:

- salaries, reviewed by the Committee on an annual basis;
- membership of the Group personal pension scheme, on the same terms as other eligible employees of the Group;
- taxable benefits which include a car allowance and private health care.

During 2017 a bonus was approved and paid to the Interim Chief Executive in recognition of his work and diligence in running the Group and ensuring critical projects were delivered within scope and on time.

Non-executive directors

Non-executive directors are remunerated by way of fees, which are recommended by the Remuneration and Nominations Committee to the Board on an annual basis. The level of fees is assessed on the basis of responsibility, experience, skill and time commitment and by comparison with other building societies and regional financial institutions.

Non-executive directors do not receive any other benefits; they do not have any pension arrangements through the Group.

All directors

The Group does not make mortgage loans available to any director. The above arrangements applied throughout 2017.

Other business interests

Details of directors' other business interests are shown in the Annual Business Statement.

Directors' emoluments

The full directors' emoluments table may be found in Note 7 to the financial statements.

Summary

This report, in addition to Note 7 to the financial statements, is intended to provide a full explanation of the policy and application of directors' remuneration. A resolution will be put to the Annual General Meeting inviting members to vote on the Directors' Remuneration Report.

On behalf of the Remuneration and Nominations Committee
H.F. Baines
Chairman
12 March 2018

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Directors' responsibilities for preparing the Annual Report and Accounts

The following statement, which should be read in conjunction with the Statement of the Auditors' responsibilities on page 20, is made by the directors to explain his or her responsibilities in relation to the preparation of the Annual Report and Accounts in accordance with applicable law and regulation.

The directors are required by the Building Societies Act 1986 ("the Act") to prepare, for each financial year, financial statements which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of affairs of the Society and the Group as at the end of the financial year.

In preparing the financial statements, the directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether the financial statements have been prepared in accordance with International Financial Reporting Standards (as adopted by the European Union); and
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Society and Group will continue in business.

In addition to the financial statements, 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 Society and the Group.

Directors' responsibilities pursuant to the Disclosure and Transparency Rules

The directors confirm that to the best of each person's knowledge and belief:

- the financial statements, prepared in accordance with International Financial Reporting Standards (as adopted by the European Union), give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and Society; and
- the Annual Business Statement and Directors' Report includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Society:

- keeps accounting records in accordance with the Building Societies Act 1986; 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 the Prudential Regulation Authority under the Financial Services and Markets Act 2000.

The directors have general responsibility for safeguarding the assets of the Group and Society, the qualitative standards for the level of CET 1 regulatory capital and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

In so far as each of the directors is aware:

- there is no relevant audit information of which the Group's auditors are unaware; and
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

The directors are responsible for the maintenance and integrity of the Society's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board of Directors
D.A. Harding
Chairman
12 March 2018

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF MANCHESTER BUILDING SOCIETY

Opinion

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

- give a true and fair view of the state of the Group's and of the Society's affairs as at 31 December 2017 and of the Group's and the Society's income and expenditure and the Group's and the Society's cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986.

We have audited the annual accounts, included within the Annual Report & Accounts (the "Annual Report"), which comprise: the Group and Society statements of financial position as at 31 December 2017; the Group and Society statements of comprehensive income, the Group and Society statements of cash flows, and the Group and Society statements of changes in equity for the year then ended; the accounting policies; and the notes to the annual accounts.

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

Basis for opinion

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

Independence

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

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

Other than those disclosed in Note 5 to the annual accounts, we have provided no non-audit services to the Group and the Society in the period from 1 January 2017 to 31 December 2017.

Material uncertainty relating to going concern – Group and Society

In forming our opinion on the annual accounts, which is not modified, we have considered the adequacy of the disclosure made in note 1 to the annual accounts concerning the Group's and Society's ability to continue as a going concern. The directors have set out the risks and uncertainties for the business given its continued run-off and the ongoing development of plans to secure the business. These conditions, along with the other matters explained in Note 1 to the annual accounts, indicate the existence of a material uncertainty which may cast significant doubt about the Group's and Society's ability to continue as a going concern. The annual accounts do not include the adjustments that would result if the Group and Society were unable to continue as a going concern.

Explanation of material uncertainty

Note 1 to the annual accounts details the directors' disclosures of the material uncertainties relating to going concern and Note 28 provides detailed disclosures relating to regulatory capital.

As described in Note 1, the going concern status of the Group and Society is dependent on successfully implementing a number of short term plans. These plans carry significant execution risk which may cast significant doubt on the ability of the Group and Society to continue as going concerns and include matters outside the Group's control such as the outcome of a legal case. The Group continues to run a shortfall against the Prudential Regulation Authority's (PRA) combined buffer capital requirement and has limited headroom relative to the requirement to meet 4.5% of the Group's risk weighted assets with Common Equity Tier 1 capital, where future changes to estimates may result in the Group being in breach of this requirement.

In forming their conclusions regarding going concern, the directors have considered the adequacy of the Group's and Society's financial resources, in particular the headroom over regulatory capital minima set by the PRA. The directors have considered the Group's and Society's underlying financial performance for the year ended 31 December 2017, the current and forecast level of liquidity held, and the Group's and Society's financial position as at 31 December 2017 and forecast financial position going forwards.

Given the risks associated with implementing these strategies, the directors have drawn attention to this in disclosing a material uncertainty relating to going concern in the basis of preparation to the annual accounts.

What audit procedures we performed

In concluding there is a material uncertainty, our audit procedures included assessing the reasonableness of the assumptions within management's forecasts for capital, liquidity and profitability, based on past business performance and the attrition rate experienced on the size of the Group's loan and savings portfolio in the absence of new lending.

We checked the Group and Society's capital disclosures given within Note 28 for consistency with the financial information in the annual accounts, and considered whether forward looking capital forecasts are consistent with the audited figures at year end.

Our procedures included considering whether the Group's capital base could withstand the impact of potential future material stress events taking place on the Society's operations, for example a large one-off loss. The risks associated are noted above and could have a material impact on the capital position and therefore the going concern position.

We continued to hold direct discussions with the PRA throughout our audit to understand the regulator's approach to the continuing supervision of the Group and Society. This involved discussing the results of the Group and Society throughout the year relative to the capital improvement plans drawn up by the directors and discussing the capital forecasts at year end. We read regulatory correspondence throughout the year as part of supporting those discussions and also understanding the board's approach to its strategy.

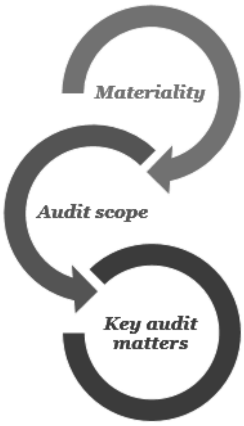
We held discussions with the directors regarding the potential for a settlement in the Society's favour relating to the legal claim being brought against ex-advisers. We read legal correspondence relating to the matter and considered a range of potential outcomes within our assessment of management's capital forecasts.

We also audited the Group and Society's IFRS 9 transition disclosure, set out in Note 1, and considered the impact that this has on the regulatory capital position with effect from 1 January 2018, under the transitional capital rules. We engaged our regulatory capital specialists as part of our audit in order to ensure appropriate treatment of the regulatory capital rules.

Finally, we assessed the reasonableness of the options available to the directors in improving the capital position of the Group and Society, as disclosed within the annual accounts, and considered the likelihood of these improving the capital position.

Our audit approach

Overview



Materiality

- £330k (2016: £380k) - Group annual accounts
- *Based on 1% of regulatory capital resources*
- £310k (2016: £360k) - *Society annual accounts*
- *Based on 1% of regulatory capital resources*

Audit scope

- We conducted all our work in Manchester using one audit team.
- We performed audit procedures over all material account balances and financial information of the Society due to its significance to the Group's financial performance.
- We performed audit procedures over specific account balances and financial information in two other Group undertakings that materially contributed to the Group's financial performance and/or position.

Key audit matters

- Loan loss provisioning (Group and Society).
- Spanish lifetime mortgage provisioning (Group and Society).
- NMB MAC loan book provisioning (Group).
- IFRS 9 transition (Group and Society)

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We gained an understanding of the legal and regulatory framework applicable to the Group and Society and the industry in which it operates, and considered the risk of acts by the Group and Society which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We designed audit procedures that focused on the risk of non-compliance related to prudential and financial conduct issues. Our tests included inspecting correspondence with regulators, corresponding with the Group and Society's legal counsel, reviewing the results of internal compliance monitoring and the results of the work of internal audit, and performing a review of customer complaints trends. We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits, we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

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

Key audit matter	***How our audit addressed the key audit matter***
Loan loss provisioning (Group and Society) The Group and Society has recognised an impairment charge on loans and advances to customers of £56k (2016: charge of £1,101k) in the year. This excludes Spanish lifetime mortgages and other portfolios which are separately considered. An individually identified provision of £5,693k (2016: £6,846k) and a collectively identified provision of £1,140k (2016: £1,058k) is held. The individually identified provision covers individually significant loans and advances where the customer is experiencing a specific case of difficulty, the property is in possession by the Society, or the customer is in arrears. For the loans in this category that are in possession or under receivership, the Society is currently engaged in disposing of the loan collateral under a managed disposal plan. All other loans that do not display an individual indicator of impairment are assessed for recoverability within the collectively identified impairment calculation. Significant judgement needs to be applied by the directors to estimate the potential loss on loans where an impairment event has occurred. Judgement is required in respect of identifying an impairment trigger event on loans and, once impaired, the estimate of loss on a loan is calculated by use of models to discount the future cash flows expected to be received on the loan. The calculation is impacted by a number of assumptions which we focussed on, including, but not limited to: • Whether customers may default on loans as a result of impairment events which have occurred at the period end date; • The value of the underlying security at the forecast disposal date once default has occurred; • Likelihood of continuing to receive cash flows between the year-end date and the date of planned disposal; and • The exit strategy of the Society, which determines the date at which proceeds from the loan will be realised. The above are subject to significant estimation uncertainty and as a result there is an increased risk that impairment allowances may be materially under or over stated. Further information can be found in Note 1 to the annual accounts, which includes the directors' disclosures of the related accounting policies, judgements and estimates; and in Note 12 for detailed disclosures.	We discussed the basis of loan loss provisions with management and the Audit Committee throughout the year. We tested impairment models and independently corroborated key inputs and assumptions. We tested the significant inputs in the models to underlying evidence from loan documentation, for example by agreeing a sample of property values in loan loss calculations to latest valuations provided by external third parties, and recalculating indexation to the period end date where appropriate. Where properties are in possession and let out to third parties we also validated on a sample basis that assumed cash flows from the period end date to the planned date of disposal are supported by historic evidence and tenancy arrangements. To test the key assumptions within the impairment calculation, we assessed supporting data used by the directors to form their assumptions. We tested this data back to historic transactions. We undertook sensitivity analysis on all key assumptions, including time to disposal, redemption cash flows on disposal of collateral, probabilities of default, and cash flows between the period end date and assumed time of disposal. This was performed to assess the degree of change required in those assumptions to result in material movements in the loan loss provisions, and we assessed the likelihood of such changes arising individually and in aggregate. Where the directors relied on third party property valuations, we engaged our valuations' experts to review the appropriateness of a sample of these valuations and to check they were in line with industry standard requirements. This included assessing the appropriateness of the surveyors used and their competencies. We evaluated the outcome of individually identified impaired loans that were redeemed in the year by comparing the losses arising to previously calculated impairment provisions in order to assess management's ability to accurately calculate loan loss provisions. Where there were changes in facts and circumstances relating to individually identified loans post year-end, we evaluated whether these changes were reflective of conditions in effect at the year-end date and considered whether these needed to be reflected in year-end loan loss calculations as appropriate. In evaluating the completeness of the loan loss provisions, we inspected the loan book data relied upon by the directors to ensure completeness and accuracy of arrears, forbearance and loan to value information. We tested the controls over the accurate allocation of cash collection to borrower accounts. We scanned 'watch lists' representing borrowers being monitored by management, to identify any loans of higher risk and investigated the past performance of these loans to assess whether an impairment event had occurred. We also re-performed management's process for identifying specifically impaired loans based on the year-end loan book data. This included assessing whether any loan accounts that are recognised as not impaired displayed impairment indicators that were not captured by impairment policy. We considered the overall condition of the Group's and Society's loan book, and how this is changing over time in its current non-lending situation. We considered whether there are any emerging risks that are not captured within the impairment policy when considering the appropriateness of the collectively identified loan loss provision. We checked the mathematical accuracy of the impairment calculation.

Key audit matter	*How our audit addressed the key audit matter*
	Based on the evidence we obtained, we determined that the assumptions used within the loan loss provisions and the data used within models were reasonable and the accounting estimate is within an acceptable range of potential outcomes calculated in accordance with accounting standards.
Spanish Lifetime provisioning (Group and Society) The Group and Society has recognised an impairment charge on loans and advances to customers held on Spanish lifetime mortgages of £2,799k (2016: £1,590k) in the year, and at the year-end holds a total provision of £7,536k (2016: £4,849k). These mortgage assets contain contractual terms that give rise to the borrower not being obligated to make any repayments of the loan until their death or until they enter long term care. The loans also contain a 'no negative equity guarantee' which results in the Group and Society bearing the losses on the mortgage at the time of redemption. Under accounting standards this gives rise to an insurance element in the contract. Management must estimate the value associated with the provision of the insurance element and reflect this within the annual accounts at the year-end date as a reduction in the carrying value of the loan portfolio. These mortgage assets are secured on residential property in Spain. Significant judgement needs to be applied by the directors to estimate the potential loss arising as a result of the provision of these contracts to customers. This loss is calculated as a function of the time to the insured event (based on assumed customer longevity), the forecast future value of Spanish properties, and an element of portfolio prepayment where there is behavioural evidence to suggest that the portfolio experiences some redemptions ahead of an insurance event. Some of the data used to form these judgements is supplied by third parties. The above are subject to significant estimation uncertainty and as a result there is an increased risk that the insurance risk provision on the book may be materially under or over stated. See Note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates and Note 12 for detailed disclosures.	We discussed the risks associated with Spanish lifetime mortgages and the process by which key judgements were formed with both the Audit Committee and management throughout the year. We tested the data associated with the provision calculations, which included agreeing a sample of loan information back to the Society's loan book administration system and underlying mortgage files to the provision calculation. For a sample of loans, we agreed that the Society has rights to the cash flows arising from the ultimate sale of underlying collateral through review of certificates of charge. We agreed collateral values to recent third party valuation reports and tested the accuracy of the indexing applied and the use of an appropriate data source in respect of Spanish property. We engaged our valuations expert to review a sample of the property valuations obtained to assess their appropriateness in following industry standard requirements. This included assessing the appropriateness of the surveyor used and their competency. We tested the completeness and accuracy of the data set management uses to form judgements regarding the level of prepayment that the portfolio experiences, and considered whether this supported management's assumption within their calculation methodology. To assess the reasonableness of longevity data used within the calculation, we engaged our actuarial specialists to review the third party data table used within management's calculation. They compared the data table against industry best practice and considered the specific circumstances regarding the Society's customer base for this portfolio. We performed a range of sensitivity analyses to understand how changes in forecast Spanish property prices impact the insurance risk provision. We agreed the third party economic index data management use within the calculation back to source, and considered alternative sources and estimates as part of drawing our conclusions on the appropriateness of the data set used by management. We checked the mathematical accuracy of the impairment calculation by involving data specialists. Based on the evidence we obtained, we determined that the assumptions used within the calculation of losses on the portfolio and the data used by management were reasonable and therefore concluded that the provision was appropriate.
NMB MAC provisioning (Group) The Group holds a beneficial interest over a portfolio of highly forborne loans within NMB Mortgage Acquisition Company Limited, some of which are regulated by the Consumer Credit Act. The Group has recognised an impairment credit on this portfolio of £67k in 2017 (2016: charge of £757k). At year-end the provision on this portfolio is £8,932k (2016: £8,628k). Many of the loans within the portfolio are past term and the Group has identified instances of regulatory non-compliance. Due to this management have brought the administration of these loans in house where previously they were administered by NMB Mortgage Acquisition Company Limited. Management have undertaken a remediation exercise throughout 2016 and	We discussed the risks associated with the NMB MAC portfolio, due to the estimation uncertainty associated with calculating impairment losses, with the Audit Committee and management throughout the year. We understood the process by which management have remediated legacy regulatory issues within the portfolio over the prior and current year, and performed testing over the accuracy of customer remediated balances during the year. We performed testing to confirm that remediated customer balances were reflected in impairment loss calculations at year end, and that these calculations accurately reflected customer correspondence and other loan book records as part of management agreeing revised repayment plans with borrowers relative to the terms of original customer loans.

Key audit matter	*How our audit addressed the key audit matter*
2017 to address compliance issues on the portfolio. The portfolio is considered to be impaired and significant judgement needs to be applied by the directors to estimate the potential impairment loss associated with these loans. The estimate of loss on the portfolio is calculated by use of models to discount the future cash flows expected to be received on the loan. The calculation is impacted by a number of assumptions which we focussed on, including, but not limited to: • How customers will respond to remediation activity undertaken by management, and whether this will result in changed cash flow experience from the portfolio relative to past trends; • The value of the underlying security at the time of planned disposal relative to the forecast value of the remaining loan assets; and • The timing of likely redemptions, especially given that much of the portfolio is past term and subject to individual arrangements with borrowers to make repayments. The above are subject to significant estimation uncertainty and, as a result, there is an increased risk that impairment allowances may be materially under or over stated as a result. See Note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgements and estimates and Note 12 for detailed disclosures.	Where third party data is used to forecast future house prices, we performed sensitivity analysis on the data set used by management and considered alternative scenarios to understand how this may impact the recoverability of the portfolio. We tested a sample of cash collections received in the year, including testing that these were allocated to the correct customer loan account. We used past cash flow data to inform our assessment of management's assumptions regarding future recoverability from the portfolio. We considered the profile of past redemptions in light of remediation and customer contact strategies, to assess the reasonableness of the assumed date of redemption within management's impairment calculation. We read a sample of correspondence with customers where arrangements to fully settle loan balances over a period of time had been agreed, and ensured this was reflected in impairment calculations. Where customer repayment plans have not yet been agreed, we considered what past redemption experience may indicate about the remaining customers in the portfolio as customer engagement strategies are developed and implemented. We checked the mathematical accuracy of the impairment calculation by involving data specialists. In forming our assessment on management's judgements, we performed sensitivity analysis on assumed future cash flows in light of past experience, to determine alternative future scenarios for portfolio recoverability, and then considered how likely these future scenarios may be in light of management agreeing arrangements to repay with borrowers. We read the legal advice obtained regarding the portfolio in the year, and checked that this had been captured within management's assessment of assumptions. We reviewed regulatory correspondence relating to the portfolio and considered whether this had been appropriately reflected in impairment calculations. Based on the evidence we obtained, we determined that the assumptions used within the calculation of losses on the portfolio and the data used by management were reasonable.
IFRS 9 transition (Group and Society) IFRS 9 is a new and complex accounting standard which the Group is required to adopt from 1 January 2018. Disclosures in 2017 are intended to provide users with an understanding of the estimated impact of the new standard, and as a result are more limited than those to be included within the 2018 financial statements. The standard introduces significant changes to both the classification and measurement, and the calculation of impairment losses in respect of financial assets. The requirements regarding classification and measurement result in management needing to reconsider the appropriateness of accounting treatments adopted. Under the new impairment model, losses are recognised on an 'expected credit loss' basis rather than an 'incurred credit loss basis' as is currently required. The calculation of expected credit losses additionally requires the use of forward looking information, reflecting management's view of potential future economic scenarios. The standard also requires management to make judgements regarding when a loan has experienced a 'significant increase in credit risk' and to make judgements regarding expected customer default rates and repayment behaviour. In order to meet the requirements of the standard, this requires revision to the current impairment modelling methodology applied to loans and advances to customers. Given that the Group has a number of different sub	We discussed management's implementation plans for IFRS 9 with the Audit Committee throughout the year. We have read the transition disclosure given within the annual accounts and note that it is consistent with management's view of the impact of IFRS 9 on the Group. We evaluated the assessment of classification and measurement of financial instruments in accordance with the requirements of the standard. We understood management's implementation plan by holding discussions with management throughout the year, and reviewing model development documentation prepared in house and by third parties. To assess the reasonableness of the impairment transition adjustment, we involved credit modelling and economic experts to re-perform certain model calculations and consider the appropriateness of economic forecasts adopted. Our credit modelling experts also assisted with assessing whether the proposed modelling solution is consistent with the requirements of the standard. We tested data used within impairment calculations for completeness, accuracy and consistency with current provision calculations. This involved agreeing calculation inputs to core loan book systems. We assessed whether the forward looking assumptions adopted by management were in line with previous loan book experience.

Key audit matter	*How our audit addressed the key audit matter*
portfolios of loans, a single modelling solution cannot be applied to the full asset base. See Note 1 to the annual accounts for the directors' disclosures relating to the impact of IFRS 9 transition on the Group.	Based on the evidence we obtained, we determined that the impairment calculations and classification and measurement assessment were appropriate and the estimated impact is accurately reflected within the IFRS 9 disclosure.

How we tailored the audit scope

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

All of the Group's activities are administered in the United Kingdom and it reports its operating results along a single business line, being the provision of competitive facilities for personal savings and for mortgage finance, primarily to support owner occupation of residential property. The Society's mortgage book is predominantly secured on UK residential and commercial property, however the Society has a portfolio of lifetime mortgages secured on residential property in Spain. This portfolio makes up 16% of overall Group assets.

The Group is formed of the Society and its two wholly owned subsidiaries, MBS (Mortgages) Limited, MBS (Property) Limited. MBS (Mortgages) Limited, both of which are material to the Group. The Group also consolidates NMB Mortgage Acquisition Company Limited. This company is not wholly owned by the Group, however forms part of the Group due to the Society's ability to control the operations of the company and is therefore considered a subsidiary for accounting purposes. NMB Mortgage Acquisitions Company Limited is not significant in the context of the operation of the Group as a whole.

A significant proportion (85%) of the Group's operating profit for the year before impairments and provisions is driven by the Society, along with 99% of the Group's total assets. Significant activity in other Group entities includes:

- The provision of back book mortgage administration services to generate an appropriate return for the Society, undertaken by MBS (Mortgages) Limited; and
- Management of the Group's head office building so as to generate an appropriate return for the Society, undertaken by MBS (Property) Limited.

The accounting records and functions for all entities within the Group are located at the Society's principal office in Manchester, with consolidation of the Group annual accounts being performed from this location. We perform all of the work to support the Group and Society opinion.

We performed audit procedures over all material account balances and financial information of the Society due to its significance to the Group's financial performance. We performed audit procedures over specific account balances and financial information in subsidiary undertakings that materially contribute to the Group's financial performance and/or position. Our audit procedures on the Society and its subsidiary undertakings provided us with sufficient audit evidence as a basis for our opinion on the Group annual accounts as a whole.

Materiality

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

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

	Group annual accounts	*Society annual accounts*
Overall materiality	£330k (2016: £380k).	£310k (2016: £360k).
How we determined it	1% of regulatory capital resources (Group and Society).	
Rationale for benchmark applied	Regulatory capital resources is considered to be the most appropriate benchmark to use in the current environment for the Society and Group, given that their strategy since 2013 has been to reduce risks and preserve regulatory capital. Regulatory capital resources is the key benchmark for management and regulators. This is a function of the statement of financial position, and it is quantitatively disclosed within the annual accounts.	

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £15.5k (2016: £18k) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

We have nothing material to add or to draw attention to other than the material uncertainty we have described in the material uncertainty relating to going concern section above. Because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Society's ability to continue as a going concern.

Reporting on other information

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

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

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

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

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

- the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the year ended 31 December 2017 is consistent with the accounting records and the annual accounts; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Responsibilities for the annual accounts and the audit

Responsibilities of the directors for the annual accounts

As explained more fully in the Statement of Directors' Responsibilities set out on page 13, the directors are responsible for the preparation of the annual accounts in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the annual accounts

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

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

Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Building Societies Act 1986 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the directors on 9 August 2013 to audit the annual accounts for the year ended 31 December 2013 and subsequent financial periods. The period of total uninterrupted engagement is 5 years, covering the years ended 31 December 2013 to 31 December 2017.

Heather Varley (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
12 March 2018

STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2017

	Note	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Interest receivable and similar income	2	12,181	13,165	11,384	12,680
Interest payable and similar charges	3	(3,162)	(4,693)	(3,162)	(4,693)
Net interest income		9,019	8,472	8,222	7,987
Fees and commission income		71	186	73	186
Fees and commission expense		(38)	(36)	(38)	(36)
Other operating income	4	579	647	914	1,265
Other operating charges	4	(52)	(59)	(195)	(202)
Net profit on financial assets designated at fair value through profit and loss	10	1	-	1	-
Total operating income		9,580	9,210	8,977	9,200
Administrative expenses	5	(7,720)	(8,449)	(7,422)	(7,394)
Depreciation	15	(235)	(214)	(166)	(145)
Operating profit before impairments and provisions		1,625	547	1,389	1,661
Impairment losses	13	(2,376)	(3,448)	(4,389)	(6,209)
Financial Services Compensation Scheme Levy	29	(29)	(67)	(29)	(67)
Loss on ordinary activities before income tax		(780)	(2,968)	(3,029)	(4,615)
Income tax expense	8	-	(382)	-	(382)
Loss for the financial year		(780)	(3,350)	(3,029)	(4,997)

The Group and the Society have no other comprehensive income.

The notes on pages 25 to 64 form part of these financial statements.

STATEMENTS OF CHANGES IN EQUITY

	Group 2017				Society 2017			
	Accumulated Losses £000	Subscribed Capital £000	PPDS £000	Total £000	Accumulated Losses £000	Subscribed Capital £000	PPDS £000	Total £000
Balance at 1 January 2017	(9,243)	9,788	17,461	18,006	(8,488)	9,788	17,461	18,761
Transactions with equity holders - interest on PIBS	-	-	-	-	-	-	-	-
Tax credit relating to interest on PIBS	-	-	-	-	-	-	-	-
Loss and total comprehensive expense for year	(780)	-	-	(780)	(3,029)	-	-	(3,029)
Balance at 31 December 2017	(10,023)	9,788	17,461	17,226	(11,517)	9,788	17,461	15,732

	Group 2016				Society 2016			
	Accumulated Losses £000	Subscribed Capital £000	PPDS £000	Total £000	Accumulated Losses £000	Subscribed Capital £000	PPDS £000	Total £000
Balance at 1 January 2016	(5,555)	9,788	17,461	21,694	(3,153)	9,788	17,461	24,096
Transactions with equity holders - interest on PIBS	(338)	-	-	(338)	(338)	-	-	(338)
Tax credit relating to interest on PIBS	-	-	-	-	-	-	-	-
Loss and total comprehensive expense for year	(3,350)	-	-	(3,350)	(4,997)	-	-	(4,997)
Balance at 31 December 2016	(9,243)	9,788	17,461	18,006	(8,488)	9,788	17,461	18,761

STATEMENTS OF FINANCIAL POSITION
AS AT 31 DECEMBER 2017

	Note	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
ASSETS					
Liquid assets					
Cash and balances with the Bank of England		32,911	67,387	32,911	67,387
Loans and advances to credit institutions	9	11,031	14,427	10,980	14,298
Investment securities	10	39	306	39	306
		43,981	82,120	43,930	81,991
Derivative financial instruments	11	280	278	264	199
Loans and advances to customers					
Loans fully secured on residential property	12	228,674	263,815	223,206	257,704
Loans fully secured on land	12	21,085	24,419	21,085	24,419
Other loans	12	1,062	1,218	1,062	1,218
		250,821	289,452	245,353	283,341
Investments					
Subsidiary undertakings	14	-	-	9,502	10,823
		-	-	9,502	10,823
Property, plant and equipment	15	6,112	5,861	404	488
Investment property	16	691	839	691	839
Deferred tax assets	17	-	-	-	-
Other assets	18	2,306	3,754	2,119	3,640
Total assets		304,191	382,304	302,263	381,321
LIABILITIES					
Due to members	19	247,628	315,391	247,628	315,391
Other deposits	20	17,858	24,753	17,858	24,753
Derivative financial instruments	11	192	1,641	188	1,641
Other liabilities	22	1,845	1,455	1,510	1,100
Provisions for liabilities and charges	29	242	1,858	147	475
Subordinated liabilities	21	14,200	14,200	14,200	14,200
Subscribed capital	23	5,000	5,000	5,000	5,000
		286,965	364,298	286,531	362,560
Equity					
Accumulated losses		(10,023)	(9,243)	(11,517)	(8,488)
Subscribed capital	23	9,788	9,788	9,788	9,788
Profit participating deferred shares	25	17,461	17,461	17,461	17,461
		17,226	18,006	15,732	18,761
Total equity and liabilities		304,191	382,304	302,263	381,321

The financial statements on pages 22 to 64 were approved by the Board of Directors on 12 March 2018.

D.A. Harding	P.A. Lynch	I.A. Dewar
Chairman	Interim Chief Executive	Director

STATEMENTS OF CASH FLOWS
AS AT 31 DECEMBER 2017

	Note	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Cash flows from operating activities					
Loss before tax		(780)	(2,968)	(3,029)	(4,615)
Adjusted for:					
Depreciation		235	214	166	145
Reversal of previous impairment on Property, Plant and Equipment	13	(413)	-	-	-
(Decrease) / increase in provisons		(88)	26	1,288	261
Fair value adjustments		148	(58)	148	(58)
Impairment losses		-	-	1,534	3,518
Decrease / (increase) in other assets		1,448	(2,055)	1,521	(1,983)
Increase / (decrease) in other liablitites		390	(127)	410	(188)
Cash flows from operating activities before changes in operating assets and liabilities		940	(4,968)	2,038	(2,920)
Increase / decrease in operating assets and liabilities					
Decrease in loans and advances to customers		37,103	41,166	36,372	40,101
(Decrease) / increase in derivative financial instruments		(1,451)	1,087	(1,521)	1,218
Decrease in deposits by banks		-	(2,002)	-	(2,002)
Decrease in amounts owed by credit institutions		267	3	267	3
Decrease in other deposits		(6,895)	(20,204)	(6,895)	(20,204)
Decrease in amount due to members		(67,763)	(9,239)	(67,763)	(9,239)
Net cash flows (used in) / from operating activities		(37,799)	5,843	(37,502)	6,957
Cash flow from investing activities					
Investments in subsidiary undertakings		-	-	(213)	(1,181)
Purchase of property and equipment	15	(81)	(155)	(81)	(163)
Disposal of property and equipment	15	8	-	-	-
Sale of securities		-	8	-	8
Investment in securities		-	(240)	-	(240)
Net cash flows (used in) investing activities		(73)	(387)	(294)	(1,576)
Cash flow from financing activities					
Repayment of subordinated loan	21	-	-	-	-
Interest paid on subscribed capital		-	(338)	2	(341)
Net cash used in financing activities		-	(338)	2	(341)
Net movement in cash and cash equivalents		(37,872)	5,118	(37,794)	5,040
Cash and cash equivalents at start of year		81,804	76,686	81,675	76,635
Cash and cash equivalents at end of year	24	43,932	81,804	43,881	81,675

1. Accounting policies and financial risk management

a) Summary of significant accounting policies

The principle accounting policies applied consistently in the preparation of these financial statements are set out below.

Basis of preparation: going concern

The Group's financial statements have been prepared on a going concern basis as explained below.

The long-term continuing operation of the Society and the Group is dependent on a successful return to lending to grow the balance sheet in order to maintain profitability and rebuild regulatory capital. At present the Group has insufficient capital to return to lending and continues to manage a long-term run-off of the balance sheet.

The Board continues to develop options which individually or in combination are reasonably expected to secure the future of the Group, enable it to continue to meet capital requirements and improve the quality of its regulatory capital. These options include improving its CET 1 capital position including through a restructuring of capital, or securing its future through merger or alternative means.

The Board expects to further develop these plans during 2018. These plans may involve third parties and as such carry execution risk. Although these represent material uncertainties which may cast significant doubt about the Society and Group's ability to continue as a going concern in the longer term, in the Board's opinion the going concern basis is appropriate whilst there are potential options available.

In order to satisfy themselves that the Society and Group have adequate resources to continue to operate for the foreseeable future as a going concern, the directors have taken into account the following:

- The ongoing legal claim against and prospects of recovery from Grant Thornton UK LLP, the previous external auditors;
- The challenge of addressing the shortfall to the qualitative standards for the level of CET 1 regulatory capital and of continuing to meet the regulatory requirement to hold 4.5% CET 1 capital against risk weighted assets;
- The Group's financial position as at 31 December 2017, including the headroom above the Individual Capital Guidance in total capital terms as set by the PRA;
- The Group's financial position as at 31 December 2017 and it's underlying financial performance for the year then ended, as well as it's financial projections for the next 2 years, in particular for income, expenditure, assets, liabilities, interest rate risk, liquidity and regulatory capital, including sensitivity analysis;
- An initial assessment of the potential impact of adopting IFRS 9 accounting for expected credit losses from 1 January 2018;
- The improved position and redress already completed in respect of the acquired NMB MAC and CLC portfolios;
- Ongoing discussions with the PRA and other stakeholders regarding the development of a plan to secure the future of the Group and its strategic direction;
- The Group's principal risks and uncertainties (as set out in the Strategic Report on page 5), including the operational risks faced by the Group to develop and deliver the strategic plan.

Should there be a material stress event in the economy or to financial markets that adversely impacts the Group, or the current options available to the Group are shown to not be viable, then there is less certainty as to the going concern position of the Group.

Having due regard to these matters and after taking into consideration the material uncertainties above the Board continues to adopt the going concern basis of accounting in preparing the financial statements

Basis of preparation: accounting standards

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") pronouncements as issued by the International Accounting Standards Board and as adopted by the European Union and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to building societies reporting under IFRS. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of all derivative contracts and certain other assets.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 1c.

No further IFRS accounting standards and pronouncements identified as being relevant to the Group were adopted with effect from 1 January 2017.

The Group has noted that there are a number of further new accounting standards, that are not effective at 31 December 2017, but which are to be adopted over the coming years. The only one of these which is likely to have a significant impact on the Group is *IFRS 9 – Financial instruments*, which replaces most of *IAS39- Financial Instruments: Recognition and Measurement.* The final version of IFRS 9 has been issued by the International Accounting Standards Board and was endorsed by the EU on 22 November 2016. The effective date is 1 January 2018. The standard includes changes for classification and measurement of the Group's financial assets and liabilities, the recognition of impairment, and hedge accounting.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Basis of preparation: accounting standards (continued)

The new classification and measurement rules are not anticipated to change the way in which management accounts for financial instruments before impairment. Appropriate classification and measurement is determined through the review of business models and whether the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding.

Assets will continue to be measured as follows:

Classification	Measurement
Loans and advances to customers	Amortised cost using the effective interest rate method
Loans and advances to credit institutions	Amortised cost using the effective interest rate method
Investment Securities	Fair value through profit or loss
Investment Properties	Fair value through profit or loss
Trade Receivables	Amortised cost using the effective interest rate method
Intragroup Loans	Amortised cost using the effective interest rate method
Derivatives	Fair value through profit or loss
Other Assets	Amortised cost using the effective interest rate method

Liabilities will continue to be measured as follows:

Classification	Measurement
Shares	Amortised cost using the effective interest rate method
Deposits	Amortised cost using the effective interest rate method
Derivatives	Fair value through profit or loss
Subordinated Liabilities	Amortised cost using the effective interest rate method
Permanent Interest Bearing Shares	Amortised cost using the effective interest rate method

The most significant impact on the Group will be in respect of the measurement of impairment of financial assets. Under IFRS 9, impairment will be based on expected credit losses ("ECL") rather than the methodology the Group currently adopts under IAS 39 which is based upon incurred credit losses. The ECL impairment provisioning under IFRS 9 includes the requirement to include more forward-looking information in order to establish expected credit losses, and also to consider multiple economic scenarios.

At initial recognition, an ECL provision is required for default events in the next 12 months, whilst following a significant increase in credit risk, a lifetime ECL is required. The review of credit risk and the calculation of ECL are required to be unbiased and probability weighted, and should include all available relevant information, with assessments of current conditions and forecasts of future economic conditions. As a result the recognition and measurement of impairment is more forward looking than is the case under IAS 39. Consequently, it is likely to lead to an increase in the total level of provision in many businesses.

The Group is required to perform a staging assessment of each financial instrument. The three stages are as follows:

- Stage 1: Loans where there has been no significant deterioration in credit risk since initial recognition of the loan by the Society
- Stage 2: Loans where there has been a significant increase in credit risk since initial recognition of the loan by the Society
- Stage 3: Loans which are deemed to be "credit impaired" (and therefore in default)

As at 31 December 2017, management believe that loans and advances to customers secured on residential property, land and other loans would be allocated as follows:

	By Loan Balance	By Number of Loans
Stage 1	67%	77%
Stage 2	12%	11%
Stage 3	21%	12%

At present, based on a detailed initial assessment, management estimates that the increase on the Group's loan loss provisions on adoption of IFRS 9 as at 1 January 2018 will be in the range of £0.2m and £0.4m which will result in an equivalent reduction in reserves.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Basis of preparation: accounting standards (continued)

These estimates are based upon accounting policies, assumptions, judgments and estimation techniques that remain subject to change until the group finalises its financial statements for year ended 31 December 2018.

The Group has confirmed to regulators that it will be utilising transitional arrangements which have been issued by the European Union. The impact of these arrangements is such that the impact to the Group's Regulatory Capital will be phased over a 5 year period with 5% of the 2018 adverse financial impact taken to CET 1 capital. The element taken to CET 1 capital will increase annually with 100% recognised by 2023.

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet on transition to IFRS 9, with no requirement to restate comparative periods.

The directors have considered the implications of adopting other standards including IFRS 15 – *Revenue Recognition* (effective from 1 January 2018) and IFRS 16 – *Leases* (effective from 1 January 2019) and do not anticipate a material impact on the financial statements of the Society and Group.

Basis of consolidation

The Group's financial statements include the financial statements of the Society, its subsidiary undertakings and NMB Mortgage Acquisition Company Limited ("NMB MAC") in which the Group held no shares but over which, per IFRS 10, it exerted control. The way in which the Group met the definition of control over NMB MAC, as set out in IFRS 10, is described more fully in Note 14.

The Society and its subsidiaries have accounting periods ending on 31 December, whilst NMB MAC has an accounting period ending on 28 February. For consolidation purposes, the accounting records of NMB MAC have been prepared at 31 December and consolidated for the 12 months ended 31 December. The accounting policies of the subsidiary undertakings are materially consistent with the Group accounting policies. The accounting policies of NMB MAC, where different from those of the Group, have been brought in line with those of the Group on consolidation. The Society's Statement of Financial Position includes the investment in the subsidiary undertakings at cost, less any provision for impairment.

Interest income and expense

Interest income and expense is recognised in the Statements of Comprehensive Income for all financial instruments measured at amortised cost using the effective interest rate method. The effective interest rate method is a method of allocating the income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated cash flows (excluding future expected credit losses) to the net carrying amount of the asset over the expected life of the instrument.

In calculating the effective interest rate all contractual terms of the financial instrument are taken into account, along with all fees paid or received, all transaction costs and any other premia or discounts.

Charges in respect of the estimated interest refund element of the customer redress provision are debited against interest income, when the provision is established.

Insurance contracts

The Group has a portfolio of lifetime mortgage loans secured on Spanish residential property. A particular clause of the mortgage contract meets the definition of an insurance contract; where a borrower dies or goes into long-term care and a redemption receipt is less than the contractual sum owed the Group does not have any further ability to recover amounts from the borrower or the estate.

Under IFRS 4 the Group has continued to account for these mortgage contracts using its existing accounting policies. The mortgage contract has been classified as being not unbundled. The impact of assessing the contracts as being "not unbundled" is that the income earned on the mortgage contracts is not split between interest and insurance premium and that the mortgage asset is included within loans and advances at the present value of future cash flows.

Measurement and recognition of the income earned on the mortgage contract has been undertaken in line with the Group's other mortgage contracts; the income earned has been included in the Income Statement within the Interest and Similar Income category. Within the Statement of Financial Position the mortgage asset and any impairment which has been calculated is disclosed in line with IAS 39.

The insurance risk liability associated with the no-negative equity guarantee is calculated by estimating potential shortfalls arising at redemption, discounted at the effective interest rate, and is represented by the impairment provision. The assessment incorporates assumptions relating to future house price values at the time of account redemption. Its assessment is also based on expected future outcomes relating to the date on which an account redeems which, given the nature of the product is expected to be on death of the borrower, but can be affected by health issues that would see borrowers move into care; it can also be affected by non-health related voluntary pre-payment. The insurance liability arising as a result of the no negative equity guarantee is presented within Note 12 to the financial statements as "Insurance risk provisions".

IFRS 4 will be replaced by IFRS 17 – *Insurance Contracts* for accounting periods beginning on 1 January 2021.

Fees and commissions

Fees and commissions relating to the origination of loans and advances to members are recognised within interest income using the effective interest rate method.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Other operating income

The Group recognises foreign exchange gains and losses and rents receivable as other operating income. The Group recognises other operating income relating to the interest that it charges on the loans made to its subsidiary undertakings.

Income from investments

Income from investments is recognised when an irrevocable agreement to sell the investment is in place.

Financial assets

The Group classifies its financial assets in the following categories under IAS 39:

(i) Financial assets at fair value through profit and loss

Derivative financial instruments. These instruments economically hedge the exchange rate risk on the Group's Euro-denominated Spanish mortgages. These instruments are carried at their fair value with changes in their fair value reflected in profit or loss as part of total operating income. Hedge accounting has not been applied by the Group.

Investment securities. These instruments are carried at their market value which reflects the fair value of the asset. Changes in their fair value are recognised in profit or loss as part of total operating income. Any gain or loss on disposal is taken through profit or loss.

Financial assets at fair value through profit and loss are subsequently carried at fair value. Fair values are obtained in line with the three tier hierarchy described in IFRS 13 from quoted market prices in active markets, revaluation techniques using specialist tools and confirmations from counterparties.

Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss category are included in the profit or loss in the period in which they arise.

The fair values of financial assets carried at amortised cost as at 31 December 2017 and 31 December 2016 are detailed in the fair values of financial assets and liabilities carried at amortised cost section on page 40 and 41.

(ii) Loans and receivables

Loans and advances to credit institutions. These are sums deposited in instantly accessible bank accounts with major high street banks, used for liquidity purposes.

Loans and advances to customers. These are sums advanced to the Group's borrowers, secured on property, land or (in a very restricted number of instances) unsecured.

Loans and receivables are carried at amortised cost using the effective interest rate method.

Purchases and sales of financial assets at fair value through profit or loss are recognised on the trade-date being the date on which the Group legally commits to purchase or sell the asset. Loans are recognised when cash is advanced to the borrowers. Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are no longer recognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Impairment

With regard to mortgage assets, the Group assesses at each financial position date whether there is objective evidence that a financial asset or group of financial assets is impaired. Objective evidence of impairment includes events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes accounts going into arrears and other observable data that comes to the attention of the Group about the following loss events:

i. the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
ii. it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
iii. observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Group, including:

   – adverse changes in the payment status of borrowers in the Group; or

   – national or local economic conditions that correlate with defaults on the assets in the Group. The above assessment includes those mortgage assets which are subject to forbearance arrangements.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Impairment (continued)

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The impairment value is then reflected in a separate account from the underlying assets in the Group's financial records and is recognised in the Statement of Comprehensive Income.

The Group's policy in relation to any properties that it has taken into possession is that it will seek their disposal with a view to minimising the losses that it may incur.

Investment in subsidiary undertakings

Subsidiaries are all entities over which the Group has control. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Investments in the Society's subsidiary undertakings are recorded in the Statement of Financial Position at historic cost less any provision for impairment. Impairment is assessed in line with *IAS 36 – Impairment of Assets* comparing the carrying value of the investment against future cash flows from the subsidiary undertakings.

Property, plant and equipment

All property, plant and equipment is stated at historical cost less depreciation and any provision for impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in each asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives, as follows:

- Freehold office premises: over 50 years.
- Office premises structural alterations: over 20 years.
- Office fixtures and fittings: over 10 years.
- Computer and sundry equipment: over 5 years.
- Other assets: over 4 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each financial reporting date. The freehold head office property has been tested for impairment and written down to fair value less estimated cost of disposal.

Investment property

Investment property is residential property acquired as a result of the settlement of an impaired mortgage asset. The properties are being held, pending their eventual sale, and are carried at their fair value. Changes in their fair value are recognised in profit or loss as part of total operating income. Any gain or loss on disposal is taken through profit or loss.

Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including: cash in hand and non-restricted balances with central banks, loans and advances to banks and amounts due from other banks.

Corporation tax

Corporation tax is charged at the current rate calculated on the basis of the profit on ordinary activities as adjusted in line with HMRC requirements for taxation purposes.

Deferred tax

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the financial position date and are expected to apply when the deferred tax asset is realised or the liability is settled.

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

Pensions - Group defined contribution scheme

The Group operates a defined contribution pension scheme for its employees. All the costs incurred by the employer are included in profit or loss.

Foreign currency

Foreign currency transactions are translated into sterling, using the exchange rates prevailing at the dates of the transactions (spot exchange rate). Foreign exchange gains and losses resulting from the settlement of such transactions and from the re-measurement of monetary items at year-end exchange rates are recognised in the Statement of Comprehensive Income.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Leases

The Group has entered into operating lease agreements. Rental income and expenditure is recognised in profit or loss on a straight line basis over the term of the lease in other income and charges in the Statement of Comprehensive Income.

Financial Liabilities

All financial liabilities including shares, deposits, derivative financial instruments, debt securities and subordinated liabilities are recognised initially at fair value, being the issue proceeds, net of transaction costs incurred as appropriate. Financial liabilities, except for derivative financial instruments, are subsequently measured at amortised cost using the effective interest rate method. Following initial recognition derivative financial instruments continue to be recognised at fair value.

Offsetting

For the financial assets and liabilities subject to enforceable master netting arrangements or similar arrangements, each agreement between the Group and the counterparty allows for net settlement of the relevant financial assets and liabilities when both elect to settle on a net basis. In the absence of such an election, financial assets and liabilities will be settled on a gross basis. However, each party to the master netting agreement or similar agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made.

Financial Services Compensation Scheme ("FSCS")

Previous claims were made on the FSCS following the failure of Bradford & Bingley plc, Heritable Bank plc, Kaupthing Singer and Friedlander Limited and London Scottish Bank plc. In order to fund the claims made under its terms of operation, the FSCS has borrowed from the Bank of England and HM Treasury. The FSCS pays interest on its borrowings; it incurs operating expenses in its own right and incurs capital losses where shortfalls arise on the realisations of assets that it is managing from the failed banks listed above. The costs of the FSCS are passed on to all UK banks and building societies.

The Group makes provision for the charge based on estimates of its share of the total levy that the FSCS will raise by comparing its level of "protected deposits" with those of all deposit taking institutions covered by the FSCS. The Group's estimates are sensitive to the level of estimated management expenditure incurred by the FSCS and the level of capital losses that will arise in future periods as the FSCS undertakes the management of the assets of the failed banks.

In accordance with *IFRIC 21 - Levies* the trigger date for recognition of a provision in respect of the FSCS levy is 1 April each year and at 31 December the Group holds an accrual for one year's interest levy.

Customer redress provision

Provision for customer redress is made when the Group is aware of a specific historic conduct or regulatory issue and it is probable that customer remediation will be required to settle the obligation. Provision is made for the estimated cost of interest refunds, which is debited against interest income, and other associated costs which are debited against other administrative expenses.

Permanent Interest Bearing Shares

The Group has two tranches of Permanent Interest Bearing Shares in issue. Both sets were issued with the intention of enhancing the Group's regulatory capital position. The PIBS issued in 2005 confer unconditional discretion on the Group's Board to cancel in part or in whole any interest payment due. Interest on the 1999 PIBS can only be cancelled in a restricted number of circumstances; the Board does not have an unconditional right to cancel this interest. Therefore, in accordance with *IAS 32 - Financial Instruments: Presentation*, within the Financial Statements the 2005 PIBS are classified as equity and the 1999 PIBS are classified as a liability. Interest paid on the 1999 PIBS issue is shown in the Statement of Comprehensive Income whereas interest paid on the 2005 PIBS issue is shown in the Statement of Changes in Equity.

As explained on page 6, as a result of the shortfall against the qualitative standards for the level of CET 1 regulatory capital, together with the loss for the year, under CRD IV article 141, in order to conserve capital, the Group may remain prohibited from making the PIBS coupon payments due in April 2018. The Board considers that there continues to be uncertainty over the Group's ability to make coupon payments thereafter.

The carrying value of the PIBS in the 2017 financial statements has not changed since initial recognition. In future, should there be greater certainty with regard to the expected future non-payment of PIBS coupons, the fair value of the 1999 PIBS liability in the financial statements will be adjusted to reflect the lower expected cash outflows (discounted back at the original effective interest rate on the instrument).

Profit Participating Deferred Shares

The Group has £18m of Profit Participating Deferred Shares, issued during 2013 (see Note 25). These instruments qualify as equity within the Statement of Financial Position. Whilst no coupon has been paid on the PPDS, any such cost would be recorded through the Statement of Changes in Equity.

1. Accounting policies and financial risk management

b) Financial risk management

Strategy in using financial instruments

The Group accepts deposits from customers at both fixed and floating rates of interest, some of which are for fixed periods and others are open-ended; it seeks to enhance its interest margins by investing these funds in high-quality mortgages, liquidity instruments and liquid assets.

The Group has more fixed rate mortgages than fixed rate savings accounts. In order to manage the interest rate risk that arises, the Group may enter into simple-form interest rate swap arrangements with the intention of gaining some economic certainty as to its net interest margin position.

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

The Board has authorised the use of derivatives by the Group to reduce the risk of loss arising from changes in market risks in accordance with Section 9A (4) of the Building Societies Act 1986 and derivatives are used by the Group for economic hedging purposes only. The Group does not run a trading book.

The principal derivatives used by the Group are foreign exchange contracts that are used to economically hedge Group Statement of Financial Position exposures. The Board does not intend to hedge its fixed rate mortgages using interest rate swaps at this time; this position is monitored regularly.

Credit risk - exposure

Credit risk is the risk that an individual or institutional counterparty to which the Group has loaned money will be unable to re-pay the sums in full when they fall due.

The Group manages the levels of credit risk it accepts by placing limits on the amount available in relation to individual borrowers and groups of borrowers. Such risks are monitored on a revolving basis and are subject to a regular review. Policy limits on the level of credit risk by product, industry sector and by country are approved by the Board. The exposure to any one borrower, including banking counterparties, is further restricted by sub-limits covering on and off balance sheet exposures. Actual exposures against limits are monitored daily.

The Group’s most significant concentration of credit risk is within the loans secured on residential property in the UK. The following table shows the credit exposure, which is the maximum potential exposure before provisions and including committed facilities.

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Financial assets				
Loans and advances to credit institutions	11,031	14,427	10,980	14,298
Investment securities	39	306	39	306
Gross loans and advances - on residential property and land	223,325	262,886	208,925	247,755
Gross loans and advances - lifetime mortgages	49,728	47,121	49,728	47,121
Gross loans and advances - other loans	1,069	1,218	1,069	1,218
Loans to subsidiary undertakings	-	-	9,503	10,823
Derivatives - exchange rate swaps	280	278	264	199
	285,472	326,236	280,508	321,720

Impairment provisions are provided for losses that have been incurred at the financial position date. The figure for lifetime mortgages is stated after deduction of an effective interest rate provision.

Credit risk - forbearance

The Group’s forbearance strategy is to seek to agree with borrowers in financial difficulty the provision of short to medium-term assistance with their monthly mortgage payments, in order to avoid or mitigate the risk of financial loss. The range of forbearance options available in certain circumstances includes arrangements to clear the arrears over a reasonable period of time, payment concessions, and capitalisation of arrears. For mortgages that are not past due, conversion to interest only payment terms, an extension of term, or suspension of monthly payments pending sale of the property are available as options to reduce the monthly payment due and these seek to avoid a mortgage entering arrears and becoming past due, allowing time for a borrower to regularise their financial position.

As at 31 December 2017, the Group had 39 accounts (2016: 43) with balances of £4.7m (2016: £5.1m) where conversion to interest only or an extension of term had taken place. Of these, 29 accounts (2016: 33) were neither past due or impaired, and 10 (2016: 10) were past due and/or impaired with an aggregate capital balance £2.3m (2016: £1.4m); aggregate arrears of £20k (2016: £13k); and aggregate impairment provision of £67k (2016: £74k)

The forbearance strategy seeks to avoid arrears arising or further increasing and to allow account performance to be restored by supporting the mortgage payments being brought up to date or to provide a period of time for repayment of the amount owed. The assessment of impaired loans incorporates management work-out strategies in relation to a number of credit exposures. If expectations were to change then this would affect the impairment risk. This is incorporated into the assessment of impairment provisions.

There are no specific concentrations of accounts in forbearance in relation to portfolios or geographical areas.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Credit risk – Loans and advances to customers

The analysis shown below, in relation to loans and advances to customers is based on the Group's balances. Information is disclosed for the Society where there is significant variance between the Group and Society figures.

- Of the £274.1m of gross assets in this class £247.8m (90.4%) (2016: 90.3%) is fully secured on residential property,£25.2m (9.2%) (2016: 9.3%) is fully secured on land and £1.1m (0.4%) (2016: 0.4%) relates to unsecured personal loans.
- With gross balances of £49.7m Lifetime mortgages represent 18.1% of this class (2016: 15.1%).

Secured lending – fully secured on residential property

The average loan to valuation ("LTV") of the Group's lending that is fully secured on residential property is estimated at 39% (2016: 37%). Further analysis of the Group's residential property lending is detailed below.

	2017 %	2016 %
<70%	65	67
70% - 80%	11	12
80% - 90%	7	7
90% - 100%	6	5
>100%	11	9
Average loan to value of stock - UK mortgages	35	34
Average loan to value of stock - Spanish mortgages	89	81

Estimates of current LTV are obtained by indexing the valuation at the last physical inspection of the property, by reference to externally published data. At 31 December 2017, 35% of the loan book had an LTV of 70% or greater (2016: 33%). In the event that valuations were to increase by 5%, at 31 December 2017 this would reduce the proportion of the loan book that had an LTV of 70% or greater to 32% (2016: 30%); in the event that House Price Indices ("HPIs") decreased by 5% at 31 December 2017, the proportion of the loan book with an LTV of 70% or greater would increase to 39% (2016: 37%).

The Group continues to review regularly the quality of its loans that are fully secured on residential property. The proportion of these loans more than 3 months in arrears is 2.9% (2016: 1.6%). There are 23 Spanish lifetime mortgages where a repayment trigger event has passed. There are no UK lifetime mortgages which are past due.

The table below provides further information on the payment due status of gross loans fully secured on residential property.

	2017 £m	2017 %	2016 £m	2016 %
Not impaired:				
Neither past due nor impaired	215.7	87	246.2	88
Past due up to 3 months	9.6	4	9.1	3
Past due 3 to 6 months	0.9	-	1.4	-
Past due 6 to 12 months	1.0	-	1.3	-
Past due over 12 months	0.6	-	0.7	-
Impaired:				
Not past due and up to 3 months	1.6	1	2.3	1
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	0.6	-	-	-
Past due over 12 months	1.4	1	2.0	1
Possessions *	2.5	1	3.1	1
	233.9	94	266.1	94
NMB MAC mortgage book - beneficial interest is held **	12.6	5	13.4	5
CLC mortgage book **	1.3	1	1.4	1
	247.8	100	280.9	100

* For properties in possession, £2.6m (2016: £2.6m) of collateral is held. In the analysis above, for all past due loans, £30.4m (2016: £31.6m) of collateral is held.

** The NMB MAC and CLC mortgage books of second charge loans were initially acquired at a deep discount and are considered impaired. Arrears banding information is not presented for these portfolios as there is insufficient reliable data to determine this accurately. The net book value of these loan books after impairment provisions is £4.4m (2016: £5.3m).

In the analysis above, loans which are not impaired and are less than 3 months past due and which have collective impairment provisions total £17.5m (2016: £14.9m).

At 31 December 2017 the Group held individually identified impairment provisions of £1.7m (2016: £2.2m).

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Geographical Analysis

The table below provides information on the geographical split of the Group's gross lending on residential property.

	2017 £m	2017 %	2016 £m	2016 %
East Midlands	3.5	1	4.1	1
Greater London	13.4	5	15.4	6
London	30.9	13	35.9	13
North	5.4	2	6.5	2
North West	89.9	36	106.3	37
Other	9.3	4	9.7	4
South East	16.9	7	20.9	7
South West	6.3	3	7.4	3
Wales	5.1	2	6.2	2
West Midlands	5.9	2	7.3	3
Yorkshire	11.3	5	13.9	5
Total UK properties	197.9	80	233.6	83
Spain (lending is lifetime mortgages)	49.7	20	47.1	17
Portugal	0.2	0	0.2	0
	247.8	100	280.9	100

Secured lending – fully secured on land

The constitution of gross loans fully secured on land by industry type is as follows:

	2017 £m	2017 %	2016 £m	2016 %
Offices	7.0	28	8.2	28
Shops	6.3	25	6.8	23
Industrial	4.0	16	4.5	16
Restaurants, Hotels and other	7.9	31	9.6	33
	25.2	100	29.1	100

The table below provides further information on the payment due status of gross loans that are fully secured on land:

	2017 £m	2017 %	2016 £m	2016 %
Not impaired:				
Neither past due nor impaired	17.8	71	20.4	70
Past due up to 3 months	1.1	4	0.9	3
Past due 3 to 6 months	-	-	0.1	-
Past due 6 to 12 months	-	-	0.3	1
Past due over 12 months	-	-	0.4	1
Impaired:				
Not past due and up to 3 months	0.7	3	1.4	5
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	-	-	-	-
Past due over 12 months	3.5	14	3.4	12
Possessions *	2.1	8	2.2	8
	25.2	100	29.1	100

* For properties in possession £0.3m of collateral is held (2016: £0.4m). In the analysis above, for all past due loans £6.3m of collateral is held (2016: £7.0m).

In the analysis above, loans which are not impaired and are less than 3 months past due have collective impairment provisions of £102k (2016: £50k).

At 31 December 2017 the Group held individually identified impairment provisions of £4.0m (2016: £4.6m).

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Unsecured lending

The table below provides further information on the payment due status of gross unsecured loans:

	2017 £m	2017 %	2016 £m	2016 %
Not impaired:				
Neither past due nor impaired	0.8	73	1.0	77
Past due up to 3 months	0.1	12	0.1	8
Past due over 12 months	0.2	15	0.1	15
	1.1	100	1.2	100

In the analysis above, loans which are not impaired and are less than 3 months past due have collective impairment provisions of £7k (2016: £nil).

At 31 December 2017 the Group held individually identified impairment provisions of £nil (2016: £nil).

Credit risk – loans and advances to banks and investment securities

Credit risk relating to liquid assets arises from the investments held by the Group in order to meet business-as-usual liquidity requirements. This aspect of credit risk is managed by the Group's Risk Committee, which sets and monitors compliance with policy and limits. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

The maximum individual counterparty exposure at the financial position date was £33m (2016: £67m) which was on deposit with the Bank of England. The number of active counterparties at the financial position date was 6 (2016: 5). All counterparties are UK domiciled banks whose registered address is within the UK and who are authorised by the PRA and regulated by the FCA and PRA as lead regulators; this is in support of the Board's low risk appetite approach to banking counterparty risk.

For credit purposes, the liquid asset portfolio comprises the following sub-portfolios as at 31 December:

	2017 £m	2017 %	2016 £m	2016 %
UK Financial institutions	44.0	100.0	81.8	100.0
Treasury Bill	-	-	0.2	-
Mortgage backed securities	-	-	0.1	-
	44.0	100.0	82.1	100.0

The Group's Risk Committee monitors exposure concentrations against a variety of criteria including industry sector / asset class and country of counterparty.

	2017 £m	2017 %	2016 £m	2016 %
UK	44.0	100	82.1	100
	44.0	100	82.1	100

Geographical exposure, assessed by reference to the registered address of the counterparty and the lead regulator of the entity, is solely within the UK.

Industry sector/asset class exposure:

	2017 £m	2017 %	2016 £m	2016 %
UK Financial institutions	44.0	100	81.8	100
UK Government	-	-	0.2	-
Asset backed securities	-	-	0.1	-
	44.0	100	82.1	100

Collateral held as security for liquid assets is determined by the nature of the instrument. Loans and debt securities are generally unsecured with the exception of asset backed securities which are secured by pools of financial assets.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Credit risk – foreign exchange derivatives and offsetting

Foreign exchange derivative financial assets are subject to offsetting, enforceable, master netting agreements. The gross amounts of these assets on the balance sheet are £280k (2016: £278k). Related amounts not set off are £192k (2016: £1,641k) financial liabilities with cash collateral received of £280k (2016: £nil).

Foreign exchange derivative financial liabilities are subject to offsetting, enforceable, master netting agreements. The gross amounts of these liabilities on the balance sheet are £192k (2016: £1,641k). Related amounts not set off are £280k (2016: £278k) financial liabilities with cash collateral deposited of £1,661k (2016: £3,105k).

Cash flow and fair value interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The Board sets limits on the level of mismatch of interest rate repricing that may be undertaken, which are monitored monthly.

The table below summarises the Group's exposure to interest rate risks. Included in the table are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

The Group's interest rate sensitivity exposure at 31 December 2017 and 31 December 2016 was:

	0-3 months £000	3-6 months £000	6-12 months £000	1-5 years £000	5-10 years £000	10-20 years £000	20-30 years £000	Over 30 years £000	Non-interest bearing £000	Total £000
At 31 December 2017										
Assets										
Cash and central banks balances	32,895	-	-	-	-	-	-	-	16	32,911
Due from other banks	11,024	-	-	-	-	-	-	-	7	11,031
Investment securities	39	-	-	-	-	-	-	-	-	39
Loans to customers	193,336	92	388	3,417	5,012	4,590	1,676	118	-	208,629
Lifetime mortgages	-	-	2,925	4,198	5,040	22,050	7,979	-	-	42,192
Derivatives	136	144	-	-	-	-	-	-	-	280
Other assets	1,661	-	-	-	-	-	-	-	7,448	9,109
Total assets	239,091	236	3,313	7,615	10,052	26,640	9,655	118	7,471	304,191
Liabilities										
Due to other banks	-	-	-	-	-	-	-	-	-	-
Other deposits	17,793	-	-	-	-	-	-	-	65	17,858
Due to members	232,920	4,768	9,684	-	-	-	-	-	256	247,628
Subordinated liabilities	9,200	-	-	-	5,000	-	-	-	-	14,200
Derivatives	63	102	27	-	-	-	-	-	-	192
Other liabilities	280	-	-	-	-	-	-	-	1,807	2,087
Subscribed capital	-	-	-	-	-	-	-	-	14,788	14,788
Profit participating deferred shares	-	-	-	-	-	-	-	-	17,461	17,461
Accumulated losses	-	-	-	-	-	-	-	-	(10,023)	(10,023)
Total liabilities	260,256	4,870	9,711	-	5,000	-	-	-	24,354	304,191
Interest rate sensitivity gap	(21,165)	(4,634)	(6,398)	7,615	5,052	26,640	9,655	118	(16,883)	-
Cumulative gap	(21,165)	(25,799)	(32,197)	(24,582)	(19,530)	7,110	16,765	16,883	-	-

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Cash flow and fair value interest rate risk (continued)

	0-3 months £000	3-6 months £000	6-12 months £000	1-5 years £000	5-10 years £000	10-20 years £000	20-30 years £000	Over 30 years £000	Non-interest bearing £000	Total £000
At 31 December 2016										
Assets										
Cash and central banks balances	67,379	-	-	-	-	-	-	-	8	67,387
Due from other banks	14,418	-	-	-	-	-	-	-	9	14,427
Investment securities	-	240	-	66	-	-	-	-	-	306
Loans to customers	228,756	190	381	2,650	2,750	9,898	2,435	119	-	247,179
Lifetime mortgages	-	-	849	5,162	4,455	20,794	11,013	-	-	42,273
	18	260	-	-	-	-	-	-	-	278
Other assets	3,105	-	-	-	-	-	-	-	7,349	10,454
Total assets	313,676	690	1,230	7,878	7,205	30,692	13,448	119	7,366	382,304
Liabilities										
Due to other banks	-	-	-	-	-	-	-	-	-	-
Other deposits	24,631	-	-	-	-	-	-	-	122	24,753
Due to members	296,802	2,794	12,784	2,499	-	-	-	-	512	315,391
Subordinated liabilities	9,200	-	-	-	-	5,000	-	-	-	14,200
Derivative financial instruments	1,214	314	113	-	-	-	-	-	-	1,641
Other liabilities	-	-	-	-	-	-	-	-	3,313	3,313
Subscribed capital	-	-	-	-	-	-	-	-	14,788	14,788
Profit participating deferred shares	-	-	-	-	-	-	-	-	17,461	17,461
Accumulated losses	-	-	-	-	-	-	-	-	(9,243)	(9,243)
Total liabilities	331,847	3,108	12,897	2,499	-	5,000	-	-	26,953	382,304
Interest rate sensitivity gap	(18,171)	(2,418)	(11,667)	5,379	7,205	25,692	13,448	119	(19,587)	-
Cumulative gap	(18,171)	(20,589)	(32,256)	(26,877)	(19,672)	6,020	19,468	19,587	-	-

The Group's financial performance is sensitive to changes in interest rates in respect of the interest it earns. Based on the assets and liabilities in the balance sheet at 31 December 2017 an increase of 1% in market interest rates across all maturities would reduce income and equity by £4.9m (2016: £5.5m reduction). These amounts are for indication only, and represent the impact of an unexpected overnight 1% parallel shift in the yield curve, without any subsequent management action, and consequently do not represent amounts that are at risk. ALCO monitor a variety of interest rate shocks from 0.5% to 2%.

Liquidity risk

The Group is exposed to daily calls on its available cash resources from customer withdrawals, maturing deposits, loan draw-downs and guarantees, and from margin and other calls on cash-settled derivatives. The Group does not maintain immediately available cash resources to meet instantly all of these needs, as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty.

The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the nature of the funds that are available to the Group on an instantly accessible basis; with the latter, the Board strategy has been to place notable sums with the Bank of England and with other UK "High Street" banks in order to ensure that it meets its objectives of ensuring that all such funds are highly liquid.

The liquidity profile throughout 2017 has aligned with the Board's low risk appetite in this area and day-to-day operations of the liquidity portfolio saw compliance with all policy limits throughout the period. Such policy limits are reviewed on a daily basis and it should be noted that the Group has consistently maintained cash resources in excess of the policy minimum.

The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

The Group has continued to hold liquidity levels well in excess of the regulatory thresholds during the year. This has contributed to downward pressure on net interest income.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Liquidity risk (continued)

The table below analyses the Group's contractual cash flows under financial liabilities.

	On demand £000	0-3 months £000	3-12 months £000	1-5 years £000	5-10 years £000	10-15 years £000	Over 15 years £000	Total £000
At 31 December 2017								
Due to members	105,306	127,828	4,798	9,696	-	-	-	247,628
Due to other banks and depositors	10,247	7,611	-	-	-	-	-	17,858
Derivative financial instruments	-	63	129	-	-	-	-	192
Other liabilities	1,617	105	242	-	-	-	-	1,964
PIBS interest	-	-	200	1,600	2,000	2,000	2,000	7,800
Subordinated liabilities	-	143	430	7,192	5,888	6,610	-	20,263
Total outflow	117,170	135,750	5,799	18,488	7,888	8,610	2,000	295,705
	£000	£000	£000	£000	£000	£000	£000	£000
At 31 December 2016								
Due to members	128,350	176,188	3,982	6,871	-	-	-	315,391
Due to other banks and depositors	12,653	12,100	-	-	-	-	-	24,753
Derivative financial instruments	-	1,215	426	-	-	-	-	1,641
Other liabilities	1,243	91	1,858	-	-	-	-	3,192
PIBS interest	-	-	200	1,600	2,000	2,000	2,000	7,800
Subordinated liabilities	-	141	422	2,250	11,021	1,675	5,270	20,779
Total outflow	142,246	189,735	6,888	10,721	13,021	3,675	7,270	373,556

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the financial position date to the contractual maturity date. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

	0-3 months £000	3-6 months £000	6-12 months £000	1-5 years £000	5-10 years £000	10-20 years £000	20-30 years £000	Over 30 years £000	Total £000
At 31 December 2017									
Assets									
Cash and central banks balances	32,911	-	-	-	-	-	-	-	32,911
Due from other banks	11,031	-	-	-	-	39	-	-	11,070
Derivative financial instruments	136	144	-	-	-	-	-	-	280
Loans to customers	11,909	2,854	5,708	48,765	47,381	86,968	4,159	884	208,629
Lifetime mortgages	-	-	5,934	12,436	10,213	12,178	1,431	-	42,192
Other assets	1,246	570	311	870	-	-	-	6,112	9,109
Total assets	57,233	3,568	11,953	62,071	57,594	99,185	5,590	6,996	304,191
Liabilities									
Due to other banks	-	-	-	-	-	-	-	-	-
Other deposits	17,858	-	-	-	-	-	-	-	17,858
Derivative financial instruments	63	102	27	-	-	-	-	-	192
Due to members	233,134	4,798	-	9,696	-	-	-	-	247,628
Subordinated liabilities	-	-	-	5,000	4,200	5,000	-	-	14,200
Other liabilities	1,845	-	242	-	-	-	-	-	2,087
Total liabilities	252,900	4,900	269	14,696	4,200	5,000	-	-	281,965
Net liquidity gap	(195,667)	(1,332)	11,684	47,375	53,394	94,185	5,590	6,996	22,226
At 31 December 2016									
Total assets	95,692	4,057	10,720	56,969	52,057	136,773	18,993	7,045	382,306
Total liabilities	332,110	3,530	2,532	6,926	9,200	5,000	-	-	359,298
Net liquidity gap	(236,418)	527	8,188	50,043	42,857	131,773	18,993	7,045	23,008

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Liquidity risk (continued)

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. The Group does not expect to be completely matched, as transacted business is often of uncertain term and of different types. An unmatched position potentially enhances profitability but could also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

Currency risk

At 31 December 2017 the Group had a foreign currency exposure of €58.0m (2016: €57.1m) in loans and receivables. At the balance sheet date this exposure is economically hedged with foreign exchange forward contracts. The Board sets limits on the level of exposures to foreign currency and these are monitored daily.

Foreign Exchange Sensitivity

The Group has assessed, on an indicative basis, the effect that a 10bp depreciation of the Euro would have on the Group's income, as a result of a revaluation of the balance sheet assets and liabilities.

	2017	**2016**
	£000	**£000**
Effect on income with no Euro forward contracts	(3,587)	(3,465)
Effect on income with Euro contracts fully matching Euro denominated assets	24	47

The Group matches the foreign exchange exposure against Euro assets net of provisions.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Classification of financial assets and liabilities

The following tables show the classification of the Group's and Society's financial assets and liabilities

	Group as at 31 December 2017			Society as at 31 December 2017		
	Loans and receivables £000	Fair value through profit or loss £000	Total £000	Loans and receivables £000	Fair value through profit or loss £000	Total £000
Assets						
Cash and balances with central banks	32,911	-	32,911	32,911	-	32,911
Loans and advances to credit institutions	11,031	-	11,031	10,980	-	10,980
Investment securities	-	39	39	-	39	39
Derivative financial instruments	-	280	280	-	264	264
Loans and advances to customers	250,821	-	250,821	245,353	-	245,353
Investments	-	-	-	9,502	-	9,502
Other assets	1,730	-	1,730	1,681	-	1,681
	296,493	319	296,812	300,427	303	300,730
Non-financial assets			7,379			1,533
Total assets			304,191			302,263
Liabilities						
Due to members	247,628	-	247,628	247,628	-	247,628
Other deposits	17,858	-	17,858	17,858	-	17,858
Derivative financial instruments	-	192	192	-	188	188
Other liabilities	1,460	-	1,460	1,405	-	1,405
Subordinated liabilities	14,200	-	14,200	14,200	-	14,200
Subscribed capital	5,000	-	5,000	5,000	-	5,000
	286,146	192	286,338	286,091	188	286,279
Non-financial liabilities			17,853			15,984
			304,191			302,263

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Classification of financial assets and liabilities (continued)

	Group as at 31 December 2016			Society as at 31 December 2016		
	Loans and receivables	Fair value through profit or loss	Total	Loans and receivables	Fair value through profit or loss	Total
	£000	£000	£000	£000	£000	£000
Assets						
Cash and balances with central banks	67,387	-	67,387	67,387	-	67,387
Loans and advances to credit institutions	14,427	-	14,427	14,298	-	14,298
Investment securities	-	306	306	-	306	306
Derivative financial instruments	-	278	278	-	199	199
Loans and advances to customers	289,452	-	289,452	283,341	-	283,341
Investments	-	-	-	10,823	-	10,823
Other assets	3,177	-	3,177	3,128	-	3,128
	374,443	584	375,027	378,977	505	379,482
Non-financial assets			7,277			1,839
Total assets			382,304			381,321
Liabilities						
Due to members	315,391	-	315,391	315,391	-	315,391
Other deposits	24,753	-	24,753	24,753	-	24,753
Derivative financial instruments	-	1,641	1,641	-	1,641	1,641
Other liabilities	1,363	-	1,363	1,008	-	1,008
Subordinated liabilities	14,200	-	14,200	14,200	-	14,200
Subscribed capital	5,000	-	5,000	5,000	-	5,000
	360,707	1,641	362,348	360,352	1,641	361,993
Non-financial liabilities			19,956			19,328
Total liabilities			382,304			381,321

Fair value of financial assets and liabilities carried at amortised cost

The tables below show the book value of the Group's and Society's financial assets and liabilities held at amortised cost in the Statement of Financial Position.

Group	2017 Carrying value	2017 Fair value	2016 Carrying value	2016 Fair value
	£000	£000	£000	£000
Financial assets				
Cash and balances with the Bank of England	32,911	32,911	67,387	67,387
Loans and advances to credit institutions	11,031	11,031	14,427	14,427
Loans and advances to customers	250,821	240,216	289,452	277,550
Other assets	1,730	1,730	3,177	3,177
	296,493	285,888	374,443	362,541
	£000	£000	£000	£000
Financial liabilities				
Due to members	247,628	247,624	315,391	315,378
Deposits from banks	-	-	-	-
Other deposits	17,858	17,858	24,753	24,753
Subordinated liabilities	14,200	14,200	14,200	14,200
Subscribed capital	5,000	1,350	5,000	1,425
Other liabilities	1,460	1,460	1,363	1,363
	286,146	282,492	360,707	357,119

1. Accounting policies and financial risk management

b) Financial risk management (continued)
Fair value of financial assets and liabilities carried at amortised cost (continued)

Society	2017 Carrying value £000	2017 Fair value £000	2016 Carrying value £000	2016 Fair value £000
Financial assets				
Cash and balances with the Bank of England	32,911	32,911	67,387	67,387
Loans and advances to credit institutions	10,980	10,980	14,298	14,298
Loans and advances to customers	245,353	234,748	283,341	271,439
Other assets	1,681	1,681	3,128	3,128
	290,925	280,320	368,154	356,252
	£000	£000	£000	£000
Financial liabilities				
Due to members	247,628	247,624	315,391	315,378
Deposits from banks	-	-	-	-
Other deposits	17,858	17,858	24,753	24,753
Subordinated liabilities	14,200	14,200	14,200	14,200
Subscribed capital	5,000	1,350	5,000	1,425
Other liabilities	1,405	1,405	1,008	1,008
	286,091	282,437	360,352	356,764

i. Cash and balances with the Bank of England – the fair value is the same as the carrying value as the amounts are repayable on demand.
ii. Loans and advances to credit institutions – the fair value of overnight deposits is the same as the carrying value as the amounts are repayable on demand. The estimated fair value of loans and advances to credit institutions is calculated based upon discounted expected future cash flows.
iii. Loans and advances to customers – the estimated fair value of loans and advances to customers represents the discounted amount of estimated future cash flows expected to be received after taking into account impairment and expected prepayment rates. Estimated cash flows are discounted using prevailing markets rates for items of similar maturity.
iv. Shares and borrowings – The estimated fair value of deposits with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on discounted cash flows using interest rates for new deposits with similar remaining maturity.

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between knowledgeable, willing market participants at the measurement date.

Wherever possible, fair values have been calculated using unadjusted quoted market prices in active markets for identical instruments held by the Group. Where quoted market prices are not available, or are unreliable, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs.

Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the Group.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these financial statements are thus advised to use caution when using this data to evaluate the Group's financial position.

The fair value measurement basis used is as follows:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 Valuation techniques where all inputs are taken from observable market data, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 Valuation techniques where significant inputs are not based on observable market data. None of the Group's assets or liabilities are valued using this technique.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Fair values of assets and liabilities held at fair value

The table below shows the fair values of the Group's assets and liabilities held at fair value in the Statement of Financial Position analysed according to the hierarchy described above:

Group	2017 Level 1 £000	2017 Level 2 £000	2017 Total £000
Financial assets			
Investment securities	39	-	39
Derivative financial instruments	-	280	280
	39	280	319
Investment properties (Note 16)	-	691	691
Financial liabilities			
Derivative financial instruments	-	192 -	192
	-	192	192

Group	2016 Level 1 £000	2016 Level 2 £000	2016 Total £000
Financial assets			
Investment securities	306	-	306
Derivative financial instruments	-	278	278
	306	278	584
Investment properties (Note 16)	-	839	839
Financial liabilities			
Derivative financial instruments	-	1,641	1,641
	-	1,641	1,641

(i) Market prices have been used to determine the fair value of listed investment securities

(ii) The fair value of derivatives and investment securities that are not listed are calculated by utilising internal valuation models using a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity. External market data is used within these internal valuation models. Derivatives are held for trading. Investment securities are designated at fair value through profit or loss. Movements in the valuations of derivatives and investment securities are treated as fair value through profit and loss, and these financial assets and liabilities are grouped into the fair value hierarchy under level 2.

(iii) The fair value of Investment Properties is determined by using available index data and reflects the market value at the balance sheet date and revaluations performed in the year.

1. Accounting policies and financial risk management

c) Critical accounting estimates and judgments in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the financial year. The most significant areas where judgments and assumptions are made are as follows:

(i) Impairment losses on loans and advances

The Group reviews its portfolio of loans to assess potential impairment periodically. Save for lifetime mortgages (discussed further below), forbearance matters, arrears positions and indexed LTVs are reviewed on all loan accounts in order to identify potential impairment indicators. For all accounts where impairment may have occurred, the recoverability of the balance due at the financial statement date is assessed by reference to the discounted cash flows associated with the loan. The assessment of these cash flows includes periodic interest and capital repayments and a redemption amount. Within this impairment assessment, assumptions are made concerning sale disposal costs, any loss that may arise from discounts incurred at the point of sale and, in instances where the Society is not the primary charge holder, any payment that must be made to other lenders by the borrower. Values at redemption are assessed as follows:

- loans secured on residential property – assessed by reference to regional HPI data published by Nationwide Building Society and economic forecast data published by Oxford Economics.
- loans secured on land (a category which includes commercial property) – historic valuation data is supplemented with periodic updated desktop, drive-by or full inspection valuation information.

Assumptions are built into the discounted cash flows regarding any work-out strategies on particular impaired accounts.

If the value of current house prices were 5% higher than that currently estimated, then the total impairment provision required for the Group would decrease from £23.3m to £22.2m. If current prices were 5% lower, then the provision requirement would increase by £1.1m to £24.4m.

The Group holds a beneficial interest in NMB MAC a portfolio of mortgage assets, some of which are MCOB regulated. The legal title of these loans remains with this third party business to which the Group provided funding and over which it holds a debenture; under IFRS 10 this third party entity, which is currently in liquidation, is consolidated within the Group Financial Statements. A further smaller portfolio, CLC, which had previously been beneficially owned and which is now legally owned by the Group has similarly MCOB regulated mortgage assets. The recoverability of loan balances has been included in the estimate of discounted future cash flows that forms the basis of the impairment provision. This has been assessed based on recent historic cash flow receipts, experience of redemptions and using estimates of the likely future redemption dates. The value of the mortgage assets, post impairment provision in these two portfolios, is £4.4m (2016: £5.3m) of which 40% (2016: 33%) relates to MCOB regulated mortgages.

A 5% uplift in cash flows from the mortgage assets in these NMB MAC and CLC portfolios, associated with greater levels of recoverability than currently estimated, would result in the provision being reduced from £9.6m to £9.4m whilst a 10% reduction in cash flows would see the provision requirement increase from £9.6m to £10.0m.

The Board monitors its credit risk exposures, underlying security values and the level of impairment provisions on a regular basis.

(ii) Provisions for customer redress and regulatory issues

In addition to considering the impact of any non-compliance on the recoverability of loan balances and thus impairment provisioning, the Group considers the conduct risk which arises from having originated regulated loans and having acquired regulated loan portfolios. As is the case for all financial institutions there is a risk that aspects of current or historic business might be considered as not being conducted in accordance with all relevant regulation, or the fair and reasonable treatment of customers.

Certain activities of the Group, particularly the NMB MAC and CLC second charge loan portfolios carry greater levels of conduct risk. These portfolios are under regular review and assessment as part of the risk management processes within the Group. The administration of the NMB MAC and CLC portfolios was brought in-house in December 2015 and following that transfer the historic conduct of these portfolios was reviewed in detail by management.

Following this review, and having remediated these loan during 2017, the Group has reduced its customer redress provision to £0.1m (2016: £1.7m) to provide for those remaining instances of non-compliance with the CCA within the NMB MAC and CLC portfolios. The provision includes an estimate of the potential cost of interest refunds during periods of non-compliance and other costs associated with a customer redress exercise. Full details of the customer redress provision are set out in Note 29.

Although a detailed review of these portfolios has been carried out, there is no judicial certainty in the legal position and there is a risk that further conduct issues or cases of non-compliance with regulations could be identified in the future. As a result the actual results could differ materially from our estimates.

Provision has been made where the Group is aware of a specific conduct or regulatory issue and can estimate its impact reliably, further details in respect of the Group's consideration of other potential conduct and regulatory issues is provided in the contingent liability Note 30.

1. Accounting policies and financial risk management

c) Critical accounting estimates and judgments in applying accounting policies (continued)

(iii) Insurance risk

The Society's lifetime mortgages total £49.7m gross (2016: £47.1m gross). All loans are at rates of interest that are fixed for the duration of the mortgage; at inception LTVs were low and borrowers were above the age of 60. Borrowers do not make monthly repayments; instead under their contractual terms, interest is capitalised within the balance and becomes repayable on redemption of the loan.

The mortgage contracts contain a clause that behaves like an insurance policy, where in certain circumstances, if the redemption receipt is less than the contractual sum due, the Society cannot pursue the borrower or the estate for the shortfall. This exposes the Society to the risk that the redemption balance may not be recovered fully. Impairment provisions are calculated using projection data regarding the expected remaining term of the loan and both historic and forecast Spanish HPI data. As redemption dates can be 25+ years in the future, the impairment provision is most sensitive to the value of the property at redemption, where a small change in property value assumptions in the earlier years can have a notable impact on the estimated redemption receipt.

Projection data obtained from external UK sources indicates average long-term year-on-year Spanish HPI appreciation at 2.53% (2016: 3.25%) over a 25 year period. If this HPI were to decrease by 0.5% per annum, the insurance provision would increase from its current level of £7.5m to £8.2m; an increase in HPI of 0.5% per annum would see the provision reduce to £6.8m. Mortality rates are based on a third party actuarial assessment. The provision is not particularly sensitive to the date of redemption, in the event that borrowers were to live for 5 years longer than current predictions the insurance provision would decrease by £0.4m. Pre-payment rates are estimated to be 6.0% (2016: 5.8%), based on experience to date. A 0.5% decrease in the pre-payment rate would see the insurance risk provision increase from £7.5m to £8.0m whilst a 0.5% increase in pre-payment would result in a reduction in the insurance risk provision from £7.5m to £7.1m.

(iv) Deferred tax

An asset is recognised to the extent that it is considered probable that future taxable profits will be available to utilise its carrying value. The most critical element of judgment applied is that relating to the Society's forecast profitability and the certainty of that profitability in the medium-term in order to meet the requirements of IAS 12 – Income Taxes. This includes a consideration of the likely changes in economic conditions and the extent of new lending, or otherwise, in the business. The Group's long-term financial projections, based on a managed run-off of the balance sheet without a return to lending, indicate that the underlying operations of the Group will remain profitable in the short to medium-term. In the medium to long-term it is likely that the net interest margin will be insufficient to cover operating costs and loan impairment charges, resulting in operating losses.

As a result no deferred tax asset has been recognised in the year. Further details may be found in Note 17.

(v) Inter-company loan impairment

No further impairment was made to the investment held in MBS (Property) Limited in the year. The investment valuation was assessed based on the discounted cash flows associated with the property, requiring an assessment of rentals, void rates and long-term property values. A discount rate of 4.00% (2016: 5.63%) was applied, being the rate associated with the financing arrangement in place. The investment value is not sensitive to small changes in rental assumptions; a 35% decrease in rental experience would be required before an impairment charge would be required. The value of the property has been assumed to grow at 2% per annum up to a future date of disposal. If the growth rate were only 1% per annum, this would lead to no increase in the impairment.

The Group holds a beneficial interest in a portfolio of mortgage assets, NMB MAC, some of which are regulated by the MCOB. These assets are held in MBS (Mortgages) Limited. Remediation of a number of these accounts following periods of non-compliance is detailed in Note 1c (ii) and Note 29. Also a reassessment of the recoverability of these assets was performed (as detailed in Note 1c (i)). This has indicated impairment to the ability of the subsidiary to repay the Society's investment in it and therefore an impairment provision of £1.5m has been made in the Society's separate financial statements, reducing the net investment in the subsidiary.

d) Segmental Analysis

The Group's results are predominately derived from the Society's principal activities. The Group's other income streams are not sufficiently material to require segmental reporting. The chief operating decision maker of the Group and the Society is deemed to be the Group Board.

2. Interest receivable and similar income

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
On loans fully secured on residential property	11,013	11,704	10,216	11,219
On other loans	970	1,114	970	1,114
On investment securities	-	1	-	1
On other liquid assets	198	346	198	346
	12,181	13,165	11,384	12,680

Interest receivable and similar income, on loans fully secured on residential property, has been increased in the year by a release of £0.5m (2016: £0.2m charge) in respect of a provision for customer redress; see Note 29 for further details.

Other than £3.4m (2016: £3.2m) generated on loans originating in Spain and £0.01m generated in Portugal, all interest receivable and similar income has been generated within the United Kingdom. Interest generated on loans originating in Spain is representative of insurance income earned on insurance assets held.

3. Interest payable and similar charges

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
On amounts due to members	2,491	3,696	2,491	3,696
On deposits and other borrowings				
Subordinated liabilities	558	573	558	573
Subscribed capital (Note 23)	-	130	-	130
Other	113	294	113	294
	3,162	4,693	3,162	4,693

4. Other operating income and charges

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Income				
Rents receivable	191	106	35	42
Interest from subsidiaries	-	-	359	521
Other income from subsidiaries	-	-	120	120
Exchange gains and losses	(1,062)	2,180	(1,118)	2,248
Fair value gains and losses on derivatives	1,450	(1,639)	1,518	(1,666)
	579	647	914	1,265
Charges				
Rents payable	50	51	193	194
Other	2	8	2	8
	52	59	195	202

Exchange gains and losses arise principally in respect of the Spanish lifetime mortgage book and are largely offset by the fair value gains and losses from the economic hedging activity with foreign exchange derivatives.

Rent payable by the Society under operating leases is payable to the Society's subsidiary MBS (Property) Limited. Rent payable by the Group under operating leases is payable to 3rd parties.

5. Administrative expenses

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Employee costs (including Executive Directors)				
Wages & salaries	1,846	1,946	1,846	1,946
Social security costs	191	214	191	214
Pension costs	174	165	174	165
	2,211	2,325	2,211	2,325
Other administrative expenses	5,509	6,124	5,211	5,069
	7,720	8,449	7,422	7,394

The reduction in administrative expenses reflects additional activity carried out during the prior year in relation to a proposed merger with another mutual entity; an exercise at the request of the PRA to evaluate the capital required to re-enter the residential mortgage market; and the preparation of a 'Capital Conservation Plan' to meet the requirements of CRD IV article 142.

Other administrative expenses include:

Remuneration of the auditors (Inclusive of Value Added Tax)

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Fees payable to the auditors for audit of the annual accounts				
Current year	352	317	352	317
Additional fees in relation to the audit of the prior year	-	72	-	72
Fees payable to the auditors for other services				
Audit of the accounts of subsidiaries	10	10	-	-
Tax compliance services	(10)	50	(8)	49
Other assurance services	63	62	63	62
	415	511	407	500

6. Employees

The average number of persons employed during the year was:

	Group 2017 Number	Group 2016 Number	Society 2017 Number	Society 2016 Number
Full-time	40	44	40	44
Part-time	9	7	9	7
	49	51	49	51

7. Directors' emoluments

Executive directors

	Salary £000	Pension Contributions £000	Bonus £000	Benefits £000	Total £000
2017					
P.A. Lynch	150	18	5	11	184
	150	18	5	11	184
2016					
P.A. Lynch	135	17	-	11	163
	135	17	-	11	163

Non-executive directors

	Fees 2017 £000	Fees 2016 £000
J.P. Allen (retired 31 December 2017)	33	29
H.F. Baines	40	36
I.A. Dewar	35	29
D.A. Harding	80	72
F.B. Smith	33	29
	221	195

Total directors' emoluments

	2017 £000	2016 £000
Executive directors	184	163
Non-executive directors	221	195
Total directors' emoluments	405	358

During the year a number of appointments to the executive management team were made on an interim basis. Further details regarding Key Management Personnel may be found in Note 26.

8. Tax expense

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Loss for the year before tax	(780)	(2,968)	(3,029)	(4,615)
Tax rate	19.25%	20.00%	19.25%	20.00%
Expected tax credit	(150)	(594)	(583)	(923)
Adjustment for non-deductible items	14	12	298	704
Income not taxable	(78)	(7)	-	(7)
Deferred tax movement closing rate/average rate difference	33	36	33	36
Current year losses for which no deferred tax asset recognised	452	752	439	390
Profits of year covered by brought forward losses in respect of which no deferred tax asset recognised	(85)	-	-	-
Adjustment in respect of prior years - deferred tax	-	(4)	-	(2)
Decrease in deferred tax asset recognised	(186)	187	(187)	184
Actual tax expense	-	382	-	382
Comprising				
Deferred tax origination and reversal of timing difference	-	382	-	382
	-	382	-	382

9. Loans and advances to credit institutions

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Accrued interest	10	10	10	10
Repayable on demand	11,021	14,417	10,970	14,288
	11,031	14,427	10,980	14,298

10. Investment securities

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Government investment securities	39	240	39	240
Listed private sector investment securities	-	66	-	66
	39	306	39	306
Investment securities have remaining maturities as follows:				
In not more than three months	39	-	39	-
In more than three months but not more than one year	-	240	-	240
In more than one year but not more than five years	39	66	39	66
	77	306	77	306

The directors of the Society consider that the primary purpose of holding investment securities is prudential. The securities are held as liquid assets with the intention of use on a continuing basis in the Group's activities.

10. Investment securities (continued)

The movement in investment securities is summarised as follows:

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
At 1 January	306	74	306	74
Additions	-	240	-	240
Fair value adjustment	1	-	1	-
Disposals	(268)	(8)	(268)	(8)
At 31 December	39	306	39	306

11. Derivative financial instruments and trading liabilities - Group

Exchange rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currency rates (for example, Sterling for Euros). No exchange of principal takes place. The Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligations. This risk is monitored by reference to the fair value of the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Group assesses counterparties using techniques including credit ratings. The fair value is based on the current discounted cash flows of the swaps when compared with the current exchange rate yields.

The Group uses foreign exchange forward contracts and swaps for hedging purposes. All derivative financial instruments are held for economic purposes.

The following table describes the significant activities undertaken by the Group, the risks associated with such activities and the types of derivatives which are typically used in managing such risks.

Activity	Risk	Type of derivative instruments used
Mortgage lending in Euros	Sensitivity to changes in exchange rates	Exchange rate swaps

	Notional amount £000	Fair value Assets £000	Fair value Liabilities £000
Derivatives held at 31 December 2017			
Exchange rate swaps	44,039	280	192
	44,039	280	192
Derivatives have remaining maturities as follows:			
Up to three months	22,696	136	62
Three to six months	14,880	144	102
Six to twelve months	6,463	-	28
	44,039	280	192
Derivatives held at 31 December 2016			
Exchange rate swaps	44,738	278	1,641
	44,738	278	1,641

12. Loans and advances to customers

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Loans fully secured on residential property	228,674	263,815	223,206	257,704
Loans fully secured on land	21,085	24,419	21,085	24,419
Other loans	1,062	1,218	1,062	1,218
	250,821	289,452	245,353	283,341

At 31 December 2017 the Group had €58.0m (2016: €57.1m) of loans denominated in Euros. These were converted into Sterling at a rate of €1.1257 to the pound (2016: €1.169).

Maturity analysis

The remaining maturity of loans and advances to customers from the date of the financial position is as follows:

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Repayable on demand	10,677	12,000	10,677	12,000
Other loans and advances secured by residual maturity repayable:				
In not more than three months	1,594	1,902	1,398	1,629
In more than three months but not more than one year	8,878	10,885	8,287	10,067
In more than one year but not more than five years	51,469	55,870	47,515	51,398
In more than five years	201,504	230,568	191,845	221,000
	274,122	311,225	259,722	296,094
Less: impairment provisions	(23,301)	(21,773)	(14,369)	(12,753)
	250,821	289,452	245,353	283,341

The Group's experience is that, in many cases, mortgages are redeemed before their natural or contractual redemption dates. As a consequence the maturity analysis above may not reflect actual experience.

12. Loans and advances to customers (continued)

	Loans fully secured on residential property £000	Other loans fully secured on land £000	Other loans £000	Total £000
Group				
At 1 January 2017				
Individually identified				
Credit risk provisions	2,208	4,638	-	6,846
Total individually identified	2,208	4,638	-	6,846
Collectively identified				
Credit risk provisions	10,028	50	-	10,078
Insurance risk provisions	4,849	-	-	4,849
Total collectively identified	14,877	50	-	14,927
Total opening provisions	17,085	4,688	-	21,773
Amounts utilised during the year				
Individually identified				
Credit risk provisions	(534)	(646)	-	(1,180)
Total individually identified	(534)	(646)	-	(1,180)
Collectively identified				
Credit risk provisions	(52)	-	-	(52)
Insurance risk provisions	(112)	-	-	(112)
Total collectively identified	(164)	-	-	(164)
Transferred from provisions for redress (Note 29)				
Collectively identified				
Credit risk provisions	91	-	-	91
Total collectively identified	91	-	-	91
Transferred to Investment Properties				
Individually identified				
Credit risk provisions	(8)	-	-	(8)
Total individually identified	(8)	-	-	(8)
Statement of Comprehensive Income				
Individually identified				
Credit risk provisions	(22)	57	-	35
Total individually identified	(22)	57	-	35
Collectively identified				
Credit risk provisions	(82)	30	7	(45)
Insurance risk provisions	2,799	-	-	2,799
Total collectively identified	2,717	30	7	2,754
Total	2,695	87	7	2,789
At 31 December 2017				
Individually identified				
Credit risk provisions	1,644	4,049	-	5,693
Total individually identified	1,644	4,049	-	5,693
Collectively identified				
Credit risk provisions	9,985	80	7	10,072
Insurance risk provisions	7,536	-	-	7,536
Total collectively identified	17,521	80	7	17,608
Total closing provisions	19,165	4,129	7	23,301

12. Loans and advances to customers (continued)

	Loans fully secured on residential property £000	Other loans fully secured on land £000	Other loans £000	Total £000
Society				
At 1 January 2017				
Individually identified				
Credit risk provisions	2,208	4,638	-	6,846
Total individually identified	2,208	4,638	-	6,846
Collectively identified				
Credit risk provisions	1,009	49	-	1,058
Insurance risk provisions	4,849	-	-	4,849
Total collectively identified	5,858	49	-	5,907
Total opening provisions	8,066	4,687	-	12,753
Amounts utilised during the year				
Individually identified				
Credit risk provisions	(534)	(646)	-	(1,180)
Total individually identified	(534)	(646)	-	(1,180)
Collectively identified				
Credit risk provisions	(31)	-	-	(31)
Insurance risk provisions	(112)	-	-	(112)
Total collectively identified	(143)	-	-	(143)
Transferred from provisions for redress (Note 29)				
Collectively identified				
Credit risk provisions	91	-	-	91
Total individually identified	91	-	-	91
Transferred to Investment Properties				
Individually identified				
Credit risk provisions	(8)	-	-	(8)
Total individually identified	(8)	-	-	(8)
Statement of Comprehensive Income				
Individually identified				
Credit risk provisions	(22)	57	-	35
Total individually identified	(22)	57	-	35
Collectively identified				
Credit risk provisions	(15)	30	7	22
Insurance risk provisions	2,799	-	-	2,799
Total collectively identified	2,784	30	7	2,821
Total	2,762	87	7	2,856
At 31 December 2017				
Individually identified				
Credit risk provisions	1,644	4,049	-	5,693
Total individually identified	1,644	4,049	-	5,693
Collectively identified				
Credit risk provisions	1,054	79	7	1,140
Insurance risk provisions	7,536	-	-	7,536
Total collectively identified	8,590	79	7	8,676
Total closing provisions	10,234	4,128	7	14,369

Total impairment losses in the Statement of Comprehensive Income of the Group and Society are disclosed in Note 13.

13. Impairment losses

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Impairment (gains)/losses on loans and advances to customers on residential property and land	(10)	1,858	56	1,101
Impairment losses on loans and advances to customers on lifetime mortgages	2,799	1,590	2,799	1,590
Impairment on loan to subsidiaries:				
- MBS(Property) Limited	-	-	-	799
- MBS(Mortgages) Limited	-	-	1,534	2,719
Reversal of previous impairment on Property, Plant and Equipment	(413)	-	-	-
	2,376	3,448	4,389	6,209

In 2017, following a further reassessment of the recoverability of the Society's investment in MBS (Property) Limited, no further impairment provision (2016: £0.8m) was required in the Society's separate financial statements. For further details of the impairment test see Note 14.

The recoverability of the Society's investment in MBS (Mortgages) Limited was also reassessed in 2017, and an impairment provision of £1.5m (2016: £2.7m) was reflected in the Society's separate financial statements reducing the net investment in this subsidiary. For further details of the impairment test see Note 14.

The Group's head office, owned by the Society's subsidiary MBS (Property) Limited, was impaired in the 2015 financial statements. Following a revaluation in the year, £0.4m (2016: £nil) of this impairment has been released.

14. Investments

Subsidiary undertakings	Shares £000	Loans £000	Total £000
At 1 January 2017	2	10,821	10,823
Impairment	-	(1,534)	(1,534)
Advances	-	213	213
At 31 December 2017	2	9,500	9,502

The Society's investment in its subsidiaries has been tested for impairment and appropriate reductions in the carrying balances have been made.

No further impairment was made to the investment held in MBS (Property) Limited in the year. The investment valuation was assessed based on the discounted cash flows associated with the property, requiring an assessment of rentals, void rates and long-term property values. A discount rate of 4.00% (2016: 5.63%) was applied, being the rate associated with the financing arrangement in place. The investment value is not sensitive to small changes in rental assumptions; a 37% decrease in rental experience would be required before an impairment charge would be required. The value of the property has been assumed to grow at 2% per annum up to a future date of disposal. If the growth rate were only 1% per annum, this would lead to no increase in the impairment.

The Group holds a beneficial interest in a portfolio of mortgage assets, NMB MAC, some of which are regulated by the MCOB. These assets are held in MBS (Mortgages) Limited. Remediation of a number of these accounts following periods of non-compliance is detailed in Note 1c (ii) and Note 29. Also a reassessment of the recoverability of these assets was performed (as detailed in Note 1c (i)). This has indicated impairment to the ability of the subsidiary to repay the Society's investment in it and therefore an impairment provision of £1.5m has been made in the Society's separate financial statements, reducing the net investment in the subsidiary.

The directors consider that the carrying value of the investment in subsidiaries is supported by their net assets.

Subsidiaries	Nature of Business	Country of Incorporation and place of business	Proportion of Ordinary shares held
MBS (Mortgages) Limited	Mortgage lending	England	100%
MBS (Property) Limited	Property ownership	England	100%

MBS (Mortgages) Limited and MBS (Property) Limited are wholly owned and wholly funded by the Society, the registered addresses are the same as that for the Society.

14. Investments (continued)

The Society's ability to recover its investment in these subsidiaries is based upon the cash flows that these subsidiaries can generate.

Connected undertakings

In 2017 there was one other entity the results of which have been consolidated with the Group position under the terms of IFRS 10: NMB Mortgage Acquisition Company Limited ("NMB MAC"). The company has been funded by the Group and is in liquidation. The Group benefited from the cash flows arising from NMB MAC, save for those used by the administrator of the businesses to meet their day-to-day running costs, and the Group had significant influence over the company. The Group had no shareholding or voting rights in the company but was exposed to variable returns from the company. There were no material non-controlling interests. The arrangement met the definition of control under IFRS 10 and so the results of NMB MAC have been consolidated in accordance with that standard.

Connected undertakings	Nature of Business	Country of Incorporation and place of business	Proportion of Ordinary shares held
NMB Mortgage Acquisition Company Limited*	Mortgage lending	England	0%

* in liquidation

As NMB MAC is in liquidation, the Group's ability to use this entity's assets or settle its liabilities is restricted by the cash flows that the entity is able to generate alongside the administrator's statutory duty to manage the entity. Save for the above, there are no other significant restrictions on the Group's ability to use assets or settle liabilities in any of the subsidiaries listed above.

The registered address for the entity is 150 Aldersgate Street, London, EC1A 4AB.

15. Property, plant and equipment

Group	Land and buildings £000	Alterations fixtures and equipment £000	Total £000
Cost			
At 1 January 2017	8,504	1,730	10,234
Additions	-	81	81
Disposals	(8)	(78)	(86)
At 31 December 2017	8,496	1,733	10,229
Accumulated depreciation			
At 1 January 2017	3,311	1,062	4,373
Charge for the year	54	181	235
Reversal of previous impairment	(383)	(30)	(413)
Eliminated on disposal	-	(78)	(78)
At 31 December 2017	2,982	1,135	4,117
Carrying amount			
At 31 December 2017	5,514	598	6,112
At 31 December 2016	5,193	668	5,861

The Group's land and building, being its head office, is owned by MBS (Property) Limited.

15. Property, plant and equipment (continued)

Society	Alterations fixtures and equipment £000	Total £000
Cost		
At 1 January 2017	1,121	1,121
Additions	81	81
Disposals	(78)	(78)
At 31 December 2017	1,124	1,123
Accumulated depreciation		
At 1 January 2017	633	633
Charge for the year	166	166
Eliminated on disposal	(78)	(78)
At 31 December 2017	720	720
Carrying amount		
At 31 December 2017	404	404
At 31 December 2016	488	488

16. Investment property - Group and Society

The movement on Investment property is as follows:

	Residential property 2017 £000	Residential property 2016 £000
Fair value		
At 1 January	839	781
Transfer from loans and advances to customers	37	-
Disposal	(170)	-
(Decrease) / increase in fair value	(15)	58
At 31 December	691	839

In 2015 the Society acquired a small number of residential properties as a result of the settlement of an impaired mortgage asset. One additional property was transferred from loans and advances to customers in the year. The properties are being held, pending their eventual sale, as investment properties and are stated at their fair value.

17. Deferred tax assets

Deferred taxes are calculated on all temporary differences under the liability method using effective tax rates of 17.0% to 18.0% depending on when the timing differences are expected to reverse. The movement on the deferred tax account is as follows:

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
At 1 January	-	382	-	382
Statement of comprehensive income	-	(382)	-	(382)
Statement of changes in equity	-	-	-	-
At 31 December	-	-	-	-
Deferred tax assets are attributable to the following items:				
Other provisions	-	-	-	-
Accelerated tax depreciation	(39)	(26)	(38)	(28)
Tax losses	1	-	-	-
Deferred tax asset on timing differences on derivative contracts	38	26	38	28
	-	-	-	-

The movement in the deferred tax account is shown below:

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Other provisions	-	(2)	-	(2)
Tax losses	-	(3)	-	-
Accelerated tax depreciation	(13)	43	(13)	37
Deferred tax movement on timing differences on derivative contracts	13	(420)	13	(417)
Deferred tax expense in statement of comprehensive income	-	(382)	-	(382)
Deferred tax credit in statement of changes in equity	-	-	-	-
	-	(382)	-	(382)

Deferred tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefits through future taxable profits is probable.

The main rate of corporation tax in the UK reduced from 20% to 19% on 1 April 2017, and is due to reduce by a further 2% to 17% on 1 April 2020.

The carrying value of the deferred tax asset (DTA) is £nil as no further assets have been recognised.

The Group's long-term financial projections, based on a managed run-off of the balance sheet without a return to lending, indicate that the underlying operations of the Group will remain profitable in the short to medium-term. In the medium to long-term it is likely that the net interest margin will be insufficient to cover operating costs and loan impairment charges, resulting in operating losses.

If the future profits of the Group were 10% higher than those envisaged in the Group's long-term financial projections referred to above, then the amount of DTA recognised in the balance sheet would not be significant, as the Group only remains profitable in the short to medium-term.

It should be noted that the DTA de-recognised in prior years is still available for tax relief purposes, as tax losses can be carried forward indefinitely under UK tax rules and can be used subject to the availability of future taxable profits.

In addition to the recognised deferred taxation assets and liabilities, certain deferred tax assets have not been recognised.

At 31 December 2017 for the Group, these were:

- £1,792k arising from timing differences on derivative contracts (2016: £2,032k) and
- £4,999k arising from losses (2016: £4,727k)

At 31 December 2017 for the Society, these were:

- £1,792k arising from timing differences on derivative contracts (2016: £2,032k) and
- £3,088k arising from losses (2016: £2,760k).

18. Other assets

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Amounts due within one year				
Credit support annex	1,350	3,105	1,350	3,105
Prepayments	576	577	438	512
Other assets	380	72	331	23
	2,306	3,754	2,119	3,640

The credit support annex balances represent the sums deposited by the Society with its derivative counterparties to collateralise the derivatives issued. The balances, whilst in cash form, are not included within Liquid Assets.

19. Due to members

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Held by individuals	247,628	315,391	247,628	315,391
Shares are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	256	512	256	512
Repayable on demand	105,216	128,350	105,216	128,350
Other shares by residual maturity repayable:				
In not more than three months	127,704	175,676	127,704	175,676
In more than three months but not more than one year	4,768	3,982	4,768	3,982
In more than one year but not more than five years	9,684	6,871	9,684	6,871
	247,628	315,391	247,628	315,391

20. Other deposits

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Amounts owed to other deposit customers are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	65	122	65	122
Repayable on demand	10,218	12,610	10,218	12,610
Other amounts owed to other deposit customers by residual maturity repayable:				
In not more than three months	7,575	12,021	7,575	12,021
In more than three months but not more than one year	-	-	-	-
	17,858	24,753	17,858	24,753

21. Subordinated liabilities

	Group and Society 2017 £000	Group and Society 2016 £000
Subordinated loans		
Loan repayable 2022 (variable interest rate of 3 months LIBOR plus 1.75%)	5,000	5,000
Loan repayable 2023 (variable interest rate of 3 months LIBOR plus 2.45%)	4,200	4,200
Loan repayable 2032 (fixed interest rate of 6.70%)	5,000	5,000
	14,200	14,200

The subordinated loans were taken to assist the financing of future development. The loans exist for a fixed period and the Society has the option to prepay the loans at par 5 years prior to the final repayment dates.

22. Other liabilities

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Amounts falling due within one year:				
Taxation and social security	105	92	105	92
Creditors	1,090	756	832	457
Interest accrued on subordinated liabilites	123	121	123	121
Accruals	527	486	450	430
	1,845	1,455	1,510	1,100

23. Subscribed capital

The Society has two tranches of PIBS in issue. The first tranche was issued in 1999 and is remunerated at 8.00% and the other was issued in 2005 and is remunerated at 6.75%.

The two tranches are accounted for differently as they are subject to differing legal arrangements. Both tranches of PIBS are unsecured and rank pari passu with each other. In priority terms, the PIBS holders rank behind the Society's depositing members, its wholesale counterparties and all subordinated note holders.

Classified as a liability:	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
8.00% Permanent Interest Bearing Shares	5,000	5,000	5,000	5,000
	5,000	5,000	5,000	5,000

Under the terms of offer, the Board may, subject to a resolution, cancel in whole or in part any scheduled interest payment due to holders of the 8.00% PIBS in restricted circumstances, when the Society were to have in issue other shares or deposits (save for deferred shares) on which the Board could cancel interest at its discretion. As no such class of share or deposit was in issue at either of the financial statement dates, it has been assessed that the terms of the PIBS confer a contractual obligation on the Society to deliver cash in the form of interest payments and as such, the 8.00% PIBS are treated as a liability on the part of the Society and interest is booked to the Statement of Comprehensive Income and set out in Note 3.

The carrying value of the PIBS classified as a liability in the 2017 financial statements has not changed since initial recognition. In the future, should there be greater certainty with regard to the expected future non-payment of PIBS coupons the fair value of the 1999 PIBS liability in the financial statements will be adjusted to reflect the lower expected cash outflows (discounted back at the original effective interest rate on the instrument).

Classified as equity:	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
6.75% Permanent Interest Bearing Shares	9,788	9,788	9,788	9,788
	9,788	9,788	9,788	9,788

Under the terms of offer, the Board may at its sole discretion, subject to a resolution, cancel in whole or in part any scheduled interest payment due to holders of the 6.75% PIBS. Whilst the Board does not intend to avail itself of this discretion, the facility to do so results in the assertion that the PIBS should be considered not to confer a contractual obligation on the Society to deliver cash in the form of interest payments. As such, the 6.75% PIBS are treated as forming a part of the Society's equity and interest is booked to Statement of Changes in Equity.

As explained on page 5, as a result of shortfall against qualitative standards for the level of CET 1 capital requirement together with the loss for the year, under CRD IV article 141, in order to conserve capital, the Society may remain prohibited from making the PIBS coupon payments due in April 2018. The Board considers that there continues to be uncertainty over the Society's ability to make coupon payments thereafter.

24. Cash and cash equivalents

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
For the purposes of the cash flow statement, cash and cash equivalents comprises the following balances with less than three months maturity from the date of acquisition:				
Cash and balances with central banks	32,911	67,387	32,911	67,387
Loans and advances to credit institutions	11,021	14,417	10,970	14,288
	43,932	81,804	43,881	81,675

25. Profit Participating Deferred Shares

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Nominal value - proceeds received	18,000	18,000	18,000	18,000
Less: issue costs	(539)	(539)	(539)	(539)
Book value	17,461	17,461	17,461	17,461
PPDS Reserve Account at 1 January (memo)	(3,236)	(2,130)		
Share of loss for the year	(234)	(1,106)		
PPDS Reserve Account at 31 December (memo)	(3,470)	(3,236)		

The Society issued £18m of PPDS in April 2013. The PPDS are deferred shares for the purposes of Section 119 of the Building Societies Act 1986 (as amended). They are perpetual instruments with no maturity date or right to repayment other than on a winding-up; in the event of a winding-up, the PPDS would rank below claims in respect of the Society's PIBS. The PPDS are not protected deposits for the purposes of the Financial Services Compensation Scheme. They are eligible as Common Equity Tier 1 Capital for regulatory purposes. Save as described below, the holders of the PPDS are eligible to receive a dividend, at the discretion of the Board of the Society, of up to 30% (the "Participation Percentage") of the annual consolidated post-tax profits of the Society and its subsidiaries (calculated prior to payment of the PPDS dividend and subject to certain other adjustments).

The PPDS will also absorb the Participation Percentage of any consolidated post-tax losses recorded by the Society and its subsidiaries, any such amount being debited to a reserve account maintained by the Society for the purpose of the PPDS (the "PPDS Reserve Account"). Any net profits which are eligible to be paid to holders of PPDS as dividends but which are not so paid will be credited to the PPDS Reserve Account.

No dividends may be paid on the PPDS when the PPDS Reserve Account is in deficit as a result of previous years' losses.

No dividend has been declared in the year.

26. Related party transactions

Key Management Personnel. The directors, the two Interim Finance Directors in the year and the two Interim Chief Risk and Compliance Officers are considered to be the Key Management Personnel as defined by *IAS 24 – Related Party Disclosures*. In line with the Board's continuing policy, there were no loans provided to any of these individuals or their close family members (2016: nil). None of the directors, or their close family members held any of the Society's PIBS (2016: nil).

In 2017 and 2016 the Group made a number of appointments to Key Management Personnel roles on an interim basis. The Remuneration and Nominations Committee reviewed these appointments and assessed the level of fees or remuneration payable, for further details of the work of this Committee see page 11. Where the services of these Key Management Personnel are provided by entities controlled by them, then the amounts paid to the entities by the Group for their services (inclusive of VAT) and any balances outstanding at year end are disclosed below.

The total remuneration of Key Management Personnel was as follows:

	Group 2017 £000	Group 2016 £000
Executive directors (Note 7)	184	163
Non-executive directors (Note 7)	221	195
Key Management Personnel	135	645
	540	1,003

Transactions with other related parties.

The Society had the following transactions with other related parties:

	Group 2017 £000	Group 2016 £000
Purchases of interim executive services from entities controlled by Key Management Personnel	231	178

The following balances are outstanding at 31 December in relation to transactions with other related parties

	Group 2017 £000	Group 2016 £000
Current payables for purchases from entities controlled by Key Management Personnel	6	19

Register. In accordance with sections 68 and 69 of the Building Societies Act 1986 a register of transactions is maintained at the Society's head office which shows details of all transactions and arrangements with directors and connected persons.

Subsidiaries. The Group is controlled by Manchester Building Society; details of the subsidiary undertakings may be found in Note 14.

26. Related party transactions (continued)

The Society had the following transactions with its subsidiary undertakings during the year:

(i) Current loan accounts - unsecured	Society 2017 £000	Society 2016 £000
As at 1 January	10,821	13,158
Loans issued during the year	2,091	2,365
Loan repayments during the year	(1,878)	(1,184)
Impairment of subsidiary loans	(1,534)	(3,518)
At 31 December	9,500	10,821
(ii) Interest income charged to subsidiaries	359	521

Interest is charged at pre-agreed rates which are either fixed, track the Bank of England base rate, or track LIBOR rates.

(iii) Other income charged to subsidiary for management of NMB MAC loan book	120	120
(iv) Society recharge to subsidiaries of head office expenses	121	142
(v) Subsidiary recharge to Society on rent for head office	143	143
(vi) Cash received from borrowers by connected undertakings		
NMB MAC - cash received and paid through to MBS (Mortgages) Limited	1,181	556
CLC - cash received and paid through to Society	300	8

27. Financial commitments

(i) Capital commitments:

None

(ii) Lease commitments

At the financial position date the Group had no outstanding commitments as lessee under operating leases.

Lease commitments:	Lessee 2017 £000	Lessee 2016 £000
Less than one year	-	41
	-	41

The Society leases its head office from the subsidiary, MBS (Property) Limited under a non-cancellable operating lease.

Contingent liabilities are considered in Note 30.

28. Capital management

Regulatory capital requirements are laid down by the Society's regulator; they are calculated, forecast and stress tested on a regular basis for the Board and period end positions are reported to the regulator. For regulatory capital purposes the Group is made up of the Society, MBS (Mortgages) Limited and, following approval from the PRA in 2016 for an amendment to the regulatory capital Group, MBS (Property) Limited, with the regulatory capital positions under CRD IV at 31 December 2017 and 31 December 2016 being:

	Group 31 Dec 16	Movement in 2017	Group 31 Dec 17	Regulatory Movement for 2018	Group 1 Jan 18
Tier 1 Capital	£000	£000	£000	£000	£000
Accumulated losses	(9,243)	(780)	(10,023)	-	(10,023)
Deductions	-	-	-	-	-
Profit Participating Deferred Shares	17,461	-	17,461	-	17,461
Total CET1 Capital	8,218	(780)	7,438	-	7,438
Permanent Interest Bearing Shares					
Nominal balance	14,788	-	14,788	-	14,788
Amortisation	(5,915)	(1,479)	(7,394)	(1,479)	(8,873)
Net Permanent Interest Bearing Shares	8,873	(1,479)	7,394	(1,479)	5,915
Total Tier 1 Capital	**17,091**	**(2,259)**	**14,832**	**(1,479)**	**13,353**
Tier 2 Capital					
Subordinated Debt					
Nominal balance	14,200	-	14,200	-	14,200
Amortisation	(2,000)	(1,399)	(3,399)	(500)	(3,899)
Net Subordinated Debt	12,200	(1,399)	10,801	(500)	10,301
Collective Provisions	1,923	(1,492)	431	-	431
Permanent Interest Bearing Shares	5,915	1,479	7,394	1,479	8,873
Total Tier 2 Capital	**20,038**	**(1,412)**	**18,626**	**979**	**19,605**
Total Regulatory Capital	**37,129**	**(3,671)**	**33,458**	**(500)**	**32,958**

Since the start of 2017 Total Regulatory Capital under CRD IV has decreased by £3,671k made up as follows:

- the retained loss of the regulatory capital group for the year of £780k;
- the continued grandfathering of Subordinated debt out of Tier 2 capital over a 9 year period, amounting to £500k in the year;
- Amortisation of Subordinated debt over a 5 year period, amounting to £899k in the year;
- a reduction in the allowed collectively identified provisions of £1,492k.

Under the CRD IV rules applicable from 1 January 2018, Total Regulatory Capital is reduced by £500k compared to the position at 31 December 2017. This is due to Tier 2 Regulatory Capital being reduced by a further £500k in respect of continuing Subordinated debt grandfathering.

As at 31 December 2017 the Group continues to have headroom above its ICG in total capital terms as set by the PRA, due to the Society's PIBS (that is Additional Tier 1 capital being amortised into Tier 2 capital) and subordinated debt (that is Tier 2 capital), but did not meet the qualitative standards for the level of CET 1 regulatory capital. The Group has continued to explore ways in which the CET 1 regulatory capital position could be improved and an updated Capital Conservation Plan was submitted to the PRA in April and September 2017. These options include improving the CET 1 regulatory capital position through a capital restructuring exercise. In addition, owing to the financial position and challenges faced by the business there is a risk that the Society will not meet the regulatory requirement to hold 4.5% of CET 1 capital against risk weighted assets in the future, though based on present projectionss this is not the case.

As a result of the shortfall against qualitative standards for the level of CET 1 capital requirement together with the loss for the year, under CRD IV article 141, in order to conserve capital, the Society may remain prohibited from making the PIBS coupon payments due in April 2018. The Board considers that there continues to be uncertainty over the Society's ability to make coupon payments thereafter.

Owing to the financial position and challenges faced by the business there is a risk that the Group may not meet the regulatory requirement to hold 4.5% of CET 1 capital against risk weighted assets in future, though based on present projectionss this is not the case. This potential risk is monitored and under constant review in ongoing discussions with the PRA.

29. Provisions for liabilities and charges

2017	Group FSCS Levy £000	Group Customer redress £000	Group Other £000	Group Total £000	Society FSCS Levy £000	Society Customer redress £000	Society Other £000	Society Total £000
At 1 January 2017	68	1,690	100	1,858	68	307	100	475
Transferred to impairment provision (Note 12)	-	(91)	-	(91)	-	(91)	-	(91)
Charge for the year	29	(500)	-	(471)	29	(93)	-	(64)
Provision utilised	(66)	(988)	-	(1,055)	(66)	(107)	-	(173)
At 31 December 2017	31	111	100	242	31	17	100	147

2016	Group FSCS Levy £000	Group Customer redress £000	Group Other £000	Group Total £000	Society FSCS Levy £000	Society Customer redress £000	Society Other £000	Society Total £000
At 1 January 2016	137	1,695	-	1,832	137	77	-	214
Transferred from creditors	-	(338)	-	(338)	-	-	-	-
Charge for the year	67	878	100	1,045	67	236	100	403
Provision utilised	(136)	(545)	-	(681)	(136)	(6)	-	(142)
				-				
At 31 December 2016	68	1,690	100	1,858	68	307	100	475

(i) Financial Services Compensation Scheme (“FSCS”) Levy

The Society’s provision for FSCS charges arises from its operation as a UK deposit taker.

The FSCS levy consists of two parts - a management expenses levy, which covers the interest cost of running the scheme, and a capital levy to cover the cost of the compensation paid, net of any recoveries.

The charge for 2017 and the provision at the end of the year include the expected management expenses levy for the FSCS scheme year 2017-18.

In 2013 the FSCS announced that there was likely to be a shortfall in their overall level of recoverability and indicated that it would levy this shortfall on deposit-taking institutions over the three years 2014-15 to 2016-17. The shortfall capital levy for the FSCS scheme year 2016-17 was received during 2017 and recognised as a charge in the Statements of Comprehensive Income for 2017. No provision is made in respect of the capital levy for scheme years beyond this period. The levy is paid during the third quarter of each year and the Society does not expect to recover any sums paid.

(ii) Customer redress provision

As is the case for all financial institutions there is a risk that aspects of current or historic business might be considered as not being conducted in accordance with all relevant regulation, or the fair and reasonable treatment of customers.

Certain activities of the Group, particularly the NMB MAC and CLC second charge loan portfolios carry greater levels of conduct risk. The administration of these portfolios was brought in-house in December 2015 and following that transfer the historic conduct of these portfolios was reviewed in detail by management.

Following a redress programme which was completed in the year, the provision of £1.7m held at 31 December 2016 has been largely utilised. Attempts to contact a number of customers have, so far, been unsuccessful and a provision of £0.1m is retained at 31 December 2017 in relation to these customers.

Although a detailed review of these portfolios has been carried out, there is no judicial certainty in the legal position and there is a risk that further conduct issues or cases of non-compliance with regulations could be identified in the future.

Provision has been made where the Group is aware of a specific conduct or regulatory issue and can estimate its impact reliably, further details in respect of the Group’s consideration of other potential conduct and regulatory issues is provided in the contingent liabilities Note 30.

(iii) Other

In October 2016 as a result of the BoS vs Rea decision the FCA identified that some mortgage firms have automatically included customers’ arrears balances within their monthly mortgage payments which are recalculated from time to time without considering the circumstances of the customer.

Such capitalisation is permitted when the individual circumstances of the customer are considered and with the customer’s agreement.

The FCA’s work indicates that the financial impact on the majority of customers is relatively small with estimated remediation likely to be in the low hundreds of pounds.

No redress has been paid in the year and the provision of £0.1m against possible remediation of affected customers is retained.

30. Contingent liabilities and assets

(i) Contingent liabilities:

Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies and other sources there is a risk that certain aspects of the Group's current or historic business, including, amongst other things, MCOB regulated loans, may be determined by the FCA and other regulatory bodies or the courts as, in their opinion, not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment.

As detailed in Note 29 provision has been made, following a detailed analysis, for the costs of customer redress in respect of identified cases in periods of non-compliance with CCA regulations.

There is a risk that other aspects of the Group's business might be considered as not having been conducted in accordance with all relevant regulation, or the fair and reasonable treatment of customers. It is also not possible to rule out the possibility of other instances of non-compliance with CCA or other regulations which have not been identified. No provisions against these risks are included in these financial statements.

(ii) Contingent assets:

The Society continues, based on legal advice, with the claim against Grant Thornton UK LLP for breach of contract, negligence and breach of statutory duty relating to audit services and advice provided between 2006 and 2011.

ANNUAL BUSINESS STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2017

1. Statutory limits

	2017 %	Statutory % limit
Lending limit	10.7	25.0
Funding limit	6.7	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986, as amended by the Building Societies Act 1997.

The Lending limit measures the proportion of business assets not in the form of loans fully secured on residential property and is calculated as (X - Y) ÷ X where:

X = business assets, being the total assets of the Group plus provisions for bad and doubtful debts less liquid assets, tangible fixed assets and intangible assets as shown in the Group financial statements.

Y = the principal of, and interest accrued on, loans owed to the Group which are fully secured on residential property and mortgage loss provisions.

The Funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X - Y) ÷ X where:

X = shares and borrowings, being the aggregate of:

(i) the principal value of, and interest accrued on, shares in the Society;
(ii) the principal value of, and interest accrued on, sums deposited with the Society or any subsidiary undertaking of the Society;
(iii) the principal value of, and interest accrued under, bills of exchange, instruments or agreements creating or acknowledging indebtedness and accepted, made, issued or entered into by the Society or any such undertaking less any amounts qualifying as own funds.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals otherwise than as bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

The statutory limits are laid down under the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a Building Society is that of making loans which are secured on residential property and are funded substantially by its members.

Other ratios

As a percentage of shares and borrowings:

	2017 %	2016 %
Gross capital	13.7	10.9
Free capital	18.1	13.6
Liquid assets	16.6	24.1
Leverage ratio	4.5	4.2

As a percentage of mean total assets:

	2017	2016
Loss after taxation	(0.23)	(0.84)
Group management expenses	2.32	2.17
Society management expenses	2.22	1.89

The above percentages have been prepared from the Group financial statements and in particular:

'Shares and borrowings' represent the total of amounts due to customers, amounts owed to banks, amounts owed to other depositors and debt securities in issue in the Group statement of financial position.

'Gross capital' represents the aggregate of reserves, other borrowed funds, profit participating deferred shares and subscribed capital as shown in the Group statement of financial position.

'Free capital' represents the aggregate of gross capital and collective loss provisions for bad and doubtful debts less property, plant and equipment in the Group statement of financial position.

'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year for the Group/Society.

'Liquid assets' represent the total of cash and balances with central banks, loans and advances to banks and debt trading securities in the Group statement of financial position.

'Leverage ratio' is the ratio of Tier 1 capital divided by total exposure, which includes the sum of on balance sheet exposures, derivative exposures and off balance sheet items.

'Management expenses' represent the aggregate of administrative expenses and depreciation taken from the Group/Society Statements of Comprehensive Income.

2. Information relating to the directors and officers as at 31 December 2017

Name	Date of Birth	Date of appointment	Occupation	Other directorships
Directors				
J.P. Allen (retired 31 December 2017)	3.6.1953	Nov 2009	Consultant	Emerson Developments (Holdings) Limited J & JA Associates Limited Jones Homes Limited Pallet-Track Limited
H.F. Baines	12.3.1957	Aug 2013	Consultant	Atlantic Pensions Sponsor Limited BHS2 Pension Scheme Trustee Limited Halifax Pension Nominees Limited Harry Baines Consulting Limited HBOS Final Salary Trust Limited Lloyds Banking Group Pension Trustees Limited PACE Trustees Limited
I.A. Dewar	14.9.1957	Aug 2013	Chartered Accountant	Aldenham Foundation Brewin Dolphin Limited Brewin Dolphin Holdings plc Arbuthnot Banking Group plc
D.A. Harding	29.7.1947	Apr 2013	Retired Company Director	
P.A. Lynch	31.8.1969	Apr 2002	Building Society Executive	MBS (Mortgages) Limited MBS (Property) Limited
F.B. Smith	3.1.1959	Jan 2015	General Counsel	
Officers				
C.W. Gee			Head of Corporate Development & Society Secretary	
J Lincoln			Interim Finance Director	JDWL Consulting Limited
I.A. Johnson			IT Manager	
V. Smith			Compliance Manager	
R. Mervill			Customer Care Manager	
A.C. Pradena			Savings Customer Services Manager	
D. Spencer			Lending Manager	
G.C. Worthington			HR Manager	

Executive Director		Position	Date of signing service contract
P.A. Lynch	31.8.1969	Interim Chief Executive	3.4.2002

The executive director has an employment contract which is terminable by the Society by giving 12 months' notice. The executive director is required to give 6 months' notice to the Society to terminate his contract.

2. Information relating to the directors and officers as at 31 December 2017 (continued)

Non-Executive Directors

Non-executive directors are not appointed under service contracts. Their appointment is terminable by 1 month's notice on either side. In the event of the Society merging with another society whilst D.A. Harding is the Chairman of the Board, he is entitled to 6 months fees under his letter of appointment.

It is indicated to each non-executive director that they would not be expected to serve more than nine years on the board, although for the avoidance of doubt this is not a contractual commitment to the directors. Accordingly, by reference to a full nine year term, the unexpired part of each non-executive director's term at 31 December 2017 would be:

J.P. Allen	retired 31 December 2017
H.F. Baines	4 years and 8 months
I.A. Dewar	4 years and 8 months
D.A. Harding	4 years and 4 months
F.B. Smith	5 years

Any documents may be served on the above named directors at the following address: Lyons Wilson, 1 Central Street, Manchester M2 5WR.

COUNTRY BY COUNTRY REPORTING

FOR THE YEAR ENDED 31 DECEMBER 2017

Capital Requirements (Country-by-Country) Reporting

The reporting obligations set out in Article 89 of the European Union's Capital Requirements Directive IV (CRD IV) have been implemented in the UK by the Capital Requirements (Country-by Country) Reporting Regulations.

Manchester Building Society is owned by its members. The means by which its value is preserved is by providing products that meet the financial needs of both existing and potential members.

The principal objectives of the Group remain the provision of competitive facilities for personal savings and for mortgage finance primarily to support owner occupation of residential property.

The Manchester Building Society Group is made up of:

Entity	Nature of Activity	Location
Manchester Building Society	Provision of mortgage and savings products	United Kingdom
and its wholly owned subsidiaries:		
MBS (Mortgages) Limited	Mortgage lending	United Kingdom
MBS (Property) Limited	Commercial property rental	United Kingdom

All of the activities of the Society and its subsidiaries are conducted in the United Kingdom and therefore 100% of the total operating income, profit before tax and the employee numbers disclosed below are related to the United Kingdom.

For the year ended 31 December 2017:

Group turnover (total operating income) was £9.6m (2016: £9.2m), the loss before tax was £0.8m (2016: loss of £3.0m). Total operating income is defined as net interest income plus fees and commissions receivable (net of fees and commissions payable) together with other operating income and charges.

The average number of Group full time employees was 40 (2016: 44).

The Society and the Group paid no corporation tax for the year (2016: £nil) due to the reversal of temporary differences and availability of brought forward trading losses.

No public subsidies were received by the Society and the Group in the year.

In 2017 the Society generated interest receivable and similar income of £3.4m (2016: £3.2m) in respect of Euro-denominated loans and advances made on properties in Spain, however, all activities of the Society were conducted in the United Kingdom.

Independent auditors' report to the Directors of Manchester Building Society

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

Directors' Responsibility for the schedule

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

Auditors' Responsibility

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

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

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

COUNTRY BY COUNTRY REPORTING

FOR THE YEAR ENDED 31 DECEMBER 2017

Opinion

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

Basis of Preparation and Restriction on Distribution

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

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

PricewaterhouseCoopers LLP

Chartered Accountants

Manchester

12 March 2018

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