ANNUAL REPORT & ACCOUNTS

2019

Manchester
BUILDING SOCIETY

125 Portland Street
Manchester M1 4QD
Tel 0161 923 8000
Web www.themanchester.co.uk

CONTENTS

THIS PAGE HAS BEEN INTENTIONALLY LEFT BLANK

CHAIRMAN'S STATEMENT

In the year ended 31 December 2019 the Society and its subsidiary (the 'Group') recorded a post-tax profit of £0.6m (2018: loss £0.9m).

Net interest income fell from £8.0m to £7.0m, in line with the decline in the size of the balance sheet as the Group continued to shrink the scale of its operations. Mortgage balances fell by 11% whilst savings balances fell by 12%. After other income and charges, total operating income was £6.9m, compared with £8.9m in the preceding twelve months. Administrative expenses fell by £5.3m owing to tight cost control and lower legal fees relating to the claim for damages made against the Society's previous auditors, Grant Thornton UK LLP ('GT') (details of which were fully explained in the Group's 2012 Annual Report and Accounts). As a result, the Group recorded an operating profit of £2.0m (2018: £1.3m loss) before impairment provisions.

The Group incurred a credit impairment charge of £2.1m in the year (2018: £0.8m) comprising a charge of £1.8m (2018: £0.8m) relating to the Society's Spanish lifetime portfolio and £0.3m (2018: £nil) for provisions on the remainder of the portfolio.

A reversal of a prior provision of £0.6m (2018: £1.1m reversal) followed a revaluation upon the disposal of the Group's head office premises at 125 Portland Street. The Group subsequently leased back one floor of the building which remains the registered office of the Society.

At 31 December 2019, the Group had negative accounting reserves of £10.7m (2018: negative £11.3m).

As in 2018, while the Group met all of its quantitative regulatory capital requirements, it did not meet the qualitative standards for CET 1 regulatory capital. The Society was therefore again prohibited by Capital Requirements Directive IV from paying the coupons on its Permanent Interest Bearing Shares ('PIBS'). The Board considers that uncertainty over the Society's ability to make coupon payments is likely to remain owing to the material uncertainty about the Society's longer-term prospects as set out in Note 1 to the financial statements.

In January 2019, the Court of Appeal upheld the decision of the High Court to award only nominal damages in respect of the Society's claim against GT. However, the Society sought leave to appeal this decision to the Supreme Court and leave to appeal was granted in July. The case is listed to be heard in October 2020. The Board plan to undertake a further strategic review of the Society's operations once the result of this appeal is known. In the meantime, the Society continues to operate in line with the strategic plan reviewed and acknowledged by the Prudential Regulation Authority ("PRA") in 2018, as updated in 2019.

The Board is acutely aware of the effect of the current low interest rate environment on savers. Market interest rates have continued to fall and, with some reluctance, the Society has found it necessary to follow this trend. Overall, however, the Society continues to offer savings products that are competitive with rates offered by other societies. Virtually all of the Society's savings deposits are covered by the Financial Services Compensation Scheme.

On behalf of the Board, I should like to thank members for their continued support and to thank our staff for their effort and continued commitment to the Society.

D.A. Harding
Chairman
4 March 2020

STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2019

Introduction

The directors present their 97th Annual Report together with the financial statements and Annual Business Statement for the Group for the year ended 31 December 2019.

The Group consists of the Society and its one wholly owned subsidiary: MBS (Mortgages) Limited. A second subsidiary MBS (Property) Limited was disposed of in August 2019. Results for MBS (Property) Limited are consolidated within these financial statements until the date of disposal.

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.

Regulatory capital conservation has continued to be a priority. The Group continues to have headroom above its Pillar 1 plus Pillar 2A requirement in total capital terms, but did not meet the qualitative standards for the level of CET 1 regulatory capital. Consequently, the Society has not paid the coupons on PIBS since April 2016 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. The medium to long term strategic plan which was independently reviewed and acknowledged by the Prudential Regulation Authority ("PRA") in 2018 was updated in the year. The PRA have agreed to monitor the Society against the updated plan. As at 31 December 2019, the requirement to hold CET 1 capital in excess of 4.5% of Risk Weighted Assets was met but it is recognised that a stress event or other significant loss could result in a future breach. Potential stress events are detailed on page 25.

Following the Court of Appeal's decision to uphold the High Court's judgment in the Group's claim for damages against GT, the Board continued to take legal advice and the Supreme Court has agreed to hear the case in 2020.

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.

Review of business performance

In 2019 the Group reported a profit for the financial year of £0.6m (2018: loss of £0.9m).

In the year the Group reported operating profit before impairments and provisions of £2.0m (2018: £1.3m loss).

The £3.3m increase in operating profit before impairments and provisions from 2018 is a result of:

- Administrative expenses reducing by £5.3m. This included a £4.6m reduction in costs in relation to the Grant Thornton case. Other savings within the cost base included a £0.3m reduction in staff costs and £0.1m on audit fees.
- Net interest income in the year being £0.9m lower than in 2018 due to an 11% reduction in Loan balances as the Society continues a managed reduction of the balance sheet.
- Other income fell by £1.1m due to a £0.4m reduction in income from foreign exchange movements and a £0.3m reduction in rental income following the sale of the Group's head office building. The 2018 figure included £0.3m damages received from the legal claim against Grant Thornton UK LLP.

The Group incurred a credit impairment charge of £2.1m in the year (2018: £0.8m) comprising a charge of £1.8m (2018: £0.8m) relating to the Society's Spanish lifetime portfolio and £0.3m (2018: £nil) for provisions on the remainder of the portfolio.

A reversal of a prior provision of £0.6m (2018: £1.1m reversal) followed a revaluation upon the disposal of the Group's head office premises at 125 Portland Street.

The Group did not meet the qualitative standards for the level of CET 1 regulatory capital as at 31 December 2019 and, in order to conserve capital, a distribution to PIBS holders in April 2020 may remain prohibited under CRD IV article 141.

PROFITABILITY

Result for the year: The Group reported a profit for the financial year of £0.6m (2018: loss of £0.9m). The movements 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 2019, £34.8m was deposited with the Bank of England (2018: £33.1m) and £11.9m was deposited with UK clearing banks (2018: £14.9m). No investment securities were held at 31 December 2019 (2018: £nil).

Mortgages and Other Loans: Group mortgage balances, after provisions, were £196.4m (2018: £219.7m), representing a year on year decrease of 10.6% (2018: 12.4% decrease). To improve its regulatory capital position, the Society made no advances during the year (2018: £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 2019, excluding the second charge portfolio, there were 17 mortgage accounts (2018: 15) where payments were 12 or more months in arrears. Outstanding balances on these accounts amounted to £7.4m (2018: £7.0m) representing 3.5% of total gross mortgage balances (2018: 2.8%), with total arrears of £1.3m (2018: £1.2m). 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 (2018: 8). These figures include the NMB MAC portfolio, and The Consumer Loans Company Limited ('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, probabilities of default, 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 £0.2m (2018: £0.4m). Three properties were disposed of in the year (2018: two).

Other assets: Included within Other assets is a sum of £0.9m (2018: £1.1m) 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 £197.8m (2018: £225.9m) 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 aims to manage capital within the regulatory limits set by the PRA. For regulatory capital purposes the Group is made up of the Society and MBS (Mortgages) Limited, with the regulatory capital positions at 31 December 2019 and 31 December 2018 being:

	Group 31 Dec 18	Movement in 2019	Group 31 Dec 19	Regulatory Movement effective from 1 Jan 2020	Group 1 Jan 20
Tier 1 Capital	£000	£000	£000	£000	£000
Accumulated (losses)/ profits	(10,974)	563	(10,411)	(45)	(10,456)
Profit Participating Deferred Shares	17,461	-	17,461	-	17,461
Total CET1 Capital	6,487	563	7,050	(45)	7,005
Permanent Interest Bearing Shares					
Nominal balance	14,788	-	14,788	-	14,788
Amortisation	(8,873)	(1,479)	(10,352)	(1,479)	(11,831)
Net Permanent Interest Bearing Shares	5,915	(1,479)	4,436	(1,479)	2,957
Total Tier 1 Capital	**12,402**	**(916)**	**11,486**	**(1,524)**	**9,962**
Tier 2 Capital					
Subordinated Debt					
Nominal balance	14,200	-	14,200	-	14,200
Amortisation	(5,584)	(2,405)	(7,989)	(500)	(8,489)
Net Subordinated Debt	8,616	(2,405)	6,211	(500)	5,711
Permanent Interest Bearing Shares	8,873	1,479	10,352	1,479	11,831
Total Tier 2 Capital	**17,489**	(926)	**16,563**	**979**	**17,542**
Total Regulatory Capital	**29,891**	**(1,842)**	**28,049**	**(545)**	**27,504**

Since the end of 2018 Total Regulatory Capital under CRD IV has decreased by £1.8m made up as follows:

- An increase to the retained profit of the regulatory capital group for the year of £0.6m which included a reduction to reserves in relation to the transitional arrangements of IFRS 9 – Financial Instruments which was adopted in 2018 as detailed below;
- a reduction of subordinated debt of £2.4m, consisting of:
  - the continued grandfathering of subordinated debt out of Tier 2 capital over a 9 year period, amounting to £0.5m in the year;
  - amortisation of subordinated debt over a 5 year period, amounting to £1.9m in the year.

Under the CRD IV rules applicable from 1 January 2020, Total Regulatory Capital is reduced by £0.5m compared to the position at 31 December 2019. This is due to Tier 2 Regulatory Capital being reduced by a further £0.5m in respect of continuing Subordinated debt grandfathering. In addition, the available IFRS 9 transitional arrangements, adopted by the Group in 2018, reduced Total Regulatory Capital by an additional £29k from 1 January 2019, and will reduce it by a further £45k from 1 January 2020. These IFRS 9 arrangements continue to be phased over a 5 year period with 15% of the 2018 adverse financial impact taken to CET 1 capital by 2019, increasing to 30% in 2020. The element taken to CET 1 capital will increase annually with 100% recognised by 2023.

As at 31 December 2019 the Group continues to have headroom above its total Pillar 1 plus Pillar 2A requirements 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. Following the Society's CET 1 capital temporarily falling below the required 4.5% of Risk Weighted Assets in 2018, a medium to long term strategic plan was produced which was independently reviewed and acknowledged by the PRA. This plan was updated in 2019 and the PRA agreed to monitor the Society against this revised plan. The PRA continue an open dialogue with the Society on future developments. 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. As at 31 December 2019, the requirement was met but a stress event or other significant loss (as detailed on page 25) could result in a future breach. This potential risk is monitored and under regular review in ongoing discussions with the PRA.

As a result of the shortfall against qualitative standards for the level of CET 1 capital requirement, under CRD IV article 141, in order to conserve capital, the Society has not paid coupons on PIBS since April 2016 and may remain prohibited from making the PIBS coupon payments due in April 2020. The Board considers that there continues to be uncertainty over the Society's ability to make coupon payments thereafter.

The Group's gross capital ratio increased to 17.1% at 31 December 2019 (2018: 14.7%). The free capital ratio at 31 December 2019 was 16.9% (2018: 11.8%). Definitions of gross capital and free capital may be found in the Annual Business Statement on page 69.

Financial Risk Management Objectives

The Group offers savings products and services mortgage 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 regarding the ability of the Society to improve its capital position as the balance sheet continues to run-off. The Board will continue to consider options to secure the long-term future of the Group and remains in regular contact with the regulators.

In January 2020 the UK left the European Union ("EU"). The medium to long-term impact of this on UK government policy, the financial markets and the wider UK economy remains 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 behavioural impact on Spanish lifetime mortgage borrowers.

In 2018 the Group adopted *IFRS 9 – Financial instruments* and in 2019 the assumptions used within the calculation of provisions were developed. The most significant impact on the Group was in respect of the measurement of impairment of financial assets. Under IFRS 9, impairment is based on expected credit losses ("ECL") rather than incurred credit losses which is the methodology the Group previously adopted under IAS 39. An ECL provision is required for default events in the next 12 months, whilst a lifetime ECL is required when a significant increase in credit risk is identified. 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 had previously been the case under IAS 39.

The UK regulators have reiterated their intention to transition from the London Inter-Bank Offered Rate ("LIBOR") to alternative benchmark rates by the end of 2021. The Society is directly impacted through exposure to LIBOR linked assets and liabilities. Planning is under way to manage the impact of this transition.

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 to customers 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 two mortgage books (the NMB MAC and CLC books), where previously it held a beneficial interest and these portfolios were administered by third parties. 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 38.

Insurance Risk: Impairment assessments incorporate the insurance risk attached 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 the borrower's 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. Details of the key sensitivities in relation to the insurance provision are given on page 50. The introduction of IFRS 17 – *Insurance Contracts* is expected to significantly affect accounting for this lifetime portfolio. IFRs 17 may be implemented for accounting periods beginning on 1 January 2021, although delayed implementation is a possibility.

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 and considered by the Board each month. During 2019, 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 not to undertake new lending. As explained on page 4 as at 31 December 2019 the Group continues to have headroom above its Pillar 1 plus Pillar 2A requirement in total capital terms, 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. As at 31 December 2019, the requirement to hold 4.5% of CET 1 capital against Risk Weighted Assets was met but it is recognised that a stress event or other significant loss could result in a future breach. This risk is monitored and under regular 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 Group has not paid coupons on PIBS since April 2016 and may remain prohibited from making the PIBS coupon payments due in April 2020. 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 20% of total mortgage assets as at 31 December 2019 (2018: 20%). The exchange rate risk arising on these balances is managed and partially mitigated by transacting foreign exchange forward contracts. 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 the Group's investment properties which are held at fair value.

The macroeconomic assumptions used in calculation of expected credit losses are shown on page 38.

Political Risk: The UK's exit from the EU in January 2020 continues to create additional uncertainties for the economy, financial markets, housing and mortgage markets, government policy and financial services regulation. The impact upon borrower behaviour and collateral values within the Spanish lifetime portfolio is uncertain. The Group has taken legal advice and contacted the regulatory authority in Spain and believes that operational risk in relation to the servicing of the loan book is limited.

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. The Group's Risk Management Framework ("RMF") is designed around the present needs of the Group. The RMF includes the responsibilities of the Board, the Risk Committee, the Conduct and Operational Risk 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 and redressed where appropriate. 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. Further details in respect of the Group's consideration of other potential conduct and regulatory issues are provided in Note 31.

DIVERSITY MATTERS

Gender Analysis: Below is a table summarising permanent, employed members of staff and directors by gender at 31 December 2019, with comparative positions for the previous year end:

	31 December 2019		31 December 2018	
	Male	**Female**	**Male**	**Female**
Directors	5	2	5	2
Staff	17	27	19	28
Total	22	29	24	30

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 impact of the UK vote to leave the EU on UK government policy, the financial markets and the wider UK economy in the medium to long-term remains 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 Group will continue to be managed in run-off for the foreseeable future and will remain in discussion with the PRA with regard to 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.

The latest medium to long-term strategic plan supports the strategy of reducing the balance sheet so as to conserve regulatory capital. The Group's focus is on delivering to that plan.

D.A. Harding
Chairman
4 March 2020

DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2019

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

H.F. Baines	Vice Chairman
I.A. Dewar	Non-executive director
D.A. Harding	Chairman
J. Lincoln	Non-executive director
P.A. Lynch	Chief Executive
F.B. Smith	Non-executive director
M.A. Winterbottom	Finance Director

At the Annual General Meeting Mr Baines and Mr Harding 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 undertaking.

Other matters

Charitable & political donations

The Society made charitable donations totalling £1k (2018: £5k) 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 2019 amounted to 11 days of average supplies (2018: 2 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
4 March 2020

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 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: https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code). In 2018, the FRC published its revision of the Code which is effective for accounting periods commencing on or after 1 January 2019.

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 2019 the Board consisted of two executive directors 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. H.F. 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 2019. 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 Chief Executive Officer 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.

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 2019, no bonus payments to any directors were approved by the Remuneration and Nominations committee.

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 & Operational Risk 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 directors 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 2019: P.A. Lynch (Chairman), C. Blore*, D. Callaghan*, M. Tang*, M.A. Winterbottom.

(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 systems 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 any non-audit work undertaken by the external auditors, which relates to seeking professional advice on accounting and tax matters. No such non-audit work was performed by PwC during 2019. The Committee monitors the financial reporting process, the statutory audit and reviews all financial information that is disclosed externally.

Membership as at 31 December 2019: J. Lincoln (Chairman), I.A. Dewar and F.B. Smith.

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.
- Going concern accounting given the material uncertainty as disclosed in Note 1a.

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.

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.
- Oversight of the Group's whistleblowing policy.
- Development of a structured risk management framework.

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 and Operational Risk Committee

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

Membership as at 31 December 2019: P.A. Lynch (Chairman), J. Johnson*, R. Mervill*, V. Smith*, M. Tang*, M.A. Winterbottom, G. Worthington*.

(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 2019: P.A. Lynch (Chairman), C. Blore*, 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 and its subsidiaries.

Membership as at 31 December 2019: D.A. Harding (Chairman), P.A. Lynch and M.A. Winterbottom.

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 2019: H.F. Baines (Chairman), I.A. Dewar, D.A. Harding, J. Lincoln, 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 2019: I.A. Dewar (Chairman), J. Lincoln, P.A. Lynch, F.B. Smith, M.A. Winterbottom.

Board and Committee attendance records for 2019

Attendance at full meetings of the Board and its Committees throughout 2019 is scheduled below. Figures displayed in brackets represent the number of meetings that any individual director was entitled to attend.

Board	Board	ALCO	Audit	Operational Risk & Conduct	Credit	Disclosure	Remuneration & Nominations	Risk
H.F. Baines	14 (15)	-	-	-	-	-	7 (7)	-
I.A. Dewar	14 (15)	-	5 (5)	-	-	-	6 (7)	4 (4)
D.A. Harding	15 (15)	-	-	-	-	3 (7)	7 (7)	-
J. Lincoln	15 (15)	-	5 (5)	-	-	-	7 (7)	4 (4)
P.A. Lynch	15 (15)	11 (11)	-	9 (9)	12 (12)	7 (7)	-	4 (4)
F.B. Smith	13 (15)	-	4 (5)	-	-	-	7 (7)	4 (4)
M.A. Winterbottom	15 (15)	10 (11)	-	7 (9)	10 (12)	7 (7)	-	4 (4)

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 auditors, 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 directors

Remuneration levels are set for the executive directors 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 directors 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.

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 2019.

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
4 March 2020

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 Group and the Society for the financial year and of the state of affairs of the Group and the Society 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 Group and Society 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 Group and the Society.

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
4 March 2020

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF MANCHESTER BUILDING SOCIETY

Report on the audit of the annual accounts

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 2019 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 and, as regards the group annual accounts, Article 4 of the IAS Regulation.

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 2019; 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; and the notes to the annual accounts, which include a description of the significant accounting policies.

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the 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.

We have provided no non-audit services to the Group and the Society in the period from 1 January 2019 to 31 December 2019.

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 following the current outcome of the court judgment in the case against its former external auditors, Grant Thornton UK LLP, and the subsequent development of a medium to long term strategic plan showing the continued run-off of 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 uncertainty relating to going concern and note 29 provides detailed disclosures relating to regulatory capital.

As described in note 1, the going concern status of the Group and Society is dependent on the position of the Prudential Regulation Authority (PRA) not changing in relation to supervision of the Society and being able to follow its medium to long term strategic plan to run-off the business. Should the Group's and Society's performance against the plan deviate significantly, the PRA may take further regulatory action which would cast significant doubt on the ability of the Group and Society to continue as a going concern. Some of the estimates, including future impairment levels due to economic stresses, changes in the run-off profile of the mortgage book or unexpected costs, are difficult to calculate.

Whilst the Society's 2020 forecasts show that it will continue to meet the requirement to hold at least 4.5% of the Group's risk weighted assets with Common Equity Tier 1 capital, there is limited headroom and 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. During the prior year the Group and Society were required to pay costs to its former auditors as a result of the ongoing legal case. This led the Group and Society to be in breach of regulatory capital minima, and as such the directors prepared a medium to long term strategic plan agreed with the PRA. This plan was updated in the current year to take account of findings from an independent review and forecasts that the Group and Society will be solvent as activities run off, provided that no significant stresses to capital or liquidity occur. The directors and the PRA are monitoring progress against this plan on a regular basis, and the approach to regulatory supervision of the Group and Society is determined by how the Group and Society performs against it. The directors were required to make judgmental assumptions when preparing the plan including forecasting future financial performance, liquidity and capital amounts held.

Given the risks associated with implementing these strategies and the judgment required in making certain estimates, 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 the plan developed during the year, 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.

Our procedures included assessing the viability of the future options available to the directors as described within their medium to long term plan and the annual accounts and considering what options are available to the directors and the PRA in the event of there being underperformance relative to the plan. We reviewed the findings of an independent review performed on behalf of the PRA into this plan, when considering whether the PRA consider the plan to be an appropriate basis for monitoring the run off of the Group's and Society's business.

We considered the results of our work on other key audit matters (as discussed below) and their impact on the future forecasts used within the plan. This included assessment of the assumptions underpinning the provision models identified as significant audit risks and the sensitivity of the future plans to changes in these assumptions.

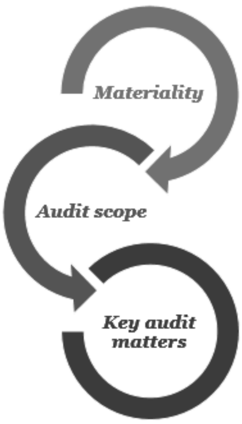
We held direct discussions with the PRA to understand their approach to the supervision of the Group and Society. This involved discussing the results of the Group and Society relative to the plan including the capital forecasts at year end. We read regulatory correspondence to gain an understanding of the board's and the PRA's approach to ongoing supervision under a range of potential future scenarios.

We reviewed the Group's and Society's capital calculation, the results of which are set out in note 29 to ensure consistency with audited financial information. We reviewed the future forecasts contained within the plan and considered whether these are consistent with the audit evidence obtained in our current year procedures.

We also assessed whether the Directors' disclosures in relation to going concern adequately reflected the risks and uncertainties facing the Group and Society based on our understanding of the business.

Our audit approach

Overview



Materiality

- £280k (2018: £300k) - Group annual accounts
- *Based on 1% of total regulatory capital*
- £238k (2018: £280k) - *Society annual accounts*
- *Based on 1% of total regulatory capital*

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

- Management judgments and modelling decisions for loan loss under IFRS 9 (Group and Society).
- Spanish lifetime mortgage provisioning (Group and Society).
- NMB MAC loan book provisioning (Group).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the annual accounts. In particular, we looked at where the directors made subjective judgments, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and Society and their industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK regulatory principles, such as those governed by the Prudential Regulation Authority, and we considered the extent to which non-compliance might have a material effect on the financial statements of the Group and Society. We also considered those laws and regulations that have a direct impact on the Group and Society financial statements, including but not limited to, the Building Societies Act 1986, the Financial Services and Markets Act 2000, the Prudential Sourcebook for Banks, Building Societies and Investment Firms, the Prudential Regulation Authority's regulations and UK tax legislation. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure or increase the capital position of the Group and Society, and management bias in accounting estimates. Audit procedures performed by the engagement team included:

- Review of the financial statement disclosures to underlying supporting documentation;
- Review of correspondence with and reports to the regulators;
- Testing significant accounting estimates (see key audit matters below);
- Testing of journal entries which contained unusual account combinations back to corroborating evidence;
- Discussions with management and those charged with governance in relation to known or suspected instances of non-compliance with laws and regulation and fraud; and
- Review of internal audit reports in so far as they related to the financial statements.

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

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 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 judgment, 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***
Management judgments and modelling decisions under IFRS 9 (Group and Society)	We discussed the basis of loan loss provisions with management and the Audit Committee throughout the year, including updates to modelling made during the year.
The Group and Society use impairment models to calculate an impairment charge on loans and advances to customers of £290k respectively (2018: charge of £545k) in the year. This excludes Spanish lifetime mortgages and other portfolios where impairment is assessed individually.	We tested underlying data used within the models to evidence from original loan documentation, for example by agreeing a sample of property values in models to latest valuations provided by external third parties, and re-calculating current and forecast collateral values.
Under the IFRS 9 impairment models, losses are recognised on an 'expected credit loss' (ECL) basis. The calculation of expected credit losses requires the use of forward looking information, reflecting management's view of potential future economic scenarios. The standard also requires management to make judgments regarding when a loan has experienced a 'significant increase in credit risk' and to make judgments regarding expected customer default rates and repayment behaviour.	We tested whether management's assessment of when a loan has suffered a significant increase in credit risk was sufficient in order to capture observable loan indicators which may imply that the loan has suffered a deterioration in credit quality. We performed tests to determine whether management's definition of default included within the expected loss calculation was aligned with the Society's arrears management process.
In order to meet the requirements of the standard, management depends on previous behaviour observed in the loan portfolios as well as relevant external data which is used to set assumptions within the impairment models.	We compared management's base case forward-looking economic assumptions to alternative external forecasts to assess their reasonableness. The severity and magnitude of the alternative scenarios used within the model were compared to external stress scenarios and

Key audit matter	*How our audit addressed the key audit matter*
We consider the appropriateness of the model methodologies and the following judgments used in the determination of the modelled expected credit loss to be significant: ● The thresholds and definitions applied by management to determine a significant increase in credit risk. These determine whether a 12 month or a lifetime expected loss provision is recorded against each loan; ● The determination of forward looking macroeconomic scenarios and the probability weights applied to ECLs associated with each scenario; and ● The completeness and appropriateness of post model adjustments to account for areas of increased risk within the portfolios or model limitations. In addition management perform individual impairment assessments for large loan exposures where unique circumstances mean that significantly more management judgment is required to determine the level of provision required. Our focus within this aspect of the models was on the principal assumptions applied by management in estimating impairment provisions such as the valuation of collateral, forecast and timing of future cash flows and the completeness and severity of considered future scenarios. Further information can be found in note 1 to the annual accounts, which includes the directors' disclosures of the related accounting policies, judgments and estimates; and in note 13 for detailed disclosures.	data from historical economic downturns to determine whether they represented sufficient stresses to meet the requirements of the standard. We involved risk modelling specialists to re-perform and review the outputs of model calculations to ensure the accuracy of the underlying model. They also assisted in the consideration of the appropriateness of economic forecasts adopted and the overall compliance of the modelling solutions within underlying IFRS 9 requirements. We considered the overall condition of the Group's and Society's loan book, and how this is changing over time. We considered whether there are any emerging risks that are not captured within the impairment policy when considering the appropriateness of the overall expected credit loss. For identified post model adjustments we tested their implementation into the final output and that the underlying rationale and methodology were appropriate. For a sample of the individually assessed loans, we tested supporting data used back to historic transactions. We reviewed the mortgage files and used these to develop independent assumptions, including time to disposal, redemption cash flows on disposal of collateral and assumed time of disposal, to model our own scenarios. We used these scenarios and their ECL to assess whether management's ECL sufficiently captured the potential losses across a range of future scenarios. Where redemptions have occured in the year we performed retrospective testing to previously recognised impairments to assess the models historical accuracy. Based on the procedures performed and the evidence obtained, we found management's judgments used in the determination of the ECLs to be reasonable.
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 £1,814k (2018: £760k) in the year, and at the year-end holds a total provision of 9,250k (2018: £8,186k). 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 any losses on the mortgage at the time of redemption. This is accounted for as an insurance risk by accounting standards. Management 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. We consider the appropriateness of the methodologies and the following judgments used in the determination of the impairment charge to be significant: ● Assumed customer longevity based on mortality assumptions;	We discussed the risks associated with Spanish lifetime mortgages and the process by which key judgments were formed with both the Audit Committee and management throughout the year. We assessed management's accounting treatment for the portfolio through a review of loan terms and the underlying accounting requirements. We tested the loan 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. 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. To assess the reasonableness of longevity data used within the calculation, we engaged our actuarial experts to review the third party data used within management's calculation. They compared the data used against industry best practice and considered the specific circumstances regarding the Society's customer base for this portfolio.

Key audit matter	***How our audit addressed the key audit matter***
● Valuation of the Spanish properties, including the indexation of current values into the future; and ● Timing of customer redemption events including a portfolio prepayment rate which estimates the impact of redemptions occuring ahead of the forecast insurance event. Some of the data used to form these judgments is supplied by third parties to the Society. See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgments and estimates and note 12 for detailed disclosures.	We tested a sample of the property valuations to assess whether these constitute a suitable basis for use within the impairment calculation. This included assessing the appropriateness of the surveyor used and their competency. We performed a range of sensitivity analyses to understand how changes in forecast Spanish property prices impact the 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 tested the completeness and accuracy of the data set management uses to form judgments regarding the level of prepayment that the portfolio experiences, and considered whether this supported management's assumption within their calculation methodology. We also considered an alternative methodology for the setting of the rate and compared the output to that of management's. We selected a sample of loans where an insurance event has taken place and reviewed the customer correspondence file to determine if trends existed within the population which may lead to an alternative rate. We checked the mathematical accuracy of the impairment calculation by involving data specialists to review formulae and ensure consistent application across modelled accounts. Based on the procedures performed and the evidence obtained, we found management's judgments used in the calculation of losses on the portfolio to be reasonable.
NMB MAC provisioning (Group) The Group holds a portfolio of highly forborne loans, some of which are second charge and regulated under the Consumer Credit Act. Many of the loans within the portfolio are past their original contract term and therefore management have entered into individual arrangements with borrowers to make repayments. The Group has recognised an impairment credit on this portfolio of £6k in 2019 (2018: credit of £501k). At year-end the provision on this portfolio is £8,425k (2018: £8,432k). The portfolio was purchased from a third party in 2007 and was considered to be credit impaired at acquisition under IFRS 9. The portfolio remains in default and significant judgment 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 the following which were deemed to be the most significant: ● The determination of different forward looking scenarios and the probability weights applied to ECLs associated with each scenario;	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 performed testing to confirm that input data to the expected credit loss calculation was consistent with underlying loan book records and records of customer correspondence from management agreeing revised repayment plans with borrowers relative to the terms of original customer loans. We obtained evidence over the existence of the Group's charge over a sample of assets within the portfolio. We agreed management's future economic data used back to source and confirmed that the providers were reputable. 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 the underlying data sets which were used by management to form assumptions on expected time to redemption of loan assets, collateral values at the point of sale and receipt of regular cash flows for customers where arrangements to pay have been agreed. We used past cash flow data to inform our assessment of management's assumptions regarding future recoverability from the portfolio, including the timing of assumed redemptions.

Key audit matter	*How our audit addressed the key audit matter*
● 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.	In forming our assessment on management's provision we formed our own view of alternative future scenarios which could occur. We performed independent modelling of these scenarios to compare the ECL calculated under these scenarios with the provision recorded by management.
See note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgments and estimates and note 12 for detailed disclosures.	Based on the procedures performed and the evidence obtained, we found management's judgments used in the determination of the ECLs to be reasonable.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the 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 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 20% of overall Group assets.

The Group is formed of the Society and its wholly owned subsidiary, MBS (Mortgages) Limited, which is material to the Group. The Group also consolidates the results of MBS (Property) Limited which was a group undertaking until its sale on the 15 August 2019 which disposed of the Group's interest in the entity. Similarly NMB Mortgage Acquisition Company Limited was liquidated on 29 June 2019 and while not wholly owned by the Group,was viewed to form part of the Group due to the Society's ability to control the operations of the company and was therefore considered a subsidiary for accounting purposes until this date. NMB Mortgage Acquisitions Company Limited is not significant in the context of the operation of the Group as a whole.

A significant proportion (98%) of the Group's total assets are driven by the Society, along with 96% of the Group's net interest income. 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.

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. This included income statement balances of MBS (Property) which are consolidated up to the point of its disposal in the year. Our audit procedures on the Society and its subsidiary undertakings provided us with sufficient audit evidence as a basis for our opinion on the Group annual accounts as a whole.

Materiality

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

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

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF MANCHESTER BUILDING SOCIETY

	Group annual accounts	***Society annual accounts***
Overall materiality	£ 280,000 (2018: £300,000).	£ 238,000 (2018: £280,000).
How we determined it	1% of total regulatory capital (Group and Society).	
Rationale for benchmark applied	Total 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. Total 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 £12k (2018: £14k) 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. For example, the terms of the United Kingdom's withdrawal from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the Group's trade, customers, suppliers and the wider economy.

Reporting on other information

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

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

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

Responsibilities for the annual accounts and the audit

Responsibilities of the directors for the annual accounts

As explained more fully in the Statement of Directors' Responsibilities set out on page 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.

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF MANCHESTER BUILDING SOCIETY

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 7 years, covering the years ended 31 December 2013 to 31 December 2019.

Daniel Brydon (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
4 March 2020

STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Interest receivable	2	6,748	7,398	6,496	7,097
Other similar income	2	3,251	3,430	3,251	3,430
Interest payable and similar charges	3	(2,965)	(2,869)	(2,965)	(2,869)
Net interest income		7,034	7,959	6,782	7,658
Fees and commission income		33	49	33	49
Fees and commission expense		(44)	(34)	(44)	(34)
Other operating income	4	(90)	978	395	1,184
Other operating charges	4	(77)	(24)	(166)	(167)
Net profit on financial assets designated at fair value through profit and loss	10	-	1	-	1
Total operating income		6,856	8,929	7,000	8,691
Administrative expenses	5	(4,610)	(9,955)	(4,536)	(9,771)
Depreciation	15	(219)	(230)	(151)	(148)
Operating profit/ (loss) before impairments and provisions		2,027	(1,256)	2,313	(1,228)
Expected credit losses	13	(272)	(1)	(268)	(880)
Other impairment losses	13	(1,814)	(760)	(1,814)	(760)
Reversal of previous impairment on property, plant and equipment	13	640	1,074	-	-
Financial Services Compensation Scheme Levy	30	11	6	11	6
Profit/ (loss) on ordinary activities before income tax		592	(937)	242	(2,862)
Income tax expense	8	-	-	-	-
Profit/ (loss) for the financial year		592	(937)	242	(2,862)

The Group and the Society have no other comprehensive income.

The notes on pages 25 to 68 form part of these financial statements.

STATEMENTS OF CHANGES IN EQUITY

	Group 2019				Society 2019			
	Accumulated Losses £000	Subscribed Capital £000	PPDS £000	Total £000	Accumulated Losses £000	Subscribed Capital £000	PPDS £000	Total £000
Balance at 1 January 2019	(11,259)	9,788	17,461	15,990	(14,679)	9,788	17,461	12,570
Profit and total comprehensive income for year	592	-	-	592	242	-	-	242
Balance at 31 December 2019	(10,667)	9,788	17,461	16,582	(14,437)	9,788	17,461	12,812

	Group 2018				Society 2018			
	Accumulated Losses £000	Subscribed Capital £000	PPDS £000	Total £000	Accumulated Losses £000	Subscribed Capital £000	PPDS £000	Total £000
Closing Balance at 31 December 2017	(10,023)	9,788	17,461	17,226	(11,517)	9,788	17,461	15,732
Credit loss adjustment to 1 January 2018 reserves in relation to implementation of IFRS 9	(299)	-	-	(299)	(300)	-	-	(300)
Opening Balance at 1 January 2018 under IFRS 9	(10,322)	9,788	17,461	16,927	(11,817)	9,788	17,461	15,432
Loss and total comprehensive expense for year	(937)	-	-	(937)	(2,862)	-	-	(2,862)
Balance at 31 December 2018	(11,259)	9,788	17,461	15,990	(14,679)	9,788	17,461	12,570

STATEMENTS OF FINANCIAL POSITION
AS AT 31 DECEMBER 2019

	Note	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
ASSETS					
Liquid assets					
Cash and balances with the Bank of England	24	34,831	33,123	34,831	33,123
Loans and advances to credit institutions	9	11,939	14,949	11,938	14,897
		46,770	48,072	46,769	48,020
Derivative financial instruments	11	1,660	30	1,660	30
Loans and advances to customers					
Loans fully secured on residential property	12	179,103	200,769	174,950	196,023
Loans fully secured on land	12	16,930	18,206	16,930	18,206
Other loans	12	347	765	347	765
		196,380	219,740	192,227	214,994
Investments					
Subsidiary undertakings	14	-	-	344	8,119
		-	-	344	8,119
Property, plant and equipment	15	475	6,955	475	255
Investment property	16	155	428	155	428
Other assets	18	1,668	2,160	1,668	1,873
Total assets		247,108	277,385	243,298	273,719
LIABILITIES					
Due to members	19	197,847	225,919	197,847	225,919
Other deposits	20	11,164	13,682	11,164	13,682
Derivative financial instruments	11	27	331	27	328
Other liabilities	22	2,270	2,225	2,246	2,005
Provisions for liabilities and charges	30	18	38	2	15
Subordinated liabilities	21	14,200	14,200	14,200	14,200
Subscribed capital	23	5,000	5,000	5,000	5,000
		230,526	261,395	230,486	261,149
Equity					
Accumulated losses		(10,667)	(11,259)	(14,437)	(14,679)
Subscribed capital	23	9,788	9,788	9,788	9,788
Profit participating deferred shares	25	17,461	17,461	17,461	17,461
		16,582	15,990	12,812	12,570
Total equity and liabilities		247,108	277,385	243,298	273,719

The financial statements on pages 22 to 68 were approved by the Board of Directors on 4 March 2020.

D.A. Harding
Chairman

P.A. Lynch
Chief Executive

M.A. Winterbottom
Finance Director

STATEMENTS OF CASH FLOWS
AS AT 31 DECEMBER 2019

	Note	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Cash flows from operating activities					
Profit/ (loss) before tax		592	(937)	242	(2,862)
Adjusted for:					
Depreciation		219	230	151	148
Reversal of previous impairment on Property, Plant and Equipment	15	(640)	(1,074)	-	-
Increase / (decrease) in provisions		584	(716)	598	(144)
Fair value adjustments		3	20	3	20
Impairment (gains) losses		-	-	(10)	378
Decrease in other assets		492	146	205	246
Increase in other liabilities		46	377	242	491
Cash flows from operating activities before changes in operating assets and liabilities		1,296	(1,954)	1,431	(1,723)
Increase / decrease in operating assets and liabilities					
Decrease in loans and advances to customers		22,756	31,293	22,156	30,071
(Decrease) / increase in derivative financial instruments		(1,934)	389	(1,931)	374
Decrease in amounts owed by credit institutions		8	39	8	39
Decrease in other deposits		(2,518)	(4,176)	(2,518)	(4,176)
Decrease in amount due to members		(28,072)	(21,709)	(28,072)	(21,709)
Net cash flows (used in) / from operating activities		(8,464)	3,882	(8,926)	2,876
Cash flow from investing activities					
Receipts from investments in subsidiary undertakings		-	-	7,785	1,005
Purchase of property and equipment	15	(397)	-	(397)	-
Disposal of property and equipment	15	7,298	1	26	1
Disposal of investment property	16	270	243	270	243
Net cash flows from investing activities		7,171	244	7,684	1,249
Cash flow from financing activities					
Interest paid on subscribed capital		(1)	3	(1)	3
Net cash used in financing activities		(1)	3	(1)	3
Net movement in cash and cash equivalents		(1,294)	4,129	(1,243)	4,128
Cash and cash equivalents at start of year		48,061	43,932	48,009	43,881
Cash and cash equivalents at end of year	24	46,767	48,061	46,766	48,009

1. Accounting policies and financial risk management

a) Summary of significant accounting policies

The principal 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 Group has not been active in the Mortgage market since 2013 and at present has insufficient capital to return to lending. There is currently no plan in place to return to lending, though this is something which may be revisited should the capital position improve to a level where such activity may be appropriate. The current strategy of the Board, therefore, continues to be the management of a long-term run-off of the balance sheet.

Following the Society's CET 1 capital temporarily falling below the required 4.5% of Risk Weighted Assets in 2018, a medium to long term strategic plan was produced which was independently reviewed and acknowledged by the PRA. This plan was updated in 2019 and the PRA agreed to monitor the Society against this revised plan. The plan shows that the Society remains viable in the medium-term and is able to rebuild its regulatory capital ratios in the medium-term. It is recognised that there are a number of risks to this plan, particularly following a stress event in the economy or financial markets. Such stress events may include a downturn in the housing market either in the UK or Spain, additional provision requirements on one or more of the Group's larger mortgage exposures, significant unexpected expenses or a materially different mortgage repayment profile to that included within the plan.

The Board expects to continue to work closely with its regulators during 2020 to develop and implement its strategic plan. Implementation may involve third parties and require regulatory approval and as such may carry execution risk.

When satisfying themselves that the Group and Society have adequate resources to continue to operate for the foreseeable future as a going concern, the directors have reviewed the plan and the ability for it to be followed. The directors are reliant on the regulators' position regarding the plan remaining unchanged.

Whilst the Group continues to have a shortfall against qualitative standards for the level of CET 1 capital, at 31 December 2019 the requirement to hold CET 1 Regulatory Capital of at least 4.5% of total Risk Weighted Assets was met. The Group continues to have headroom above its total Pillar 1 plus Pillar 2A requirements in total capital terms as set by the PRA. The liquidity position also remains strong with significant headroom above both its policy and operational limits.

Having due regard to these matters and after taking into consideration the material uncertainties above, which may cast significant doubt over the Group's ability to continue as a going concern, 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.

Changes in accounting policies

On 1 January 2019 the Group adopted IFRS 16 – *Leases* as issued by the IASB in January 2016. IFRS 16 replaces IAS 17 – *Leases*, IFRIC 4 – *Determining whether an Arrangement contains a Lease*, SIC-15 – *Operating Leases – Incentives* and SIC-27 – Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

IFRS 16 introduces new or amended requirements with respect to lease accounting. It introduces significant changes to lessee accounting by removing the distinction between operating and finance leases and requiring the recognition of a right-of-use asset and a lease liability at the lease commencement for all leases, except for short-term leases and leases of low value assets. The requirements for lessor accounting have remained largely unchanged.

Impact on lessor accounting

Prior to the sale of MBS (Property) Limited in August 2019, the Group acted as lessor in relation to the occupancy and use of its head office building. The introduction of IFRS 16 has not impacted on the Group's accounting as a lessor.

Impact on lessee accounting

Prior to the sale of its subsidiary MBS (Property) Limited in August 2019, the Society leased both the fourth and fifth floors of 125 Portland Street from MBS (Property) Limited. There was no formal documentation governing this arrangement with either party able to end the arrangement at short notice. As there was no commitment in excess of 12 months, the rental agreements for the fourth and fifth floors prior to the sale of MBS (Property) Limited have been viewed as short-term leases for the purposes of IFRS 16 and the Society has elected to recognise the lease payments associated with those leases as an expense on a straight-line basis.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Following the disposal of MBS (Property) Limited, the Society entered into a formal lease agreement as tenant for the fifth floor of 125 Portland Street, covering a five year period with an option to break the lease after three years. As the lease term exceeds 12 months, the Society and Group are required to account for the lease under IFRS 16. The contractual five year lease term is used as the basis of the initial accounting for the lease under IFRS 16.

The Society has recognised a lease liability for the fifth floor lease arrangement, which was initially measured as the present value of the total lease payments due over the lease term, discounted using the rate implicit in the lease. This liability is included on the Statement of Financial Position within other liabilities (Note 22). This liability incurs interest expenditure at the rate implicit in the lease, which is recognised in the Statement of Comprehensive Income as part of interest payable and similar charges (Note 3). Lease payments by the Society reduce the amount of this liability.

The Society has recognised a right-of-use asset for the lease, which is included on the Statement of Financial Position within property, plant and equipment (Note 15), with depreciation charged through the Statement of Comprehensive Income (Note 15). This asset was initially measured as the present value of future lease payments due over the lease term plus initial direct costs incurred by the Society in relation to the lease set up. The rate implicit in the lease has been used to derive the initial present value of the right-of-use asset. Depreciation is charged on a straight-line basis over the five year period covered by the lease agreement.

The recognition of the right-of-use asset and the lease liability has resulted in the inclusion of the following amounts within the 2019 Statements of Comprehensive Income:

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Depreciation expense on right-of-use assets (Note 15)	30	-	30	-
Interest expense on lease liabilities (Note 3)	10	-	10	-
	40	-	40	-

Further details of amounts that have been recognised within the Statements of Comprehensive Income in relation to leases are disclosed in Note 26.

Basis of consolidation

The Group's financial statements include the financial statements of the Society and its subsidiary undertaking, MBS (Mortgages) Limited. At 31 December 2018, the Group's Financial Statements also included MBS (Property) Limited which was a fully owned subsidiary of the Society and was sold in August 2019. The Group's Statement of Comprehensive Income includes the performance of MBS (Property) Limited up to the date of disposal.

The Society and its subsidiary each have accounting periods ending on 31 December. 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 life of the financial instrument. 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.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Insurance contracts

The Group has a portfolio of lifetime mortgage loans secured on Spanish residential property. The "No Negative Equity Guarantee" 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 Other Similar Income category. Within the Statement of Financial Position the mortgage asset is reported within the Loans and Advances to Customers category, net of any impairment provision.

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 is due to be replaced by IFRS 17 – *Insurance Contracts* for accounting periods beginning on 1 January 2021. Implementation may be delayed until 1 January 2022 or later. The Group's initial assessment of IFRS 17's implementation is ongoing.

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.

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.

Financial Instruments

At initial recognition, the Group measures a financial asset or financial liability at its fair value. For financial assets or financial liabilities not held at fair value through profit or loss, adjustments are made for any transaction costs that are incremental and directly attributable. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss ("FVPL") are expensed in profit or loss. Immediately after initial recognition, an expected credit loss allowance ("ECL") is recognised for financial assets measured at amortised cost and investments in debt instruments measured at fair value through other comprehensive income ("FVOCI"). This results in an accounting loss being recognised in profit or loss when an asset is newly originated.

Financial assets

The Group classifies its financial assets in the following categories under IFRS 9:

(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.

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.

(ii) Financial assets held at amortised cost

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. These include the NMB MAC and CLC portfolios, which have been categorised as purchased or originated credit – impaired ('POCI') financial assets and for which the original credit – adjusted effective interest rate is applied to the amortised cost of these financial assets, instead of the gross carrying amount.

The fair values of financial assets carried at amortised cost as at 31 December 2019 and 31 December 2018 are detailed in the fair values of financial assets and liabilities carried at amortised cost section on page 41 and 42.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Financial Instruments (continued)

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.

The Group and Society sets policy with regards to classification and measurement of financial instruments following consideration of its business model and whether cash flows are considered solely payments of principle and interest 'SPPI'. These are explained as follows:

Business model: the business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVPL. Factors considered by the Group in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Impairment

The Group assesses on a forward-looking basis the expected credit losses ('ECL') associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Note 1b provides more detail of how the expected credit loss allowance is measured.

Investment in subsidiary undertaking

MBS (Mortgages) Limited is an entity 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.

Investment in the Society's subsidiary undertaking relates to the share capital of the subsidiary and the remaining intragroup loan advanced to the subsidiary, and is recorded in the Statement of Financial Position at historic cost less any provision for impairment. Impairment of the intragroup loan is assessed in line with the Group's IFRS 9 – Financial Instruments impairment policy and compares the carrying value of the investment against future cash flows from the subsidiary undertaking.

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 year 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.
- Office right-of-use assets: over 5 years.
- Computer and sundry equipment: over 5 years.
- Other assets: over 4 years.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2019

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Property, plant and equipment (continued)

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each financial reporting date. A formal revaluation of the head office property resulted in a £1.1m partial reversal of the previously assessed impairment in value at 31 December 2018. Prior to its sale in August 2019, the freehold head office property was revalued, based on the agreed value at sale, and a further £0.6m partial reversal of the previously assessed impairment was recognised at that time.

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.

Leases

Rental income and expenditure in relation to short-term leases (with no lease commitment in excess of 12 months) 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.

For lease arrangements which are not classified as short-term, a lease liability is recorded at inception of each lease, based on the present value of the total lease payments due over the lease term, discounted using the rate implicit in the lease. The lease liability incurs interest expenditure at the rate implicit in the lease. A right-of-use asset is also recognised for such leases, initially measured as the present value of future lease payments due over the lease term plus initial direct costs incurred by the Group in relation to the lease set up. The rate implicit in the lease is used to derive the initial present value of the right-of-use asset. Depreciation is charged through the Statement of Comprehensive Income on a straight-line basis over the period covered by the lease agreement.

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.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Financial Services Compensation Scheme ("FSCS")

Previous claims were made on the FSCS following the failure of a number of financial institutions. 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.

No provision is required at 31 December 2019 as no shortfall exists within the scheme.

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 4, as a result of the shortfall against the qualitative standards for the level of CET 1 regulatory capital under CRD IV article 141, in order to conserve capital, the Group has not paid coupons on PIBS since April 2016 and may remain prohibited from making the coupon payments due in April 2020. The Board considers that there continues to be uncertainty over the Group's ability to make coupon payments thereafter.

Profit Participating Deferred Shares

The Group has £18m of Profit Participating Deferred Shares ('PPDS'), 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

The following section discusses the Group's risk management policies. The measurement of ECL under IFRS 9 uses the information and approaches that the Group uses to manage credit risk, though certain adjustments are made in order to comply with the requirements of IFRS 9.

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 to raise funding. The Group also uses derivative financial instruments 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.

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Financial assets				
Loans and advances to credit institutions	11,939	14,949	11,938	14,897
Gross loans and advances - on residential property and land	172,674	193,264	160,096	180,086
Gross loans and advances - lifetime mortgages	47,019	48,789	47,019	48,789
Gross loans and advances - other loans	380	776	380	776
Loans to subsidiary undertakings	-	-	344	8,119
Derivatives - exchange rate swaps	1,660	30	1,660	30
	233,672	257,808	221,437	252,697

Impairment provisions are provided for expected credit losses in accordance with *IFRS 9 – Financial Instruments*. The figure for lifetime mortgages is stated after deduction of an effective interest rate provision.

Credit Risk

Credit risk is the risk of suffering financial loss, should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk arises mainly from interbank, commercial and consumer loans and advances, and loan commitments arising from such lending activities.

The Group is also exposed to other credit risks arising from its trading activities ('trading exposures') including derivatives and settlement balances with market counterparties. Credit risk is the single largest risk for the Group's business; management therefore carefully manages its exposure to credit risk. The credit risk management and control are centralised in a credit risk management group which reports regularly to the Credit Committee and Executive Committee.

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 2019, the Group had 35 accounts (2018: 36) with balances of £4.3m (2018: £4.5m) where conversion to interest only or an extension of term had taken place. Of these, 4 accounts (2018: 12) were neither past due or impaired, and 31 (2018: 24) were past due and/or impaired with an aggregate capital balance of £4.1m (2018: £3.3m); aggregate arrears of £6k (2018: £14k); and aggregate impairment provision of £213k (2018: £230k).

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. The Group's implementation of IFRS 9 impairment specifically categorises forborne loans as stage 3 (credit impaired), and therefore in default for provisioning purposes.

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 £220.1m of gross assets in this class £199.9m (90.8%) (2018: 90.7%) is fully secured on residential property, £19.8m (9.0%) (2018: 9.0%) is fully secured on land and £0.4m (0.2%) (2018: 0.3%) relates to unsecured personal loans.
- With gross balances of £47.0m, lifetime mortgages represent 21.4% of this class (2018: 20.1%).

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 46% (2018: 45%). Further analysis of the Group's residential property lending is detailed below.

	2019 %	**2018 %**
<70%	62	64
70% - 80%	10	11
80% - 90%	6	6
90% - 100%	5	7
>100%	17	12
Average loan to value of stock - UK mortgages	35	36
Average loan to value of stock - Spanish mortgages	104	97

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 2019, 39% of the loan book had an LTV of 70% or greater (2018: 36%). In the event that valuations were to increase by 5%, at 31 December 2019 this would reduce the proportion of the loan book that had an LTV of 70% or greater to 34% (2018: 33%); in the event that House Price Indices ("HPIs") decreased by 5% at 31 December 2019, the proportion of the loan book with an LTV of 70% or greater would increase to 42% (2018: 39%).

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 3.0% (2018: 2.6%). There are 33 Spanish lifetime mortgages (2018: 34) where an event has occurred which under the terms of the mortgage means a repayment is now due. No UK lifetime mortgages are past due.

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

	2019 £m	**2019 %**	**2018 £m**	**2018 %**
Not past due and up to 3 months	181.8	91	202.0	92
Past due 3 to 6 months	0.9	-	0.4	-
Past due 6 to 12 months	0.4	-	1.5	-
Past due over 12 months	1.9	1	1.7	1
Possessions *	2.8	1	2.2	1
	187.8	93	207.8	94
NMB MAC mortgage book - beneficial interest is held **	11.0	6	11.4	5
CLC mortgage book **	1.1	1	1.1	1
	199.9	100	220.3	100

* For properties in possession, £3.0m (2018: £2.0m) of collateral is held. In the analysis above, for all past due loans, £32.0m (2018: £36.5m) 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 £2.9m (2018: £3.5m).

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:

	2019 £m	2019 %	2018 £m	2018 %
East Midlands	2.8	1	2.9	1
Greater London	9.8	5	11.5	5
London	23.8	12	27.0	12
North	4.3	2	4.4	2
North West	68.7	34	77.0	35
Other	7.7	4	8.4	4
South East	13.6	7	15.0	7
South West	4.5	2	5.2	2
Wales	4.0	2	4.4	2
West Midlands	5.2	3	5.5	3
Yorkshire	7.5	4	10.0	5
Total UK properties	151.9	76	171.3	78
Spain (lifetime mortgages)	48.0	24	48.9	22
Portugal	-	-	0.1	-
	199.9	100	220.3	100

Secured lending – fully secured on land

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

	2019 £m	2019 %	2018 £m	2018 %
Offices	6.1	31	6.4	30
Shops	5.1	26	5.3	24
Industrial	3.6	18	3.8	17
Restaurants, Hotels and other	5.0	25	6.3	29
	19.8	100	21.8	100

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

	2019 £m	2019 %	2018 £m	2018 %
Not past due and up to 3 months	15.7	79	16.9	77
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	-	-	0.4	2
Past due over 12 months	4.1	21	3.6	17
Possessions *	-	-	0.9	4
	19.8	100	21.8	100

* No collateral is held for properties in possession (2018: £0.2m). In the analysis above, for all past due loans, £5.0m of collateral is held (2018: £4.7m).

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:

	2019 £m	2019 %	2018 £m	2018 %
Not past due and up to 3 months	0.4	100	0.6	78
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	-	-	-	-
Past due over 12 months	-	-	0.2	22
	0.4	100	0.8	100

Credit risk – loans and advances to credit institutions 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 £35m (2018: £33m) which was on deposit with the Bank of England. The number of active counterparties at the financial position date was 5 (2018: 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:

	2019 £m	2019 %	2018 £m	2018 %
UK Financial institutions	46.8	100	48.1	100
	46.8	100	48.1	100

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

	2019 £m	2019 %	2018 £m	2018 %
UK	46.8	100	48.1	100
	46.8	100	48.1	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:

	2019 £m	2019 %	2018 £m	2018 %
UK Financial institutions	46.8	100	48.1	100
	46.8	100	48.1	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 £1,660k (2018: £30k). Related amounts not set off are £27k (2018: £331k) financial liabilities with cash collateral received of £1,231k (2018: £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 £27k (2018: £331k). Related amounts not set off are £1,660k (2018: £30k) financial assets with cash collateral deposited of £1,161k (2018: £1,381k).

Credit risk – Expected credit loss measurement

Under IFRS 9, impairment is based on expected credit losses ("ECL") rather than the methodology the Group previously adopted under IAS 39 which is based upon incurred credit losses.

ECL is calculated as the product of Probability of Default, Exposure at Default and Loss Given Default for each account, which are defined as:

- Probability of Default ("PD") is an estimate of the likelihood of the account defaulting over either 12 months (Stage 1) or the lifetime of the account (Stage 2)
- Exposure at Default ("EAD") is the expected balance sheet exposure at the time of default taking into account all expected changes over the lifetime of the account. This includes capitalisation of interest, repayments and the impact of forward-looking economic estimates
- Loss Given Default ("LGD") is the amount of loss that will be incurred in the event of default incorporating the impact of forward-looking economic estimates

The ECL impairment provisioning under IFRS9 includes the requirement to include 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.

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)

Significant increase in credit risk

A significant increase in credit risk is not a defined term, and is determined by Management, based on their experience and judgment. In assessing whether the credit risk has significantly increased the Group has identified a series of quantitative, qualitative and backstop criteria (30 days past due as set by IFRS 9) which take into account forward-looking macroeconomic factors. These are referred to as the staging criteria.

The staging criteria have been extensively tested to ensure the characteristics of the portfolio are correctly reflected and accounts appropriately flow through the stages prior to default. The Group has considered how long is a suitable period after a loan no longer falls within an arrears category before it is appropriate to consider that the loan has "cured" and can have its credit risk status upgraded. A cure period of six months has been deemed appropriate for Stage 2. This means that an account remains in stage 2 for a period of six months after it ceases to meet any stage 2 criteria.

The staging criteria take into account the following:

- Quantitative criteria – if an account's current lifetime PD is greater than a fourfold increase of origination lifetime PD then the credit risk of the account is considered to have increased significantly;
- Qualitative criteria – if an account enters forbearance or demonstrates other indicators of financial difficulty, not yet caught by an increase in PD, then the credit risk of the account is considered to have increased significantly; and
- Backstop – if the account is 30 days past due it will automatically transition to Stage 2.

The staging criteria are monitored and revisited in advance of each reporting date.

The Group has not used the low credit risk exemption for any financial instruments in the years ended 31 December 2019 and 31 December 2018.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Significant increase in credit risk (continued)

Definition of default

The definition of default is used to determine both the PD and the transition to stage 3 (all accounts which have defaulted are recognised in stage 3).

The Group defines a financial instrument as in default, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments or if the loan maturity date has passed.

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- The borrower is in long-term forbearance
- The borrower is deceased
- The borrower is insolvent
- Concessions have been made by the lender relating to the borrower's financial difficulty
- The borrower has entered bankruptcy
- The borrower is subject to a lasting power of attorney
- The collateral has been repossessed or surrendered
- The borrower is subject to litigation
- The borrower is subject to a debt management agreement
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) throughout the Group's expected loss calculations.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of 12 months. This period of 12 months has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The Expected Credit Loss (ECL) is measured on either a 12 month or Lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

Probability of default (PD)

PD is a key component in the calculation of ECL and the transition from stage 1 to stage 2. It is an estimate of the likelihood of default over either 12 months or the lifetime of the account. Management have used historical data, assumptions and expectations of future conditions to model PD over time. An origination PD is required for each account. Where origination PDs were not available at the origination date, the origination PD was approximated, based on available account level data.

Exposure at default (EAD)

EAD is the amount that the Group expects the exposure to be at the point of default based on the contractual payment profile, historic behaviours and the impact of applying forward-looking economic estimates.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Loss given default (LGD)

LGD is the amount of loss that will be incurred in the event of default. It represents the actual cash flows expected to be recovered for an individual account, and takes in to account collateral values and other cash recovered e.g. rental income due on properties in possession.

The ECL is determined by projecting the PD, LGD and EAD for each individual exposure or collective segment. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The Lifetime PD is developed by applying a maturity profile to the current 12-month PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. This is supported by historical analysis.

The 12 month and lifetime EADs are determined based on the contractual repayments owed by the borrower over a 12 month or lifetime basis.

The 12 month and lifetime LGDs are determined based on the factors which impact the recoveries made post default. This is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed.

Expected life

The calculation of ECL is over the contractual life of the account. Where an account is past its contractual term it will be treated as being impaired (in default) and the loss calculated as at that point, assigning a PD=1 and remaining term = 0.

Origination dates

The origination date of an exposure is the contractual origination date. The origination date is when the origination PD is determined, which will be referenced at each reporting period when determining if there has been a significant increase in credit risk.

Forward-looking economic information is also included in determining the 12 month and lifetime PD, EAD and LGD.

Forward looking information included in the ECL models

Unbiased macro-economic scenarios covering multiple potential outcomes are required by IFRS 9 to be incorporated into the ECL calculation.

The macro-economic variables with the most significant impact on PD and LGD, for the Group, are judged to be house price inflation; UK unemployment rate; consumer price index; LIBOR (3 month) and bank base rate.

The Group has determined an approach to the selection and application of multiple scenarios. The Group does not have an in-house economics function and has therefore sourced complete economic scenarios from a third party. These scenarios are supported by director review and approval of appropriateness of assumptions.

The Group considers four scenarios on a probability-weighted approach. These scenarios include a base, an upturn, a mild downturn and a severe downturn scenario. The combination of the four scenarios provides an unbiased but representative macro view of possible future outcomes capturing any non-linearity's of account behaviour. At 31 December 2018, weightings applied 70% to the base, 10% to the upturn, 15% to the mild downturn and 5% to the severe downturn. During the year the Group engaged an external supplier to provide all economic forecasts which are subject to review, challenge and approval by the directors. At 31 December 2019, weightings applied 39% to the base, 30% to the upturn, 30% to the mild downturn and 1% to the severe downturn.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes based on reliable available information.

Economic forecasts are produced every three months for base, upturn and mild downturn; and every six months for the severe downturn.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Forward looking information included in the ECL models (continued)

The macro-economic assumptions adopted in the latest ECL calculation of each scenario are:

	2019				2018			
	Upturn	Base	Mild Downturn	Severe Downturn	Upturn	Base	Mild Downturn	Severe Downturn
House price index (5 year average)	5.0%	2.4%	(2.5%)	(9.1%)	2.7%	2.1%	0.8%	(5.3%)
Consumer price index (5 year average)	2.1%	1.7%	1.1%	0.6%	1.9%	2.2%	2.4%	3.2%
UK Unemployment rate (5 year average)	3.5%	3.7%	5.1%	5.5%	3.6%	3.9%	4.3%	7.4%
LIBOR (3 month) (5 year average)	1.6%	1.1%	0.7%	0.9%	1.6%	1.3%	0.6%	3.8%
Bank base rate (5 year average)	1.4%	1.0%	0.5%	0.3%	1.4%	1.1%	0.5%	3.5%

Sensitivity Analysis

The most significant assumptions affecting the ECL allowance are as follows:

- **The weighting given to the economic scenarios used within the ECL calculation**

  The Group have considered four scenarios when calculating a weighted ECL with weightings based upon expert judgment. The table below sets out the ECL of each scenario prior to weighting:

	2019				2018			
	Upturn £000	Base £000	Mild Downturn £000	Severe Downturn £000	Upturn	Base	Mild Downturn	Severe Downturn
Weighting	30%	39%	30%	1%	10%	70%	15%	5%
ECL (100% weighting)	13,472	13,905	15,669	17,841	14,635	14,671	15,516	16,846

- **House price index**

  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 £23.7m to £22.6m. If current prices were 5% lower, then the provision requirement would increase by £1.2m to £24.9m.

- **The value of cash receipts within the NMB MAC and CLC portfolios**

  The Group held a beneficial interest in NMB MAC, a portfolio of mortgage assets, some of which are MCOB regulated. During October 2018, the legal title of these loans was assigned to the Group from the third party business to which the Group provided funding and over which it held a debenture; under IFRS 10 this third party entity, which was in liquidation, was consolidated within the Group Financial Statements until the time of assignment. 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 £2.9m (2018: £3.5m) of which 41% (2018: 39%) 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 £9.1m to £9.0m whilst a 10% reduction in cash flows would see the provision requirement increase from £9.1m to £9.4m.

  19 suspended possession orders are held against properties and following legal advice the directors believe that these orders remain valid and would result in recoveries. A risk exists that a court may not give leave to enforce the order and that alternative recovery action would need to be undertaken. If recovery as a result of such orders was not possible in all cases, the increase to the provision held at 31 December 2019 would be £0.3m.

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

1. Accounting policies and financial risk management

b) Financial risk management (continued)

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 2019 and 31 December 2018 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 2019										
Assets										
Cash and central banks balances	34,820	-	-	-	-	-	-	-	11	34,831
Due from other banks	11,936	-	-	-	-	-	-	-	3	11,939
Loans to customers	148,081	155	309	2,417	4,396	3,066	286	-	-	158,710
Lifetime mortgages	-	-	3,354	5,030	5,861	19,380	4,045	-	-	37,670
Derivatives	513	1,010	137	-	-	-	-	-	-	1,660
Other assets	850	-	-	-	-	-	-	-	1,448	2,298
Total assets	196,200	1,165	3,800	7,447	10,257	22,446	4,331	-	1,462	247,108
Liabilities										
Other deposits	11,125	-	-	-	-	-	-	-	39	11,164
Due to members	186,537	4,264	6,829	-	-	-	-	-	217	197,847
Subordinated liabilities	9,200	-	-	-	5,000	-	-	-	-	14,200
Derivatives	-	1	26	-	-	-	-	-	-	27
Other liabilities	1,231	-	-	-	-	-	-	-	1,057	2,288
Subscribed capital	-	-	-	-	-	-	-	-	14,788	14,788
Profit participating deferred shares	-	-	-	-	-	-	-	-	17,461	17,461
Accumulated losses	-	-	-	-	-	-	-	-	(10,667)	(10,667)
Total liabilities	208,093	4,265	6,855	-	5,000	-	-	-	22,895	247,108
Interest rate sensitivity gap	(11,893)	(3,100)	(3,055)	7,447	5,257	22,446	4,331	-	(21,433)	-
Cumulative gap	(11,893)	(14,993)	(18,048)	(10,601)	(5,344)	17,102	21,433	21,433	-	-

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 2018										
Assets										
Cash and central banks balances	33,111	-	-	-	-	-	-	-	12	33,123
Due from other banks	14,938	-	-	-	-	-	-	-	11	14,949
Investment securities	-	-	-	-	-	-	-	-	-	-
Loans to customers	166,801	172	283	2,877	4,268	4,165	505	117	-	179,188
Lifetime mortgages	-	-	2,930	5,384	5,331	21,586	5,321	-	-	40,552
	15	14	1	-	-	-	-	-	-	30
Other assets	1,070	-	-	-	-	-	-	-	8,473	9,543
Total assets	215,935	186	3,214	8,261	9,599	25,751	5,826	117	8,496	277,385
Liabilities										
Other deposits	13,633	-	-	-	-	-	-	-	49	13,682
Due to members	212,433	4,554	8,682	-	-	-	-	-	250	225,919
Subordinated liabilities	9,200	-	-	-	5,000	-	-	-	-	14,200
Derivative financial instruments	123	158	50	-	-	-	-	-	-	331
Other liabilities	-	-	-	-	-	-	-	-	2,263	2,263
Subscribed capital	-	-	-	-	-	-	-	-	14,788	14,788
Profit participating deferred shares	-	-	-	-	-	-	-	-	17,461	17,461
Accumulated losses	-	-	-	-	-	-	-	-	(11,259)	(11,259)
Total liabilities	235,389	4,712	8,732	-	5,000	-	-	-	23,552	277,385
Interest rate sensitivity gap	(19,454)	(4,526)	(5,518)	8,261	4,599	25,751	5,826	117	(15,056)	-
Cumulative gap	(19,454)	(23,980)	(29,498)	(21,237)	(16,638)	9,113	14,939	15,056	-	-

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 2019 an increase of 1% in market interest rates across all maturities would reduce income and equity by £3.9m (2018: £4.2m 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 2019 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	0-3 months	3-12 months	1-5 years	5-10 years	10-15 years	Over 15 years	Total
	£000	£000	£000	£000	£000	£000	£000	£000
At 31 December 2019								
Due to members	71,216	91,311	35,320	-	-	-	-	197,847
Due to other banks and depositors	7,204	3,960	-	-	-	-	-	11,164
Derivative financial instruments	-	513	1,147	-	-	-	-	1,660
Other liabilities	1,721	93	70	278	-	-	-	2,162
PIBS interest	-	-	200	1,600	2,000	2,000	2,000	7,800
Subordinated liabilities	-	150	449	10,967	1,675	5,940	-	19,181
Total outflow	80,141	96,027	37,186	12,845	3,675	7,940	2,000	239,814
	£000	£000	£000	£000	£000	£000	£000	£000
At 31 December 2018								
Due to members	81,689	98,921	45,309	-	-	-	-	225,919
Due to other banks and depositors	8,360	5,322	-	-	-	-	-	13,682
Derivative financial instruments	-	122	209	-	-	-	-	331
Other liabilities	2,007	92	38	-	-	-	-	2,137
PIBS interest	-	-	200	1,600	2,000	2,000	2,000	7,800
Subordinated liabilities	-	151	452	7,042	5,875	6,275	-	19,795
Total outflow	92,056	104,608	46,208	8,642	7,875	8,275	2,000	269,664

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	3-6 months	6-12 months	1-5 years	5-10 years	10-20 years	20-30 years	Over 30 years	Total
	£000	£000	£000	£000	£000	£000	£000	£000	£000
At 31 December 2019									
Assets									
Cash and central banks balances	34,831	-	-	-	-	-	-	-	34,831
Due from other banks	11,939	-	-	-	-	-	-	-	11,939
Derivative financial instruments	513	1,010	137	-	-	-	-	-	1,660
Loans to customers	9,486	2,366	4,730	46,033	42,057	51,947	1,580	511	158,710
Lifetime mortgages	-	-	5,741	11,705	9,309	10,172	743	-	37,670
Other assets	407	-	1,260	630	-	-	-	-	2,297
Total assets	57,176	3,376	11,868	58,368	51,366	62,119	2,323	511	247,107
Liabilities									
Other deposits	11,164	-	-	-	-	-	-	-	11,164
Derivative financial instruments	-	2	25	-	-	-	-	-	27
Due to members	162,527	32,289	3,031	-	-	-	-	-	197,847
Subordinated liabilities	-	-	-	9,200	-	5,000	-	-	14,200
Other liabilities	1,957	17	35	278	-	-	-	-	2,287
Total liabilities	175,648	32,308	3,091	9,478	-	5,000	-	-	225,525
Net liquidity gap	(118,472)	(28,932)	8,777	48,890	51,366	57,119	2,323	511	21,582
At 31 December 2018									
Total assets	59,879	2,630	9,920	60,037	54,266	79,784	3,048	7,821	277,385
Total liabilities	196,666	36,814	8,715	9,200	-	5,000	-	-	256,395
Net liquidity gap	(136,787)	(34,184)	1,205	50,837	54,266	74,784	3,048	7,821	20,990

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 2019 the Group had a foreign currency exposure of €57.2m (2018: €56.5m) 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.

	2019 £000	2018 £000
Effect on income with no Euro forward contracts	(3,084)	(3,478)
Effect on income with Euro contracts fully matching Euro denominated assets	1	20

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

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 2019			Society as at 31 December 2019		
	Financial assets held at amortised cost £000	Fair value through profit or loss £000	Total £000	Financial assets held at amortised cost £000	Fair value through profit or loss £000	Total £000
Assets						
Cash and balances with central banks	34,831	-	34,831	34,831	-	34,831
Loans and advances to credit institutions	11,939	-	11,939	11,938	-	11,938
Derivative financial instruments	-	1,660	1,660	-	1,660	1,660
Loans and advances to customers	196,380	-	196,380	192,227	-	192,227
Investments	-	-	-	344	-	344
Other assets	204	-	204	204	-	204
	243,354	1,660	245,014	239,544	1,660	241,204
Non-financial assets			2,094			2,094
Total assets			247,108			243,298
Liabilities						
Due to members	197,847	-	197,847	197,847	-	197,847
Other deposits	11,164	-	11,164	11,164	-	11,164
Derivative financial instruments	-	27	27	-	27	27
Other liabilities	2,194	-	2,194	2,170	-	2,170
Subordinated liabilities	14,200	-	14,200	14,200	-	14,200
Subscribed capital	5,000	-	5,000	5,000	-	5,000
	230,405	27	230,432	230,381	27	230,408
Non-financial liabilities			16,676			12,890
			247,108			243,298

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Classification of financial assets and liabilities (continued)

	Group as at 31 December 2018			Society as at 31 December 2018		
	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	33,123	-	33,123	33,123	-	33,123
Loans and advances to credit institutions	14,949	-	14,949	14,897	-	14,897
Derivative financial instruments	-	30	30	-	30	30
Loans and advances to customers	219,740	-	219,740	214,994	-	214,994
Investments	-	-	-	8,119	-	8,119
Other assets	1,160	-	1,160	1,089	-	1,089
	268,972	30	269,002	272,222	30	272,252
Non-financial assets			8,383			1,467
Total assets			277,385			273,719
Liabilities						
Due to members	225,919	-	225,919	225,919	-	225,919
Other deposits	13,682	-	13,682	13,682	-	13,682
Derivative financial instruments	-	331	331	-	328	328
Other liabilities	2,133	-	2,133	1,925	-	1,925
Subordinated liabilities	14,200	-	14,200	14,200	-	14,200
Subscribed capital	5,000	-	5,000	5,000	-	5,000
	260,934	331	261,265	260,726	328	261,054
Non-financial liabilities			16,120			12,665
Total liabilities			277,385			273,719

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	2019 Carrying value £000	2019 Fair value £000	2018 Carrying value £000	2018 Fair value £000
Financial assets				
Cash and balances with the Bank of England	34,831	34,831	33,123	33,123
Loans and advances to credit institutions	11,939	11,939	14,949	14,949
Loans and advances to customers	196,380	188,420	219,740	210,856
Other assets	204	204	1,160	1,160
	243,354	235,394	268,972	260,088
	£000	£000	£000	£000
Financial liabilities				
Due to members	197,847	197,824	225,919	225,826
Other deposits	11,164	11,164	13,682	13,682
Subordinated liabilities	14,200	14,200	14,200	14,200
Subscribed capital	5,000	950	5,000	1,103
Other liabilities	2,194	2,194	2,133	2,133
	230,405	226,332	260,934	256,944

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	**2019 Carrying value £000**	**2019 Fair value £000**	**2018 Carrying value £000**	**2018 Fair value £000**
Financial assets				
Cash and balances with the Bank of England	34,831	34,831	33,123	33,123
Loans and advances to credit institutions	11,938	11,938	14,897	14,897
Loans and advances to customers	192,227	184,267	214,994	206,110
Other assets	204	204	1,089	1,089
	239,200	231,240	264,103	255,219
	£000	**£000**	**£000**	**£000**
Financial liabilities				
Due to members	197,847	197,824	225,919	225,826
Other deposits	11,164	11,164	13,682	13,682
Subordinated liabilities	14,200	14,200	14,200	14,200
Subscribed capital	5,000	950	5,000	1,103
Other liabilities	2,170	2,170	1,925	1,925
	230,381	226,308	260,726	256,736

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	**2019 Level 1 £000**	**2019 Level 2 £000**	**2019 Total £000**
Financial assets			
Derivative financial instruments	-	1,660	1,660
	-	1,660	1,660
Investment properties (Note 16)	-	155	155
Financial liabilities			
Derivative financial instruments	-	27	27
	-	27	27

Group	**2018 Level 1 £000**	**2018 Level 2 £000**	**2018 Total £000**
Financial assets			
Derivative financial instruments	-	30	30
	-	30	30
Investment properties (Note 16)	-	428	428
Financial liabilities			
Derivative financial instruments	-	331	331
	-	331	331

(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 preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. Management also needs to exercise judgment in applying the Group's accounting policies.

This note provides an overview of the areas that involve a higher degree of judgment or complexity, and major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment within the next financial year. Detailed information about each of these estimates and judgments is included in the related notes together with information about the basis of calculation for each affected line item in the financial statements.

(i) Measurement of the expected credit loss allowance (IFRS 9)

The measurement of the expected credit loss allowance for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed on page 35, which also sets out key sensitivities of the ECL to changes in these elements.

A number of significant judgments are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing groups of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgments and estimates made by the Group in the above areas is set out in Note 1b.

1. **Accounting policies and financial risk management**

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

Credit risk exposure

Information regarding the Group's credit risk exposures at 31 December 2019 and 31 December 2018, including corresponding expected credit losses and coverage ratios, can be found in the tables below.

At 31 December 2019	Stage 1	Stage 2	Stage 3	Purchased credit-impaired	Total
Gross exposure (£000)					
Fully secured on residential property	100,163	19,468	21,157	12,056	152,844
Fully secured on land	22	9,999	9,810	-	19,831
Other loans	233	-	146	-	379
Total	**100,418**	**29,467**	**31,113**	**12,056**	**173,054**
Expected credit loss (£000)					
Fully secured on residential property	78	109	2,115	9,108	11,410
Fully secured on land	-	53	2,848	-	2,901
Other loans	-	-	32	-	32
Total	**78**	**162**	**4,995**	**9,108**	**14,343**
Coverage ratio (%)					
Fully secured on residential property	0.1%	0.6%	10.0%	75.5%	7.5%
Fully secured on land	0.0%	0.5%	29.0%	0.0%	14.6%
Other loans	0.0%	0.0%	21.9%	0.0%	8.4%
Total	**0.1%**	**0.5%**	**16.1%**	**75.5%**	**8.3%**

At 31 December 2018	Stage 1	Stage 2	Stage 3	Purchased credit-impaired	Total
Gross exposure (£000)					
Fully secured on residential property	116,951	20,618	21,398	12,562	171,529
Fully secured on land	29	11,259	10,496	-	21,784
Other loans	272	2	503	-	777
Total	**117,252**	**31,879**	**32,397**	**12,562**	**194,090**
Expected credit loss (£000)					
Fully secured on residential property	67	74	2,063	9,109	11,313
Fully secured on land	-	108	3,470	-	3,578
Other loans	-	-	12	-	12
Total	**67**	**182**	**5,545**	**9,109**	**14,903**
Coverage ratio (%)					
Fully secured on residential property	0.1%	0.4%	9.6%	72.5%	6.6%
Fully secured on land	0.0%	1.0%	33.1%	0.0%	16.4%
Other loans	0.0%	0.0%	2.4%	0.0%	1.5%
Total	**0.1%**	**0.6%**	**17.1%**	**72.5%**	**7.7%**

1. Accounting policies and financial risk management

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

Collateral and other credit enhancements

The Group's policies regarding collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

A portion of the Group's financial assets originated by the mortgage business has sufficiently low 'loan to value' (LTV) ratios, which results in no loss allowance being recognised in accordance with the Group's expected credit loss model. The carrying amount of such financial assets is £41.2m as at 31 December 2019 (2018: £95.8m).

The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses.

Individually assessed financial assets that are credit-impaired (this excludes purchased-credit impaired assets) and related collateral held in order to mitigate potential losses are shown below:

	Gross Exposure	Impairment Allowance	Carrying amount	FV of collateral held *
	£000	£000	£000	£000
Fully secured on residential property	8,063	1,987	6,076	6,889
Fully secured on land	7,558	2,846	4,712	4,615
Other loans	29	28	1	-
Total	15,650	4,861	10,789	11,504

* Latest valuation of collateral used in impairment calculations

The following table shows the distribution of LTV ratios for the Group's credit-impaired individually assessed portfolio:

LTV distribution	Credit Impaired (gross carrying amount) £000
Lower than 50%	279
50 to 60%	-
60 to 70%	81
70 to 80%	882
80 to 90%	705
90 to 100%	779
Higher than 100%	12,924
Total	15,650

Loss Allowance

The loss allowance in the period is impacted by a variety of factors, as described below:

- Transfers between stages due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit impaired in the period, and the consequent "step up" (or "step down") between 12 month and Lifetime ECL
- Releases for instruments derecognised during the period
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models
- Impacts on the measurement of ECL due to changes made to models and assumptions
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis
- Financial assets derecognised during the period and write offs of allowances related to assets that were written off during the period.

The following tables explains the changes in the loss allowance during 2019 and 2018 due to these factors:

1. Accounting policies and financial risk management

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

	Stage 1	Stage 2	Stage 3		
	12-month ECL	Lifetime ECL	Lifetime ECL	Purchased credit-impaired	Total
Loss allowance as at 31 December 2018	**67**	**183**	**5,544**	**9,109**	**14,903**
Movements with P&L Impact					
Transfers (deterioration in credit):					
Transfers from Stage 1 to Stage 2	(2)	5	-	-	3
Transfers from Stage 1 to Stage 3	-	-	69	-	69
Transfers from Stage 2 to Stage 3	-	(4)	52	-	48
Transfers (cure):					
Transfers from Stage 2 to Stage 1	2	(6)	-	-	(4)
Transfers from Stage 3 to Stage 2	-	3	(47)	-	(44)
Transfers from Stage 3 to Stage 1	-	-	(12)	-	(12)
ECL release due to redemption	(3)	(4)	(27)	(261)	(295)
Other movements	14	(15)	260	260	519
Total net P&L charge during the period	**11**	**(21)**	**295**	**(1)**	**284**
Movements with no P&L Impact					
Write-offs	-	-	(844)	-	(844)
Loss allowance as at 31 December 2019	**78**	**162**	**4,995**	**9,108**	**14,343**

	Stage 1	Stage 2	Stage 3		
	12-month ECL	Lifetime ECL	Lifetime ECL	Purchased credit-impaired	Total
Loss allowance as at 1 January 2018	**89**	**284**	**5,999**	**9,692**	**16,064**
Movements with P&L Impact					
Transfers (deterioration in credit):					
Transfers from Stage 1 to Stage 2	(3)	6	-	-	3
Transfers from Stage 1 to Stage 3	(5)	-	42	-	37
Transfers from Stage 2 to Stage 3	-	(104)	164	-	60
Transfers (cure):					
Transfers from Stage 2 to Stage 1	2	(8)	-	-	(6)
Transfers from Stage 3 to Stage 2	-	1	(44)	-	(43)
Transfers from Stage 3 to Stage 1	-	-	(9)	-	(9)
ECL release due to redemption	(17)	(4)	(25)	(271)	(317)
Other movements	1	8	622	(312)	319
Total net P&L charge during the period	**(22)**	**(101)**	**750**	**(583)**	**44**
Movements with no P&L Impact					
Write-offs	-	-	(1,205)	-	(1,205)
Loss allowance as at 31 December 2018	**67**	**183**	**5,544**	**9,109**	**14,903**

In the tables above, other movements are driven by changes to any of the modelling inputs other than stage, such as collateral revaluations, or different repayments to those forecast.

1. Accounting policies and financial risk management

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

(ii) Insurance risk

The Society's lifetime mortgages total £47.0m gross (2018: £48.7m 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 forecast 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 2.45% (2018: 2.42%) 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 £9.4m to £10.0m; an increase in HPI of 0.5% per annum would see the provision reduce to £8.7m. 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 £0.5m. Pre-payment rates refer to earlier than expected repayments and are estimated to be 5.5% (2018: 6.0%), based on experience to date. A 0.5% decrease in the pre-payment rate would see the insurance risk provision increase from £9.4m to £9.9m whilst a 0.5% increase in pre-payment would result in a reduction in the insurance risk provision from £9.4m to £9.0m.

(iii) Inter-company loan impairment

The Society sold its investment in MBS (Property) Limited during 2019, resulting in the repayment of the inter-company loan in full.

The Group held a beneficial interest in a portfolio of mortgage assets, NMB MAC, some of which are regulated by the MCOB. During 2018, the legal ownership of the NMB MAC loans was formally transferred to the Group. These assets are held in MBS (Mortgages) Limited. Remediation of a number of these accounts following periods of non-compliance is detailed in Note 30. Also a reassessment of the recoverability of these assets was performed in 2017. This indicated impairment to the ability of the subsidiary to repay the Society's investment in it and therefore an impairment provision of £1.5m was made in the Society's separate financial statements in 2017, which reduced the net investment in the subsidiary at that time. The Group's continued customer contact strategy has resulted in improved inflows during 2018 and 2019, which has resulted in no further impairment of the Society's loan in 2018 or 2019.

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 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Interest Receivable				
On loans fully secured on residential property	5,615	6,256	5,363	5,956
On other loans	779	837	779	837
On other liquid assets	354	305	354	304
	6,748	7,398	6,496	7,097
Other Similar Income				
On loans fully secured on residential property	3,251	3,430	3,251	3,430
	3,251	3,430	3,251	3,430

'Other similar income' reflects income generated from the Group's portfolio of Spanish lifetime mortgage loans, which are categorised as insurance contracts. Under IFRS 4 the Group has continued to account for these mortgage contracts using its existing accounting policies and, following the implementation of IFRS 9 in 2018, this income has been recorded as 'other similar income'.

Other than £3.3m (2018: £3.4m) generated on loans originating in Spain and Portugal, all interest receivable and other similar income has been generated within the United Kingdom.

3. Interest payable and similar charges

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
On amounts due to members	2,276	2,183	2,276	2,183
On deposits and other borrowings				
Subordinated liabilities	601	585	601	585
Lease liabilities (Note 26)	10	-	10	-
Other	78	101	78	101
	2,965	2,869	2,965	2,869

4. Other operating income and charges

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Income				
Rents receivable	(62)	225	10	23
Interest from subsidiaries	-	-	156	288
Other income from subsidiaries	-	-	120	120
Exchange gains and losses	(1,681)	805	(1,683)	792
Judgment awarded in court case		336	-	336
Fair value gains and losses on derivatives	1,653	(388)	1,792	(375)
	(90)	978	395	1,184
Charges				
Rents payable	(46)	(19)	(135)	(162)
Other	(31)	(5)	(31)	(5)
	(77)	(24)	(166)	(167)

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.

Prior to its sale in August 2019, rent payable by the Society under operating leases was payable to the Society's subsidiary MBS (Property) Limited. All other rent payable by the Society and Group under operating leases is payable to third parties.

Rent receivable includes a reversal of £214k in respect of previous rental income accrued which will now not be received following the sale of MBS (Property) Limited in the year.

The Society was awarded £319k plus interest of £17k on 2 May 2018 in relation to the legal case against Grant Thornton UK LLP.

5. Administrative expenses

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Employee costs (including Executive Directors)				
Wages & salaries	1,710	1,923	1,710	1,923
Social security costs	173	195	173	195
Pension costs	174	193	174	193
	2,057	2,311	2,057	2,311
Other administrative expenses	2,553	7,644	2,479	7,460
	4,610	9,955	4,536	9,771

The decrease in administrative expenses reflects a reduction of £4.6m in legal costs associated with the claim against Grant Thornton, including interest.

Other administrative expenses include:

Remuneration of the auditors (Inclusive of Value Added Tax)

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Fees payable to the auditors for audit of the annual accounts				
Current year	355	453	355	453
Fees payable to the auditors for other services				
Audit of the accounts of subsidiaries	5	10	-	-
	360	463	355	453

6. Employees

The average number of persons employed during the year was:

	Group 2019 Number	Group 2018 Number	Society 2019 Number	Society 2018 Number
Full-time	33	35	33	35
Part-time	13	13	13	13
	46	48	46	48

7. Directors' emoluments

Executive directors

	Salary £000	Pension Contributions £000	Bonus £000	Benefits £000	Total £000
2019					
P.A. Lynch	170	21	-	11	202
M.A. Winterbottom	109	13	-	-	122
	279	34	-	11	324
2018					
P.A. Lynch	163	20	-	11	194
M.A. Winterbottom (appointed 1 July 2018)	50	6	-	-	56
	213	26	-	11	250

Non-executive directors

	Fees 2019 £000	Fees 2018 £000
H.F. Baines	40	40
I.A. Dewar	35	35
D.A. Harding	80	80
J. Lincoln (appointed 1 July 2018)	35	18
F.B. Smith	35	33
	225	206

Total directors' emoluments

	2019 £000	2018 £000
Executive directors	324	250
Non-executive directors	225	206
Total directors' emoluments	549	456

Further details regarding Key Management Personnel may be found in Note 27.

8. Tax expense

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Profit/ (loss) for the year before tax	592	(937)	242	(2,862)
Tax rate	19.00%	19.00%	19.00%	19.00%
Expected tax expense/ (credit)	112	(178)	46	(544)
Adjustment for non-deductible items	16	14	4	73
Income not taxable	(121)	(200)	-	-
Deferred tax movement closing rate/average rate difference	(5)	50	(5)	50
Current year losses for which no deferred tax asset recognised	153	586	110	586
Profits of year covered by brought forward losses in respect of which no deferred tax asset recognised	-	(105)	-	-
Decrease in deferred tax asset recognised	(155)	(167)	(155)	(165)
Actual tax expense	-	-	-	-
Comprising				
Deferred tax origination and reversal of timing difference	-	-	-	-
	-	-	-	-

9. Loans and advances to credit institutions

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Accrued interest	3	11	3	11
Repayable on demand	11,936	14,938	11,935	14,886
	11,939	14,949	11,938	14,897

10. Investment securities

The movement in investment securities is summarised as follows:

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
At 1 January	-	39	-	39
Fair value adjustment	-	1	-	1
Disposals	-	(40)	-	(40)
At 31 December	-	-	-	-

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 2019			
Exchange rate swaps	39,843	1,660	27
	39,843	1,660	27
Derivatives have remaining maturities as follows:			
Up to three months	14,025	513	-
Three to six months	18,062	1,010	1
Six to twelve months	7,756	137	26
	39,843	1,660	27
Derivatives held at 31 December 2018			
Exchange rate swaps	42,457	30	331
	42,457	30	331

12. Loans and advances to customers

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Loans fully secured on residential property	179,103	200,769	174,950	196,023
Loans fully secured on land	16,930	18,206	16,930	18,206
Other loans	347	765	347	765
	196,380	219,740	192,227	214,994

At 31 December 2019 the Group had €57.2m (2018: €56.5m) of loans denominated in Euros. These were converted into Sterling at a rate of €1.1765 to the pound (2018: €1.1176).

Maturity analysis

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

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Repayable on demand	8,566	10,317	8,543	10,292
Other loans and advances secured by residual maturity repayable:				
In not more than three months	1,238	1,364	1,113	1,227
In more than three months but not more than one year	7,344	5,829	6,887	5,338
In more than one year but not more than five years	53,122	53,499	50,532	50,263
In more than five years	149,803	171,820	140,420	162,531
	220,073	242,829	207,495	229,651
Less: impairment provisions	(23,693)	(23,089)	(15,268)	(14,657)
	196,380	219,740	192,227	214,994

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.

GROUP		Balance at 31 December 2018 £000	Charge for the year £000	Utilised during the year £000	Balance at 31 December 2019 £000
Loans fully secured on residential property	Expected Credit Loss Risk	11,313	98	(1)	11,410
	Collective Insurance Risk	8,186	1,814	(650)	9,350
Loans fully secured on land	Expected Credit Loss Risk	3,578	166	(843)	2,901
Other Loans	Expected Credit Loss Risk	12	20	-	32
Total		**23,089**	**2,098**	**(1,494)**	**23,693**

SOCIETY		Balance at 31 December 2018 £000	Charge for the year £000	Utilised during the year £000	Balance at 31 December 2019 £000
Loans fully secured on residential property	Expected Credit Loss Risk	2,882	105	(1)	2,986
	Collective Insurance Risk	8,186	1,814	(650)	9,350
Loans fully secured on land	Expected Credit Loss Risk	3,577	165	(842)	2,900
Other Loans	Expected Credit Loss Risk	12	20	-	32
Total		**14,657**	**2,104**	**(1,493)**	**15,268**

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

13. Impairment losses/ (gains)

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Expected credit losses				
Impairment losses on loans and advances to customers on residential property and land	284	44	290	545
Amounts recovered on loans and advances to customers on residential property and land, written off in prior periods	(12)	(43)	(12)	(43)
Impairment on loan to subsidiaries:				
- MBS(Property) Limited	-	-	(10)	378
Total expected credit losses	272	1	268	880
Other impairment losses				
Impairment on loan to subsidiaries:				
- MBS (Mortgages) Limited	-	-	-	-
Impairment losses on loans and advances to customers on lifetime mortgages	1,814	760	1,814	760
Total other impairment losses	1,814	760	1,814	760
Reversal of previous impairment on Property, Plant and Equipment	(640)	(1,074)	-	-
Total impairment losses/ (gains)	1,446	(313)	2,082	1,640

The Group's head office, owned by the Society's subsidiary MBS (Property) Limited, was impaired in the 2015 financial statements. Following a revaluation of the head office when MBS (Property) Limited was sold in August 2019, £0.6m of this impairment was released (2018: £1.1m release).

The recoverability of the Society's investment in MBS (Mortgages) Limited was reassessed in 2019, and no impairment provision (2018: nil) 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.

In addition to the impairment losses recorded in the 2018 statement of comprehensive income, the opening balance sheet as at 1 January 2018 includes a reduction in equity of £299k for additional provision requirement following the implementation of IFRS 9.

14. Investments

Subsidiary undertakings	Shares £000	Loans £000	Total £000
At 1 January 2019	2	8,117	8,119
Impairment	-	-	-
Net (receipts) advances	(1)	(7,774)	(7,775)
At 31 December 2019	1	343	344

The Society's investment in MBS (Property) Limited was sold in August 2019, with no further impairment recognised. The Society's investment in MBS (Mortgages) Limited has been tested for impairment under IFRS 9, with expected credit losses assessed. The loan to MBS (Mortgages) Limited is assessed as being a Stage 3 loan (credit impaired and therefore in default).

No further impairment was made to the Society's investment in MBS (Mortgages) Limited in the year (2018: nil), despite being a Stage 3 asset, due to the continued improved repayment performance of the underlying NMB MAC loan book.

14. Investments (continued)

The Group held a beneficial interest in a portfolio of mortgage assets, NMB MAC, some of which are regulated by the MCOB. During 2018, the legal ownership of the NMB MAC loans was formally transferred to the Group. These assets are held in MBS (Mortgages) Limited. Remediation of a number of these accounts following periods of non-compliance is detailed in Note 30. Also a reassessment of the recoverability of these assets was performed (as detailed in Note 1c (iv)). This has indicated no impairment to the ability of the subsidiary to repay the Society's investment in it and therefore an impairment provision of £nil has been made in the Society's separate financial statements, requiring no reduction in the net investment in the subsidiary (2018: £nil impairment).

The directors consider that the carrying value of the investment in the subsidiary is supported by its 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 (Mortgages) Limited is wholly owned and wholly funded by the Society, the registered addresses are the same as that for the Society. The Society's ability to recover its investment in this subsidiaries is based upon the cash flows that this subsidiary can generate.

15. Property, plant and equipment

Group	Land and buildings £000	Right-of-use assets £000	Alterations fixtures and equipment £000	Total £000
Cost				
At 1 January 2019	8,496	-	1,557	10,053
Additions	-	397	-	397
Disposals	(8,496)	-	(809)	(9,305)
At 31 December 2019	-	397	748	1,145
Accumulated depreciation				
At 1 January 2019	2,044	-	1,054	3,098
Charge for the year	53	30	136	219
Reversal of previous impairment	(640)	-	-	(640)
Eliminated on disposal	(1,457)	-	(550)	(2,007)
At 31 December 2019	-	30	640	670
Carrying amount				
At 31 December 2019	-	367	108	475
At 31 December 2018	6,452	-	503	6,955

The Group's land and building, being its head office, was owned by MBS (Property) Limited. The head office property was disposed of by the Group as part of the sale of MBS (Property) Limited in August 2019.

15. Property, plant and equipment (continued)

Society	Right-of-use assets £000	Alterations fixtures and equipment £000	Total £000
Cost			
At 1 January 2019	-	949	949
Additions	397	-	397
Disposals	-	(200)	(200)
At 31 December 2019	397	749	1,146
Accumulated depreciation			
At 1 January 2019	-	694	694
Charge for the year	30	121	151
Eliminated on disposal	-	(174)	(174)
At 31 December 2019	30	641	671
Carrying amount			
At 31 December 2019	367	108	475
At 31 December 2018	-	255	255

16. Investment property - Group and Society

The movement on Investment property is as follows:

	Residential property 2019 £000	Residential property 2018 £000
Fair value		
At 1 January	428	691
Disposal	(270)	(243)
Decrease in fair value	(3)	(20)
At 31 December	155	428

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 during 2017. Three properties were sold in 2019 (2018: two sold). 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 an effective tax rate of 17.0%. The movement on the deferred tax account is as follows:

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
At 1 January	-	-	-	-
Statement of comprehensive income	-	-	-	-
Statement of changes in equity	-	-	-	-
At 31 December	-	-	-	-

Deferred tax assets are attributable to the following items:

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Other provisions	-	-	-	-
Accelerated tax depreciation	-	(16)	-	(13)
Tax losses	-	3	-	-
Deferred tax asset on timing differences on derivative contracts	-	13	-	13
	-	-	-	-

The movement in the deferred tax account is shown below:

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Other provisions	-	-	-	-
Tax losses	(3)	2	-	-
Accelerated tax depreciation	16	23	13	25
Deferred tax movement on timing differences on derivative contracts	(13)	(25)	(13)	(25)
Deferred tax expense in statement of comprehensive income	-	-	-	-
Deferred tax credit in statement of changes in equity	-	-	-	-
	-	-	-	-

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.

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 2019 for the Group, these were:

- £1,465k arising from timing differences on derivative contracts (2018: £1,627k) and
- £5,203k arising from losses (2018: £5,497k)

At 31 December 2019 for the Society, these were:

- £1,465k arising from timing differences on derivative contracts (2018: £1,627k) and
- £3,799k arising from losses (2018: £3,684k).

18. Other assets

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Amounts due within one year				
Credit support annex	851	1,071	851	1,071
Prepayments	303	688	303	473
Other assets	514	401	514	329
	1,668	2,160	1,668	1,873

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 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Held by individuals	197,847	225,919	197,847	225,919
Shares are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	217	250	217	250
Repayable on demand	71,151	81,609	71,151	81,609
Other shares by residual maturity repayable:				
In not more than three months	91,239	98,844	91,239	98,844
In more than three months but not more than one year	35,240	45,216	35,240	45,216
In more than one year but not more than five years	-	-	-	-
	197,847	225,919	197,847	225,919

20. Other deposits

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Amounts owed to other deposit customers are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	39	49	39	49
Repayable on demand	7,183	8,336	7,183	8,336
Other amounts owed to other deposit customers by residual maturity repayable:				
In not more than three months	3,942	5,297	3,942	5,297
	11,164	13,682	11,164	13,682

21. Subordinated liabilities

	Group and Society 2019 £000	Group and Society 2018 £000
Subordinated loans		
Loan repayable 2022 (variable rate of interest of 3 months LIBOR plus 1.75%)	5,000	5,000
Loan repayable 2023 (variable rate of interest of 3 months LIBOR plus 2.45%)	4,200	4,200
Loan repayable 2032 (fixed rate of interest 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 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Amounts falling due within one year:				
Taxation and social security	76	92	76	80
Creditors	143	188	143	117
Credit support annex	1,231	-	1,231	-
Lease liabilities (Note 26)	347	-	347	-
Interest accrued on subordinated liabilites	125	126	125	126
Accruals	348	1,819	324	1,682
	2,270	2,225	2,246	2,005

The credit support annex balances represent the sums deposited with the Society by its derivative counterparties to collateralise the derivatives issued. The deposits received by the Society are included within Liquid Assets.

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 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £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 any interest is booked to the Statement of Comprehensive Income.

Classified as equity:	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £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, under CRD IV article 141, in order to conserve capital, the Society may remain prohibited from making the PIBS coupon payments due in April 2020. 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 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £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	34,831	33,123	34,831	33,123
Loans and advances to credit institutions	11,936	14,938	11,935	14,886
	46,767	48,061	46,766	48,009

The above balances exclude accrued interest of £3k (2018: £11k) which is shown in Note 9.

25. Profit Participating Deferred Shares

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £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)	(3,751)	(3,470)		
Share of profit/ (loss) for the year	178	(281)		
PPDS Reserve Account at 31 December (memo)	(3,573)	(3,751)		

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. Leases

The Society leases the office space on the fifth floor of 125 Portland Street, Manchester, which is used as the Group's head office.

Prior to the sale of its subsidiary MBS (Property) Limited in August 2019, the Society leased both the fourth and fifth floors of 125 Portland Street from MBS (Property) Limited. There was no formal documentation governing this arrangement with either party able to end the arrangement at short notice. As there was no commitment in excess of 12 months, the rental agreements for the fourth and fifth floors prior to the sale of MBS (Property) Limited have been viewed as short-term leases for the purposes of IFRS 16 - *Lease Accounting* and the Society has elected to recognise the lease payments associated with those leases as an expense on a straight-line basis.

Following the disposal of MBS (Property) Limited, the Society entered into a formal lease agreement as tenant for the fifth floor of 125 Portland Street, covering a five year period with an option to break the lease after three years. As the lease term exceeds 12 months, the Society and Group are required to account for the lease under IFRS 16. The contractual five year lease term is used as the basis of the initial accounting for the lease under IFRS 16.

26. Leases (continued)

The Society has recognised a lease liability for the fifth floor lease arrangement, which was initially measured as the present value of the total lease payments due over the lease term, discounted using the rate implicit in the lease. This liability is included on the Statement of Financial Position within other liabilities (Note 22). This liability incurs interest expenditure at the rate implicit in the lease, which is recognised in the Statement of Comprehensive Income as part of interest payable and similar charges (Note 3). Lease payments by the Society reduce the amount of this liability.

Lease Liability Maturity Analysis	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Not later than 1 year	69	-	69	-
Later than 1 year and not later than 5 years	278	-	278	-
Later than 5 years	-	-	-	-
Total lease liability (Note 22)	347	-	347	-

The Society has recognised a right-of-use asset for the lease, which is included on the Statement of Financial Position within property, plant and equipment (Note 15), with depreciation charged through the Statement of Comprehensive Income (Note 15). This asset was initially measured as the present value of future lease payments due over the lease term plus initial direct costs incurred by the Society in relation to the lease set up. The rate implicit in the lease has been used to derive the initial present value of the right-of-use asset. Depreciation is charged on a straight-line basis over the five year period covered by the lease agreement.

The following amounts have been recognised within the Statements of Comprehensive Income in relation to leases:

	Group 2019 £000	Group 2018 £000	Society 2019 £000	Society 2018 £000
Rents Receivable (Note 4)	(62)	225	10	23
Depreciation expense on right-of-use assets (Note 15)	30	-	30	-
Interest expense on lease liabilities (Note 3)	10	-	10	-
Expense relating to short-term leases	19	19	108	162
	(3)	244	158	185

27. Related party transactions

Key Management Personnel. The directors, the Compliance Manager, and the HR manager 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 (2018: nil). None of the directors, or their close family members held any of the Society's PIBS (2018: nil).

The total remuneration of Key Management Personnel was as follows:

	Group 2019 £000	Group 2018 £000
Executive directors (Note 7)	324	250
Non-executive directors (Note 7)	225	206
Key Management Personnel	71	88
	620	544

27. Related Party Transactions (continued)

Transactions with other related parties.

The Society had the following transactions with other related parties:

	Group 2019 £000	Group 2018 £000
Purchases of interim executive services from entities controlled by Key Management Personnel	-	41

No balances are outstanding at 31 December in relation to transactions with other related parties.

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.

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

(i) Current loan accounts - unsecured	Society 2019 £000	Society 2018 £000
As at 1 January	8,117	9,500
Loans issued during the year	744	1,221
Loan repayments during the year	(8,518)	(2,226)
Impairment of subsidiary loans	-	(378)
At 31 December	343	8,117
(ii) Interest income charged to subsidiaries	158	288

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	28	86
(v) Subsidiary recharge to Society on rent for head office	89	143
(vi) Cash received from borrowers by connected undertakings NMB MAC - cash received and paid through to MBS (Mortgages) Limited	-	1,257

28. Financial commitments

(i) Capital commitments:

The Group has no capital commitments as at 31 December 2019 (2018: nil).

The Society leased its head office from its subsidiary, MBS (Property) Limited under a non-cancellable operating lease. Following the sale of of MBS (Property) Limited, the Society now leases its head office from a third party (Note 26).

Contingent liabilities are considered in Note 31.

29. 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 and MBS (Mortgages) Limited. Prior to its sale in August 2019 and, following approval from the PRA in 2016 for an amendment to the regulatory capital Group, MBS (Property) Limited was also included within the Group. Regulatory capital positions under CRD IV at 31 December 2019 and 31 December 2018 were as follows:

	Group 31 Dec 18	Movement in 2019	Group 31 Dec 19	Regulatory Movement effective from 1 Jan 2020	Group 1 Jan 20
Tier 1 Capital	£000	£000	£000	£000	£000
Accumulated (losses)/ profits	(10,974)	563	(10,411)	(45)	(10,456)
Profit Participating Deferred Shares	17,461	-	17,461	-	17,461
Total CET1 Capital	6,487	563	7,050	(45)	7,005
Permanent Interest Bearing Shares					
Nominal balance	14,788	-	14,788	-	14,788
Amortisation	(8,873)	(1,479)	(10,352)	(1,479)	(11,831)
Net Permanent Interest Bearing Shares	5,915	(1,479)	4,436	(1,479)	2,957
Total Tier 1 Capital	**12,402**	**(916)**	**11,486**	**(1,524)**	**9,962**
Tier 2 Capital					
Subordinated Debt					
Nominal balance	14,200	-	14,200	-	14,200
Amortisation	(5,584)	(2,405)	(7,989)	(500)	(8,489)
Net Subordinated Debt	8,616	(2,405)	6,211	(500)	5,711
Permanent Interest Bearing Shares	8,873	1,479	10,352	1,479	11,831
Total Tier 2 Capital	**17,489**	(926)	**16,563**	**979**	**17,542**
Total Regulatory Capital	**29,891**	**(1,842)**	**28,049**	**(545)**	**27,504**

Since the end of 2018 Total Regulatory Capital under CRD IV has decreased by £1.8m made up as follows:

- An increase to the retained profit of the regulatory capital group for the year of £0.6m which included a reduction to reserves in relation to the transitional arrangements of IFRS 9 – Financial Instruments which was adopted in 2018 as detailed below;
- a reduction of subordinated debt of £2.4m, consisting of:
    - the continued grandfathering of subordinated debt out of Tier 2 capital over a 9 year period, amounting to £0.5m in the year;
    - amortisation of subordinated debt over a 5 year period, amounting to £1.9m in the year.

Under the CRD IV rules applicable from 1 January 2020, Total Regulatory Capital is reduced by £0.5m compared to the position at 31 December 2019. This is due to Tier 2 Regulatory Capital being reduced by a further £0.5m in respect of continuing Subordinated debt grandfathering. In addition, the available IFRS 9 transitional arrangements, adopted by the Group in 2018, reduced Total Regulatory Capital by an additional £29k from 1 January 2019, and will reduce it by a further £45k from 1 January 2020. These IFRS 9 arrangements continue to be phased over a 5 year period with 15% of the 2018 adverse financial impact taken to CET 1 capital by 2019, increasing to 30% in 2020. The element taken to CET 1 capital will increase annually with 100% recognised by 2023.

As at 31 December 2019 the Group continues to have headroom above its total Pillar 1 plus Pillar 2A requirements 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. Following the Society's CET 1 capital temporarily falling below the required 4.5% of Risk Weighted Assets in 2018, a medium to long term strategic plan was produced which was independently reviewed and acknowledged by the PRA. This plan was updated in 2019 and the PRA agreed to monitor the Society against this revised plan. The PRA continue an open dialogue with the Society on future developments. 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. As at 31 December 2019, the requirement was met but a stress event or other significant loss could result in a future breach. This potential risk is monitored and under regular review in ongoing discussions with the PRA.

As a result of the shortfall against qualitative standards for the level of CET 1 capital requirement, under CRD IV article 141, in order to conserve capital, the Society may remain prohibited from making the PIBS coupon payments due in April 2020. The Board considers that there continues to be uncertainty over the Society's ability to make coupon payments thereafter. The Society last made a coupon payment in April 2016.

30. Provisions for liabilities and charges

2019	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 2019	11	25	2	38	11	2	2	15
Charge for the year	(11)	(7)	-	(18)	(11)	-	-	(11)
Provision utilised	-	-	(2)	(2)	-	-	(2)	(2)
At 31 December 2019	-	18	-	18	-	2	-	2

2018	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 2018	31	111	100	242	31	16	100	147
Charge for the year	(6)	(4)	(78)	(88)	(6)	(2)	(78)	(86)
Provision utilised	(14)	(82)	(20)	(116)	(14)	(12)	(20)	(46)
				-				
At 31 December 2018	11	25	2	38	11	2	2	15

(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 2019 and the provision at the end of the year include the expected management expenses levy for the FSCS scheme year 2019-20, offset by a small FSCS repayment to Deposit takers.

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 during 2017, the provision of £0.1m held at 31 December 2017 has been largely utilised. Attempts to contact some customers have, so far, been unsuccessful and a provision of £18k is retained at 31 December 2019 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 31.

(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 remediation exercise in relation to this provision completed during 2018.

31. 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.

In recent years the Group has undertaken a redress and remediation programme in relation to the NMB MAC and CLC portfolios. These have now been completed and all known issues have been remediated. There remains 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 regulations which have not been identified. No provisions against these risks are included in these financial statements.

The rulings in May 2018 and January 2019 on the legal case against Grant Thornton led to a liability to pay an element of Grant Thornton's legal fees in relation to the case. An interim payment was made during 2018, with outstanding costs settled by the Society during 2019.

(ii) Contingent assets:

If the Supreme Court appeal on the Grant Thornton case overturns the first instance judgment, the Society would expect to receive damages from Grant Thornton.

ANNUAL BUSINESS STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2019

1. Statutory limits

	2019 %	Statutory % limit
Lending limit	10.6	25.0
Funding limit	5.3	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:

	2019 %	2018 %
Gross capital	17.1	14.7
Free capital	16.9	11.8
Liquid assets	22.4	20.1
Leverage ratio	4.0	4.2

As a percentage of mean total assets:

	2019	2018
Profit/ (loss) after taxation	0.23	(0.32)
Group management expenses	1.84	3.50
Society management expenses	1.81	3.44

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 2019

Name	Date of birth	Date of appointment	Occupation	Other directorships
Directors				
H.F. Baines	12.3.1957	Aug 2013	Consultant	Halifax Pension Nominees Limited Harry Baines Consulting Limited HBOS Final Salary Trust Limited Lloyds Banking Group Pension Trustees Limited Lloyds Bank Pension Trust (No. 1) Limited Lloyds Bank Pension Trust (no. 2) Limited Lloyds Bank S.F. Nominees Limited Cadent Pension Trustees
I.A. Dewar	14.9.1957	Aug 2013	Chartered Accountant	Brewin Dolphin Limited Brewin Dolphin Holdings plc
D.A. Harding	29.7.1947	Apr 2013	Retired Company Director	
J. Lincoln	8.2.1957	Jul 2018	Retired Finance Director	Penrith Building Society Darlington Mind Limited
P.A. Lynch	31.8.1969	Apr 2002	Building Society Executive	MBS (Mortgages) Limited
F.B. Smith	3.1.1959	Jan 2015	General Counsel	
M.A. Winterbottom	19.9.1978	Jul 2018	Finance Director	MBS (Mortgages) Limited
Officers				
C. Blore			Financial Planning and Analysis Manager	
D. Callaghan			Treasurer and Financial Controller	
R. Mervill			Customer Care Manager	
J. Platt			Finance Department Manager	
A.C. Pradena			Savings Customer Services Manager	
V. Smith			Compliance Manager	
D. Spencer			Lending Manager	
M. Tang			IT and Operations Manager	
G.C. Worthington			HR Manager	

Executive Directors	Date of birth	Position	Date of signing service contract
P.A. Lynch	31.8.1969	Chief Executive	3.4.2002
M.A. Winterbottom	19.9.1978	Finance Director	5.9.2018

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

ANNUAL BUSINESS STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2019

Information relating to the directors and officers as at 31 December 2019 (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 2019 would be:

H.F. Baines	2 years and 8 months
I.A. Dewar	2 years and 8 months
D.A. Harding	2 years and 4 months
J. Lincoln	7 years and 6 months
F.B. Smith	4 years

Any documents may be served on the above named directors at the following address: Addleshaw Goddard, Milton Gate, 60 Chiswell Street, London EC1Y 4AG.

COUNTRY BY COUNTRY REPORTING

FOR THE YEAR ENDED 31 DECEMBER 2019

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 subsidiary:		
MBS (Mortgages) Limited	Mortgage lending	United Kingdom

All of the activities of the Society and its subsidiary 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.

Basis of preparation – country-by-country reporting

Note 1 to the 2019 Annual Report and Accounts details the basis of preparation relating to going concern and accounting policies.

For the year ended 31 December 2019:

Group turnover (total operating income) was £6.9m (2018: £8.9m), the profit before tax was £0.6m (2018: loss of £0.9m). 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 33 (2018: 35).

The Group and the Society paid no corporation tax for the year (2018: £nil) due to the reversal of temporary differences and availability of brought forward trading losses.

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

In 2019 the Society generated interest receivable and similar income of £3.3m (2018: £3.4m) 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

Opinion

In our opinion, Manchester Building Society's country-by-country information for the year ended 31 December 2019 has been properly prepared, in all material respects, in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

We have audited the country-by-country information for the year ended 31 December 2019 in the accompanying schedule.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the country-by-country information section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

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

Emphasis of matter - Basis of preparation

In forming our opinion on the country-by-country information, which is not modified, we draw attention to the basis of preparation note to the country-by-country information which describes the basis of preparation. The country-by-country information is prepared for the directors for the purpose of complying with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013. The country-by-country information has therefore been prepared in accordance with a special purpose framework and, as a result, the country-by-country information may not be suitable for another purpose.

Material uncertainty relating to going concern

In forming our opinion on the country-by-country information, which is not modified, we have considered the adequacy of the disclosure made in the basis of preparation note to the country-by-country information 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 following the ongoing legal case against its former external auditors, Grant Thornton LLP, and the subsequent development of a medium to long term strategic plan which sets out the orderly wind down of the business. These conditions 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 country-by-country information does not include the adjustments that would result if the Group and Society were unable to continue as a going concern.

Responsibilities for the country-by-country information and the audit

Responsibilities of the directors for the country-by-country information

The directors are responsible for the preparation of the country-by-country information in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013 as explained in the basis of preparation in the basis of preparation note to the country-by-country information and for determining that the basis of preparation and accounting policies are acceptable in the circumstances. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of country-by-country information that is free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the country-by-country information

It is our responsibility to report on whether the country-by-country information has been properly prepared in accordance with the relevant requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

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

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

Use of this report

This report, including the opinion, has been prepared for and only for the Society's directors in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
1 Hardman Square
Manchester
M3 3EB

4 March 2020

NOTES

125 Portland Street
Manchester M1 4QD
Tel 0161 923 8090
Web www.themanchester.co.uk