ANNUAL REPORT & ACCOUNTS

2013

Manchester
BUILDING SOCIETY

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CONTENTS

The Society's core business performance remained robust and in line with the Board's expectations, but the 2013 annual results reflect a number of adjustments and a significant increase in provisions.

In April 2013 the Society issued new capital in the form of Profit Participating Deferred Shares in order to improve the Group's regulatory capital position. Later in the year the Board carried out a comprehensive review of the Group's operations and management structure to determine how best to serve the interests of members in the continuing low interest rate environment, whilst also focusing on business risk reducing. The Board has taken actions to streamline operational teams, refresh the Board and focus on reducing business risk whilst maintaining the existing level of service provided to members.

Results for the current year are summarised below. The prior year result has been restated, in line with professional advice booking a provision for insurance risk associated with the Group's Lifetime mortgage assets, a re-classification of the 1999 PIBS from Equity to Liability, and the adoption of new accounting guidance regarding the treatment of levies. The combined impact of these was to reduce opening equity by £7.6 million.

The financial results for the year to 31 December 2013 are set out in detail later in this report but in essence the Group recorded total operating income of £13.5 million in the year compared with £3.0 million in 2012 (restated). After administrative expenses and depreciation, operating profit before impairment and provisions was £7.6 million compared with a restated loss of £1.9 million the previous year. The Group has also recognised an impairment charge of £8.7 million (2012: £0.9 million, restated). This impairment refers, in the main, to a mortgage book held by a third party but funded by the Society; and mortgage assets in Spain.

After impairment and the compulsory Financial Services Compensation Scheme levy, the Group recorded a loss before tax of £1.6 million (2012: loss £3.1 million, restated). After tax, the loss for the year is £7.1 million (2012: loss £3.3 million, restated) which includes a write down of £5.1 million of the Group's deferred tax asset, in line with IAS 12 - *Income Taxes*.

The Society scaled back its lending operations during 2013 with Group total assets reducing by £130.6 million. Internal restructuring actions delivered a reduction to the Group's underlying cost base. In addition, as a result of deciding to withdraw from certain types of lending, the Society's UK Lifetime mortgage book was sold for £68.4 million in December 2013 at a premium of £1.2 million. The result is a smaller Group with a high level of liquidity.

A process of refreshing the Board commenced in April 2013. David Cowie, Chief Executive retired and was replaced by Allan Hodges acting on a long-term interim basis. In June 2013 Susan Molloy resigned as a non-executive director following a prolonged period of ill health and at the close of the year Alec Finch, non-executive director and Chairman of the Audit Committee, retired after 7 years on the Board. After serving for nearly six years as a non-executive director, Bob Dyson has also indicated his wish to retire after the forthcoming AGM. I should like to thank them all for their service to the Society.

Three new non-executive directors have been appointed:

- Harry Baines joined the Board in August 2013 following an executive career as General Counsel to a number of major financial institutions, including Lloyds Banking Group plc.
- Ian Dewar also joined in August 2013, having retired in 2012 as a partner with KPMG. He brings valuable experience of Audit practices and Risk management.
- Fiona Smith joined the Board in January 2014. She also has wide experience as an in-house lawyer and currently occupies the role of General Counsel at the National Employment Savings Trust.

The low interest rate environment is, I know, of great concern to the saving members of the Society. Interest rates are at an unprecedentedly low level and seem likely to remain that way for some time to come. The Society has reduced the rates paid on savings in line with the trend in the market while trying to offer savers fair value. While borrowing members have, in general, benefited from lower interest rates, there are inevitably a small number of members who have moved into arrears. In these cases, with forbearance in mind, we have worked closely with these borrowers to seek a satisfactory solution to any payment problems.

The needs of our members and the service that we provide to them are key areas of focus for all members of staff, from the Board to the operational customer service teams. Our overriding aim is to provide a range of products that meet our members' needs and at all times to ensure that the service that we provide to them is second to none. This level of customer focus sees the Society's customer-facing staff aiming to deal with all member enquiries and queries at the first point of interaction – whether this be through our website, telephone contact teams, the branch or by post. The level of complaints and expressions of dis-satisfaction that we receive remain very low and we firmly believe that this is as a direct result of the level of member service that we provide.

I should like to thank all members of staff for their contribution during the year.

D.A. Harding
Chairman
3 May 2014

DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2013

Introduction
The directors are pleased to present their 91st Annual Report together with the Accounts and Annual Business Statement for the Group for the year ended 31 December 2013.

Strategic Report
The Group consists of the Society and its two wholly owned subsidiaries: MBS (Mortgages) Limited and MBS (Property) Limited. 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. Offering a safe home for individual and corporate deposits and making mortgage funding available on a cautious, controlled and appropriately remunerated basis allow for a suitable net interest margin to be reported, which in turn funds the increase in reserves. Careful management of the Group's regulatory capital allows the Society to support its mortgage book and to accommodate unforeseen mortgage losses. With this latter point in mind, in order to enhance its regulatory capital position and ratios, the Board actively manages the Group's assets so that they attract lower regulatory capital risk weightings. The Group's strategy was reviewed during 2013 in order to reduce risk and improve regulatory capital by a combination of:

- Overall shrinkage of the total mortgage book
- Re-profiling of the Group's mortgage assets
- Management of its interest rate risk
- A low risk approach to lending activity
- Active management of net interest margins
- Focus on overhead management

Business Model
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.

Emphasis in achieving these principal business objectives is placed on offering a secure home for retail depositors' savings and on high standards of customer services to support the Group's range of products.

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

- Capital
- Liquid assets
- Customer balances
- Mortgages and other loans
- Management expenses
- Profit

The KPIs are considered in more detail on pages 6 & 7, with indications as to why each metric is considered to be of importance in assessing financial performance. Additional commentary on the Group's performance is contained within the Chairman's Statement on page 4.

Restatements
PricewaterhouseCoopers LLP ("PwC") were appointed as the Group's external auditors during the year. A detailed review of accounting processes and policies has also been carried out. This review has highlighted two areas where a restatement of a previously adopted accounting treatment has been required relating to the Society's Permanent Interest Bearing Shares ("PIBS") and its Spanish Lifetime Mortgage assets. Additionally, the Group has chosen to adopt early the provisions of IFRIC 21, which impacts the recognition of the Financial Services Compensation Scheme ("FSCS") levy and which is also treated as a prior year adjustment.

The financial impact of the restatements may be found within note 2.

- **PIBS**

IAS 32 – Financial Instruments: Presentation

The Society issued two tranches of PIBS: one in 1999 and the other in 2005. The Board's ability to cancel interest on the 1999 PIBS is drafted in more narrow terms than those for the 2005 instruments. Regarding *IAS 32 – Financial Instruments: Presentation*, in relation to the 1999 PIBS, the Board does not have an unconditional right to cancel interest payments and accordingly these have been reclassified as a liability rather than as equity. The terms of the 2005 PIBS confer complete discretion on the Society's Board to cancel in part or in whole any interest payment due and accordingly the 2005 PIBS continue to be classified as equity. The impact of the restatement on the 2012 and earlier years' position is: subscribed capital within the liabilities heading increased by £5m, subscribed capital within the equity heading reduced by £5m, interest expense increased by £400k, the profit before tax decreased by £400k. There was a credit direct to the statements of changes in equity of £302k being the tax effected interest adjustment.

- **Lifetime Mortgages**

IFRS 4 – Insurance Contracts

At the year end, the Society has a portfolio of Spanish Lifetime Mortgage loans secured on borrowers' residential property. It was identified during the 2013 year end audit that a particular clause of the mortgage contract meets the definition of an insurance contract; where a borrower dies or goes into long term care and a subsequent redemption receipt is less than the outstanding loan balance, the Society does not have any further ability to recover amounts from the borrower or their estate. The recognition of an insurance liability based on this insurance risk results in a prior year adjustment. The impact of the restatement is: An increase in provisions of £4.2m at 2012 (2011: increase of £3.1m) and an impairment loss of £0.5m in 2012 and reduction in interest and similar income of £0.2m, reflecting an adjustment to profit before tax of £0.7m, and a reduction in income tax of £0.2m and a reduction to 2012 opening retained earnings of £3.1m.

- **FSCS Levy**

IFRIC 21 – Levies

IFRIC 21 – Levies clarifies the treatment of the levy charged by FSCS. The IFRIC indicates that the trigger for recognising a provision in respect of the FSCS levy moves from 31 December to the following 1 April. The impact of this is that, at the financial statement date, the Society would not have passed the trigger point for requiring accrual of the following year's levy and accordingly would only be required to hold an accrual for a single year levy where previously the equivalent of two years levy was held. Adoption of IFRIC 21 is mandatory for accounting periods beginning on or after 1 January 2014; early adoption is permitted and the Society has chosen to adopt early the provisions of IFRIC 21. The impact of the restatement was to reduce provisions for liabilities and charges by £375k for 2012 (2011: £177k) and to increase profit before tax by £375k.

Note 2 on page 28 provides further details of the financial impact of the restatements within the Balance Sheet and Income Statement

Review of the Business

Where 2012 figures are quoted within this report, they are restated figures, as per the above restatement.

The Group reported a loss before tax for the year of £1.6m (2012: loss £3.1m). This was after accommodating a number of large and exceptional items as follows:

	£000
Items that increased profit:	
Gain on disposal of UK Lifetime mortgage assets	1,183
Gain on sale of Icelandic banking debt	348
Items that decreased profit:	
Organisational restructuring costs	(827)
Provisioning impairment charge in the year	(8,706)

As mentioned in the Chairman's Statement, during 2013 the Board undertook a comprehensive review of the Group's operations and took a number of actions that had a direct financial impact on the results for the year. The timing of these actions and the impact that they had on profit before tax in 2013 was as follows:

- April 2013 - New capital issued - no impact on the Group's profit
- June 2013 - Organisational restructure - cost: £827k
- December 2013 - Sale of impaired Icelandic Banking debt - gain: £348k
  - Disposal of a mortgage book - gain £1,183k

• **New capital**. Subscribed capital in the form of £18m of Profit Participating Deferred Shares ("PPDS") was issued. These instruments, issued and subscribed at par, are classified as equity within the Financial Statements and included as Core Tier 1 capital for regulatory purposes. Their cost of issue was £539k and this has been deducted from the proceeds when arriving at their carrying value within the Financial Statements.

• **Organisational Restructure**. A review and restructuring of internal support teams was carried out. This streamlined the Society's operations, with a reduction in headcount of 22 occurring. The cost of the exercise was £827k, which covered contractual notice periods, redundancy payments and legal advice. The Board considers that the current staffing levels will support existing business levels.

• **Icelandic Banking Counterparties.** The Society sold its remaining Icelandic banking debt, recording a gain of £348k as a result.

• **Disposal of UK Lifetime Mortgage Assets.** Having already identified earlier in 2013 that the UK Lifetime mortgage market was not a core part of its future activities, divestment of this £68m book of equity release assets occurred at the end of the year with the disposal generating a gain of £1.2m for the Group. In addition the disposal reduced the risk profile of the balance sheet and the level of regulatory capital that the Society was required to hold. At 31 December 2013, the majority of the consideration received was held as liquid assets.

PROFITABILITY

• **Result for the year**: The Group reported a pre-tax loss for the year of £1.6m (2012: £3.1m loss).

• **Net Interest Income**: The Group's net interest income was:

	2013 £000	2012 £000
Interest receivable and similar income	27,354	28,214
Interest payable and similar charges	(12,947)	(17,421)
Net interest income	14,407	10,793

The level of interest earned on mortgages and loans (2013: £24.0m 2012: £25.4m) was lower in 2013 compared to 2012 due to lower mortgage balances and interest on investment securities was lower (2013: £1.1m; 2012: £2.0m) owing to a reduction in the level of securities held. Also included in interest receivable and other income in 2013 was the £1.2m gain (2012: nil) that was generated when the Society's UK lifetime mortgage book was disposed of at a value in excess of its carrying amount.

Interest paid to savings members reduced from £15.0m in 2012 to £10.2m in 2013; reflecting the combined impact of lower interest rates paid on a reducing savings book (2013: £502.6m of balances owed to members compared with £617.0m at 31 December 2012).

The range of savings and mortgage products was similar to those of previous years, which allows for ready year on year comparison of the net interest income result.

• **Other income and other charges**: As the Society's portfolio of interest rate swaps was not effective for IAS 39 hedge accounting purposes, the Board decided to exit from all of these derivatives. Exiting from this portfolio of swaps had a beneficial effect on the Group's other income as the level of loss on derivatives for the year reduced materially (2013: £0.3m; 2012: £8.3m). The net swap interest costs, being interest payments less interest receipts, reduced to £2.5m (2012: £4.5m). Also, at the point in time of exiting the swaps, their fair value, excluding interest, was £2.2m higher than that recorded at the previous financial statement date and accordingly, this £2.2m impacted favourably upon the Society and Group's other income during 2013. Another element of other income is the return that the Group earns on its investment securities; the income on these securities reduced during 2013 as a result of holding a lower level of investments (2013: £23.1m; 2012: £67.6m); the reduction in the level of investment securities arose through a combination of natural maturities and through managed disposal of selected instruments during Q2 2013, with the proceeds in all cases being retained in cash rather than being re-invested. The Group recorded a loss on these financial instruments of £1.13m (2012: £nil).

• **Administrative expenses**: In combination, the Group's administrative and depreciation expenses increased during the year from £4.9m to £5.9m. Of the £1.0m increase, £827k related to the organisational restructure referred to above. The cost savings that arose from the organisational restructure were offset in the year by the costs of the exercise itself, but it is expected that a reduction in the underlying level of administrative expenses will be seen in 2014 and onwards.

• **Impairment losses:** Impairment losses in 2013 were £8.7m (2012: £0.9m). All elements of the Group's mortgage and loan book were tested for impairment during the year and all impairment provisions were re-assessed. There were two particular parts of the book where provisions increased during the year, being: mortgage assets over which the Society holds a beneficial interest and Lifetime mortgage assets. In relation to the former, the Group has a beneficial interest in a mature portfolio of first and second charge mortgage assets which are consolidated in these accounts. This portfolio, which has a carrying value after impairment provisions, of £6.2m, includes both non-regulated residential mortgage assets and assets regulated under the Consumer Credit Act ("CCA"). Full legal title to these mortgages rests with a third party. The acquisition was made through a funding arrangement with a third party and the Group holds a debenture over both the third party business and the mortgage assets concerned. Administration of the mortgage book is undertaken by the same third party that owns the legal title of the assets. During the course of the year the Group identified instances where certain of the requirements of the CCA relating to post contract documentation had not been fully complied with by the mortgage administrator. An exercise was undertaken to estimate the future cashflows that could be generated from these mortgage assets and to discount these at the effective rate of interest; this resulted in an increase in impairment provisions of £6.7m (2012: £0.7m) which was booked in December 2013. As the Group benefits from all of the cashflows that this mortgage book generates, any refunds made by the mortgage administrator to customers where CCA compliance has fallen short, adversely affect the Group's recoverability. The Group has estimated that the administrator will need to make refunds to customers of the order of £273k and accordingly this sum has been booked in the Group's accounts, although it is noted that legal liability to repay such sums rests with the administrator and not the Group. Separately, in relation to the Society's Lifetime mortgage assets, having booked a prior year restatement to reflect a provision for the insurance risk associated with these assets, this provision increased during the year by £0.9m as a result of movements in Spanish house price inflation assumptions (2012: £1.2m).

FINANCIAL POSITION

• **Liquid Assets**: The Group's liquid assets are deposited with UK "high street" banking counterparties in either instantly accessible bank accounts, or in instruments that can be converted into cash in a very short period of time. Of the Society's total liquid funds at the year end, £95.7m was deposited with the Bank of England (2012: £50.4m). The increase was predominately due to £35m from the proceeds of the sale of lifetime mortgages in December 2013 being deposited with the Bank of England.

• **Mortgages and Other Loans:** Group mortgage balances, after provisions, were £454.0m (2012: £570.5m), representing a year on year decrease of 20.4% (2012: 6.5% reduction). Of this decrease, 11.9% is accounted for from the disposal of the Group's UK Lifetime Mortgage book in December 2013. Further, to help maintain its regulatory capital position, the Society was less active in terms of making new or further sums available to borrowing members, with advances to 70 new and 1 existing borrowers occurring during the year, to a total value of £10.1m (2012: £12.3m).

The Group has continued in its efforts to minimise mortgage arrears and to help borrowers in difficulties to resolve their situations, taking a consultative approach with borrowers who experience payment difficulties and applying forbearance as appropriate. At 31 December 2013 there were 18 mortgage accounts (2012: 25) where payments were 12 or more months in arrears. Outstanding balances on these accounts amounted to £6.0m (2012: £6.6m) with total arrears of £0.7m (2012: £0.7m), representing 1.3% of total mortgage balances (2012: 1.1%). These figures represent assets where the Group holds legal title.

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

• **Other Assets**: Included within Other Assets is a sum of £1.1m (2012: £42.3m) relating to collateral deposited in the form of cash under credit support annex agreements ("CSA") with the Group's counterparty providers of derivative contracts. As the Group exited from all of its interest rate derivative contracts in June 2013 the level of CSA balances reduced materially.

• **Retail Balances**: Retail balances reduced in proportion to 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 member protection as a regulated deposit taker. The Board manages capital within the regulatory limits set by the PRA, with Basel II regulatory capital positions being:

	31 Dec 2013 £000	31 Dec 2012 £000
Tier 1 Capital		
Retained earnings	(1,374)	5,611
PPDS	17,461	-
PIBS	14,788	14,788
Total Tier 1 Capital	30,875	20,399
Tier 2 Capital		
Subordinated debt	14,500	14,800
Collectively identified provisions	13,688	1,364
Total Tier 2 Capital	28,188	16,164
Total Regulatory Capital	59,063	36,563

Since the start of 2013, noteable movements in capital have arisen from:

	£000
Opening position at 1 January 2013 (as previously reported)	39,154
Reduction in reserves arising from restating 2012 and earlier years	(2,591)
Opening position at 1 January 2013 (restated)	36,563
Issuance of new PPDS	17,461
Movements in Tier 2 capital	12,024
Reduction in retained earnings arising from current year trading	(6,985)
Closing position at 31 December 2013	59,063

Concurrent with the approval of the 2012 financial statements, £18m of new capital was issued in April 2013 in the form of PPDS. These instruments, issued and subscribed at par, are classified as equity within the Financial Statements and included as Core Tier 1 capital for regulatory purposes. The figure disclosed is the proceeds received less the costs of issue.

The Board is focused on further actions to reduce risk and rebuild reserves, as demonstrated by the sale of the UK lifetime mortgage portfolio. The 31 December 2013 capital position reflects the actions taken by the Board, along with the impact of the accounting adjustments and impairments booked in these 2013 accounts.

As a result of the implementation of Basel III on 1 January 2014, the Society's regulatory capital at that time was assessed to be £42m.

The Group's gross capital improved from 4.9% at 31 December 2012 to 7.3% at 31 December 2013. The free capital at 31 December 2013 was 8.2% (2012: 4.6%). Definitions of gross capital and free capital may be found on page 45.

Financial Risk Management Objectives

The Group offers mortgage and savings products. It undertakes limited interaction with the wholesale money market for cashflow 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 and Operational Risk.

Principal Risks and Uncertainties

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

It is recognised that there is always a possibility of the non-repayment of sums due to the Group, which could arise from a variety of borrower or counterparty circumstances. In order to ensure that the Group does not expose itself to too great a level of risk, the Group's strategies, policies, procedures and Board approved risk appetites allow all of its directors and staff to focus on those areas that could expose the Group to wider loss.

The principal risks and uncertainties facing the Group are credit risk, liquidity risk, interest rate risk and currency risk. Certain aspects of the macro economic environment also influences the risks that the Society faces. The Board believes that the profile of risks that the Society will face in 2014 is similar to those experienced during 2013.

The principal risks that the Group faces are summarised below:

• **Credit Risk:** The Group is exposed to the risk that it may not receive back in full any sum that has been borrowed (in relation to loans and advances) or any sum that it has deposited with a 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. In relation to loans and advances, credit risk presents as more of a consideration than in relation to the Society'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 the risk is assessed as being very low. Credit risk is mitigated by appropriately underwriting all mortgage applications and by limiting the Group's exposure to particular market sectors or loans exhibiting particular attributes. Impairment provisions are made when it becomes evident that the Group is likely to incur losses. In addition to its first charge mortgage lending, the Group has an interest in a small portfolio of second charge mortgage assets; these are all mature and it has been assessed that the risk of non-repayment arising from there being insufficient equity in the properties to satisfy both the first and second charge holder is low. No impairment provision has been made specifically in relation to second charge assets. The Group holds a beneficial interest in a portfolio of mortgage assets, some of which are regulated by the Consumer Credit Act. The legal title of these loans remains with a third party business, to which the Group provided funding and over which it holds a debenture; due to this beneficial interest held, these assets are consolidated in the Group balance sheet. During the year the Group identified instances of non-compliance with the CCA which have led to legal advice being sought and an assessment being made of the impact of such on the loan book. This has been incorporated within the assessment of the estimate of discounted future cash flows expected to arise from these loans which forms the basis for the impairment provision. The requirements of the CCA in respect to these issues have not been subject to significant judicial consideration to date. The Group has considered its legal and regulatory position with respect to these matters and has obtained external legal advice to support the views taken. It is not clear what regulatory position the FCA will adopt and there is no judicial certainty in the legal position. The actual result could therefore differ materially from this estimate.

• **Insurance Risk:** In the context of lifetime mortgages, impairment assessments incorporate the insurance risk attaching to the contracts. 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 which, given the nature of the product is expected to be on the 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. 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 (see page 28 for further disclosure on insurance risk).

• **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 executive directors every week and considered by the Board each month. During 2013, the Group continued to have a significant proportion of its liquid assets deposited with the Bank of England. It should be noted that, by holding greater proportions of liquidity in Bank of England deposits, (for regulatory purposes) liquidity yields are lower.

• **Capital Risk:** The Group is required to hold sufficient capital by its regulator; regulatory capital includes retained earnings, PPDS, PIBS and subordinated debt. The level of capital that the Group is directed to hold by its regulator is driven by the nature of the Group's assets and the regulator's assessment of its risk profile. In order to ensure the Group continues to hold more capital than required, it is targeting the holding of assets that do not attract higher capital weightings and the return of post-tax profits to its general reserves. Shrinkage in the size of the mortgage book assists in this risk management process. This has been achieved by both organic reduction in the mortgage book and the sale of the UK lifetime mortgages. From 1 January 2014 the extent to which remunerated capital instruments may be included within regulatory capital is set to change, as a result of the implementation of Basel III. For the Group, the impact is that certain elements that are currently included within its regulatory capital, being PIBS and certain tranches of subordinated debt, will amortise over a 10 year period. The Society has assessed the impact of this future amortisation of instruments and it is satisfied that, based on current projections, it will continue to meet its regulatory requirements without the need to issue further capital instruments. The Group is continuing to assess the impact that Basel III will have on its business.

• **Interest Rate Risk:** The Group's mortgage and savings products have different interest rate types and different maturities. 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 Society holds. The Society has more fixed rate mortgage products (notably its Lifetime mortgages) than it has fixed rate savings products. The interest rate risk had been offset through the purchase of interest rate swaps. At the previous financial statement date, it had been identified that these swaps were not effective for hedge accounting purposes under IAS 39. The result of this was that the fair value movement on the interest rate swaps was recorded through profit or loss. The fair value of the interest rate swaps was volatile to a material degree by reference to movements in yield curves. The Board's view was that the risk of volatility in its retained reserves (and consequentially upon its regulatory capital) was too great and as a result, it exited from all of its interest rate swaps in June 2013. Presently, there are no interest rate swaps in place. 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 capital to mitigate the risk of interest rate movement. The disposal of the Society's UK Lifetime mortgage book had a beneficial impact in reducing the overall level of interest rate risk, as it removed from the mortgage book approximately one third of the Group's fixed rate assets. The Board does not intend to hedge its remaining fixed rate mortgages using interest rate swaps at this time; this position is monitored regularly.

• **Currency Risk**: The Group faces currency movement risks on its Euro denominated mortgage balances which represent 7.3% of total mortgage assets as at 31 December 2013. The exchange rate risk arising on these balances is managed and mitigated by transacting exchange rate swaps. The exchange rate risk position is reported to the 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. Following the launch of the Bank of England's Funding for Lending Scheme, it is apparent that there has been an easing in the rates that retail institutions pay to their saving members and as a consequence, the impact of this has been an improvement in the Society's interest margin during 2013.

Diversity Matters

Gender Analysis

Below is a table summarising Directors and Staff by gender at 31 December 2013, with comparative positions for the previous year end:

	31 December 2013		31 December 2012	
	Male	Female	Male	Female
Directors	8	0	9	1
Staff	20	23	33	31
Total	28	23	42	32

Given the size and scale of the Society's operations and its head count, it does not have any members of staff that would be considered for 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, which 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.

Directors

Current Directors

J.P. Allen	Non-executive director	
H.F. Baines	Non-executive director	(appointed 30 August 2013)
I.A. Dewar	Non-executive director	(appointed 30 August 2013)
R.W. Dyson	Non-executive director	
C.W. Gee	Finance Director	
D.A. Harding	Chairman	(appointed 17 April 2013)
P.A. Lynch	Operations Director	
F.B. Smith	Non-executive director	(appointed 1 January 2014)
J. Smith	Vice Chairman	

Former Directors

D.E. Cowie	Chief Executive	(retired 5 June 2013)
A. Finch	Non-executive director	(resigned 31 December 2013)
S.M. Molloy	Non-executive director	(resigned 26 June 2013)
M.J. Prior	Chairman	(resigned 17 April 2013)
I.M. Richardson	Executive Director	(resigned 28 June 2013)

At the Annual General Meeting: Harry Baines, Ian Dewar and David Harding will offer themselves for election as they were appointed to the Board during 2013. In addition, Fiona Smith, who was appointed to the Board in January 2014, will also offer herself for election; this would normally occur at the AGM in 2015, but the resolution to elect her has been brought to the 2014 AGM as, in the view of the Board the timing of the appointment and 2014 AGM allow for her election to occur at that time. Further, Chris Gee will retire by rotation and being eligible, will offer himself for re-election. Bob Dyson has indicated that he will step down from the Society's Board at the AGM.

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

Other matters

Pillar 3

The disclosure requirements of Pillar 3 may be found on the Society's website.

Charitable & political donations

The Society made charitable donations totalling £5,000 (2012: £5,000) during the year. No contributions were made for political purposes.

Supplier payment policy & practice

The Society'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 Society's contractual and other legal obligations

Trade creditors at 31 December 2013 amounted to 9 days of average supplies (2012: 16 days).

Going concern

The directors must satisfy themselves that it is reasonable to conclude that the financial statements should be prepared on a going concern basis. The Group's business activities require it to manage carefully its liquidity and capital resources. In managing its key resources through the setting of Board policies and operating procedures, the directors are mindful of the principal risks and uncertainties that the Group faces; these are summarised on pages 7 and 8.

During the year to December 2013, and prior to the issuance of the December 2012 accounts, an accounting adjustment was identified in relation to unwinding hedge accounting previously applied in the accounts. The impact was a reduction in reserves of £28.7m. As a result, and concurrent with the approval of the prior year accounts, the Society issued further subscribed capital in the form of £18m of Profit Participating Deferred Shares which are incorporated in Core Equity Tier 1 capital for regulatory purposes.

The Group has continued to focus on managing the risks and uncertainties facing the business and assessing regular forecasts covering profitability, liquidity and capital assessments. Impairment losses in the year on specific books of assets and accounting restatements have impacted capital resources. The key areas of judgment in the December 2013 accounts, as reflected in the summary on pages 7 and 8, relate to the sensitivity of the lifetime mortgage insurance risk provisions to changes in key estimates, the assessment of impairment risk in relation to mortgage assets, and any further legal and regulatory risk which may be associated with the small portfolio of CCA regulated loans, over which the Society holds a beneficial interest.

The Board has performed scenario analysis to consider eventualities using more pessimistic business and economic assumptions than those used in its Corporate Plan forecasts, including stresses applied to the interest margin and the cost base. The outputs of these projections also incorporate steps to reduce interest rate risk and identifies that the Group is able to meet its regulatory capital position both now and over the Corporate Planning period.

Based on the output of the Boards projections, scenario analysis and through its regular discussions with the PRA (which include dialogue relating to its regulatory capital and corporate planning forecasts), the Board has a reasonable expectation that the Group will continue to operate on a going concern basis.

Auditors

Following the 2013 AGM, Grant Thornton UK LLP resigned as auditors and PricewaterhouseCoopers LLP were appointed. A resolution for their appointment as auditors of the Society will be proposed at the Annual General Meeting.

Outlook

The Board's view is that the UK mortgage and savings markets will continue to be challenging over the short term as the impact of economic and inflationary pressures come to bear. It is expected that the Bank of England's Funding for Lending Scheme will result in further downward pressure on both retail savings rates and on the short term rates offered on new mortgage lending across the UK.

It is the Board's view that interest margins will improve further when Bank Base Rate starts to increase, although the timing of this remains uncertain.

The Group will continue with its approach of prudent underwriting of all mortgage applications.

The continued prudential management of the Group's capital, interest rate risk, interest margin and liquidity will be areas of focus during 2014 and beyond.

On behalf of the Board of Directors

D.A. Harding

Chairman
3 May 2014

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

In order to ensure that, as a mutual organisation, it is appropriately governed, the Society has regard to the principles of the UK Corporate Governance Code ("the Code"), which is issued by the Financial Reporting Council. Whilst the Code is more directly relevant to listed companies, its provisions can be adopted by a mutual organisation.

At 31 December 2013, the Board consisted of two executive directors and six non-executive directors. The role of Chief Executive is being filled by Allan Hodges who is not a director of the Society, as this is an interim appointment. 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. Joe Smith 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

During 2013, there have been three new non-executive director appointments. The appointment process, led by the Nominations and Remuneration Committee, focussed on members of the business community in order to identify suitable candidates with specific, relevant skills and experience. Search consultants were not involved in this process.

On joining the Board, each director and the interim Chief Executive was provided with an induction which included reading material and meetings with executive directors 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 their role within the Group.

FINANCIAL AND BUSINESS REPORTING

The respective responsibilities of the Directors and the Auditors for preparing and reporting on the Accounts are contained within the Statement of Directors' Responsibilities on page 13 and the Independent Auditors' Report on page 14.

The Directors' Report on page 5 includes an explanation of the Society's strategy and the means by which it generates and preserves value over the medium term.

REMUNERATION

There are no bonus arrangements in place for any director.

No director is involved in the discussion of or Board voting activity that relates to their remuneration.

The Directors' Remuneration Report can be found on page 12. The remuneration policy is contained within the Remuneration Report and service contract details may be found the Annual Business Statement on page 46. Details of directors' remuneration are contained in Note 9 to the Accounts.

INTERACTION WITH MEMBERS

The "shareholders" of the Group are its borrowing and investing members. Unlike a PLC as each member can only have one vote, there are no "major" or "significant" shareholders whose views can be canvassed for the Board. There are very 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 five Committees, of which three (Audit, Nominations and Remuneration and Risk) are oversight committees and two (Assets and Liabilities Committee ("ALCO") and Credit) are executive committees. The Board retains responsibility for the setting of strategy and the approval of all policy matters. The three 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 two executive committees is on more day-to-day operational matters, operating within the Board-approved policy framework. Operational matters are delegated to 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.

ALCO

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

Membership as at 31 December 2013: A. Hodges (Chairman), C.W. Gee, P.A. Lynch.

Audit Committee

The Committee receives reports from the Society's internal and external auditors; its focus is in relation to systems and controls matters, including risk systems and compliance with statutory and regulatory requirements.

The Audit Committee had primary responsibility for making a recommendation to the Board for the appointment of PricewaterhouseCoopers LLP as external auditors, following the resignation of Grant Thornton UK LLP. The Committee monitors the non-audit work undertaken by the external auditors, which related to seeking professional advice on accounting, tax and business planning matters. The Audit Committee is satisfied that this non-audit work does not impair PwC's independence.

Membership as at 31 December 2013: I.A. Dewar (Chairman), J.P. Allen, J. Smith.

Credit Committee

The Committee met monthly to consider all lending policy matters, including lending product development, loan book profile, arrears management and provisioning matters.

Membership as at 31 December 2013: A. Hodges (Chairman), C.W. Gee, P.A. Lynch.

Nominations and Remuneration Committee

The Committee is responsible for making recommendations to the Board in relation to the appointment of new directors and also relating to the mix of skills and experience of the Board and also in relation to the levels of remuneration for all Board members and senior managers

Membership as at 31 December 2013: J. Smith (Chairman), R.W. Dyson, D.A. Harding.

Risk Committee

In its oversight capacity, the Committee 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 2013: I.A. Dewar (Chairman), J.P. Allen, R.W. Dyson, C.W. Gee, A. Hodges, P.A. Lynch, J. Smith.

Board and Committee attendance records for 2013

Attendance at full meetings of the Board and its Committees throughout 2013 is scheduled below. Figures displayed in brackets represent the number of meetings that any individual director was due to attend.

Current Directors	Board	ALCO	Audit	Credit	Nominations & Remuneration	Risk
J.P. Allen	10 (11)	-	4 (4)	-	-	5 (5)
H.F. Baines	4 (4)	-	-	-	-	-
I.A. Dewar	4 (4)	-	2 (2)	-	-	2 (2)
R.W. Dyson	10 (11)	-	-	-	4 (4)	4 (5)
C.W. Gee	10 (11)	9 (12)	-	8 (12)	-	5 (5)
D.A. Harding	8 (8)	-	-	-	4 (4)	-
P.A. Lynch	10 (11)	11 (12)	-	11 (12)	-	1 (1)
J.Smith	11 (11)	-	4 (4)	-	6 (6)	5 (5)

Former Directors	Board	ALCO	Audit	Credit	Nominations & Remuneration	Risk
D.E. Cowie retired 5 June 2013	4 (4)	4 (5)	-	4 (5)	2 (2)	2 (2)
A. Finch resigned 31 December 2013	10 (11)	-	4 (4)	-	-	4 (5)
S.M. Molloy resigned 12 June 2013	0 (5)	-	0 (1)	-	-	-
M.J. Prior resigned 17 April 2013	3 (3)	-	-	-	2 (2)	-
I.M. Richardson resigned 28 June 2013	4 (5)	4 (5)	-	4 (5)	-	2 (2)

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 their 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.

Evaluation

The non-executive directors led by the senior independant director, are responsible for assessing the performance of the Chairman. The Chief Executive attends the Chairman's appraisal in order that executive views may 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.

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.

Nominations and Remuneration Committee

The Nominations and Remuneration 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 Nominations and Remuneration 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 Society, given that the Society is a mutual institution.

Executive directors

Remuneration levels are set for 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 Nominations and Remuneration Committee reviews the remuneration arrangements for the executive directors on a periodic basis and compares their 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, save for David Cowie, the former Chief Executive, whose membership of the scheme attracted an increased level of employer pension contributions and a lower level of employee contribution
- taxable benefits which include a car allowance and private health care

Since 1 January 2011 there have been no bonus arrangements in place for any executive director.

Non-executive directors

Non-executive directors are remunerated by way of fees, which are recommended by the Nominations and Remuneration 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 2013.

Other business interests

Details of directors' other business interests are shown in the Annual Business Statement on page 46.

Directors' emoluments

The full directors' emoluments table may be found in Note 9 to the Accounts.

Summary

This report, in addition to Note 9 to the Accounts and the table on page 11, 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 Nominations and Remuneration Committee
J. Smith
Chairman

3 May 2014

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Directors' responsibilities for preparing the Annual Accounts

The following statement, which should be read in conjunction with the statement of the Auditors' responsibilities on page 14, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Report and Accounts, Annual Business Statement and Directors' Report.

The directors are required by the Building Societies Act 1986 ("the Act") to prepare, for each financial year, Annual Accounts which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of affairs of the Society and the Group as at the end of the financial year. The Act states that references to International Financial Reporting Standards (as adopted by the European Union) giving a true and fair view are references to their achieving a fair presentation.

In preparing the accounts, the directors are required to:

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

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

Directors' responsibilities pursuant to the Disclosure and Transparency Rules

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

- the financial statements, prepared in accordance with International Financial Reporting Standards (as adopted by the European Union), give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and Society; and
- the Directors' Report and notes to the Annual Accounts 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 Group:

- 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 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 Society'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 corporate and financial information included on 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

3 May 2014

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF MANCHESTER BUILDING SOCIETY

Report on the financial statements

Our opinion

In our opinion the financial statements, defined below:

- give a true and fair view of the state of the Group's and the Society's affairs as at 31 December 2013 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 International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

This opinion is to be read in the context of what we say in the remainder of this report.

What we have audited

The financial statements, which are prepared by Manchester Building Society, comprise:

- the Group and Society Statements of Comprehensive Income for the year then ended;
- the Group and Society Statements of Changes in Equity for the year then ended;
- the Group and Society Statements of Financial Position as at 31 December 2013;
- the Group and Society Statements of Cash Flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and the Society's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on other matters prescribed by the Buildings Societies Act 1986

In our opinion:

- the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the accounting records and the financial statements; 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.

Other matters on which we are required to report by exception

Propriety of accounting records and information and explanations received

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

- proper accounting records have not been kept, by the Society; or
- the Society financial statements 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.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 13, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

Heather Varley (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
3 May 2014

STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	Group 2013 £000	Group Restated 2012 £000	Society 2013 £000	Society Restated 2012 £000
Interest receivable and similar income	3	27,354	28,214	26,494	27,058
Interest payable and similar charges	4	(12,947)	(17,421)	(12,947)	(17,421)
Net interest income		14,407	10,793	13,547	9,637
Fees and commission income		505	531	505	531
Fees and commission expense		(20)	(35)	(20)	(35)
Other operating income	5	222	49	1,090	976
Other operating charges	5	(125)	(77)	(205)	(200)
Loss from derivatives	6	(329)	(8,277)	(329)	(8,277)
Net loss on financial assets designated at fair value through profit or loss	12	(1,134)	(1)	(1,134)	(1)
Total operating income		**13,526**	**2,983**	**13,454**	**2,631**
Administrative expenses	7	(5,689)	(4,587)	(5,344)	(4,343)
Depreciation	17	(218)	(275)	(79)	(136)
Operating Profit/(Loss) before impairments and provisions		7,619	(1,879)	8,031	(1,848)
Impairment losses	15	(8,706)	(864)	(7,646)	(147)
Financial Services Compensation Scheme Levy	31	(489)	(318)	(489)	(318)
Loss on ordinary activities before income tax		**(1,576)**	**(3,061)**	**(104)**	**(2,313)**
Income tax expense	10	(5,517)	(219)	(5,645)	(361)
Loss and total comprehensive income for the year		**(7,093)**	**(3,280)**	**(5,749)**	**(2,674)**

The notes on pages 18 to 44 form part of these accounts.

STATEMENTS OF CHANGES IN EQUITY

	Group 2013 £000				Society 2013 £000			
	Retained Earnings	Subscribed Capital	PPDS	Total	Retained Earnings	Subscribed Capital	PPDS	Total
Reported balance at 31 December 2012 (as previously reported)	6,171	14,788	-	20,959	7,310	14,788	-	22,098
Restatements for 2011 and 2012	(2,591)	(5,000)	-	(7,591)	(2,591)	(5,000)	-	(7,591)
Balance at 1 January 2013	3,580	9,788	-	13,368	4,719	9,788	-	14,507
Issue of PPDS at par	-	-	18,000	18,000	-	-	18,000	18,000
Cost of issue of PPDS	-	-	(539)	(539)	-	-	(539)	(539)
Transactions with equity holders - interest on PIBS	(675)	-	-	(675)	(675)	-	-	(675)
Tax credit relating to interest on PIBS	135	-	-	135	135	-	-	135
Loss and comprehensive income for the year	(7,093)	-	-	(7,093)	(5,749)	-	-	(5,749)
Balance at 31 December 2013	**(4,053)**	**9,788**	**17,461**	**23,196**	**(1,570)**	**9,788**	**17,461**	**25,679**

	Group Restated 2012 £000				Society Restated 2012 £000			
	Retained Earnings	Subscribed Capital	PPDS	Total	Retained Earnings	Subscribed Capital	PPDS	Total
Reported balance at 31 December 2011 (as previously reported)	9,706	14,788	-	24,494	10,239	14,788	-	25,027
Restatements for 2011 (in 2013 Annual Accounts)	(2,336)	(5,000)	-	(7,336)	(2,336)	(5,000)	-	(7,336)
Updated balance at 31 December 2011	7,370	9,788	-	17,158	7,903	9,788	-	17,691
Transactions with equity holders - interest on PIBS	(1,075)	-	-	(1,075)	(1,075)	-	-	(1,075)
Tax credit relating to interest on PIBS	263	-	-	263	263	-	-	263
Restatements for 2012 (in 2013 Annual Accounts)	(255)	-	-	(255)	(255)	-	-	(255)
Loss and comprehensive income for the year (as previously reported)	(2,723)	-	-	(2,723)	(2,117)	-	-	(2,117)
Balance at 31 December 2012	**3,580**	**9,788**	**-**	**13,368**	**4,719**	**9,788**	**-**	**14,507**

STATEMENTS OF FINANCIAL POSITION

AS AT 31 DECEMBER 2013

		Group			Society		
			Restated			Restated	
ASSETS	Note	2013 £000	2012 £000	2011 £000	2013 £000	2012 £000	2011 £000
Liquid assets							
Cash and balances with the Bank of England		95,677	50,377	50,129	95,677	50,377	50,129
Loans and advances to credit institutions	11	58,313	24,992	49,745	58,263	24,942	49,695
Investment securities	12	23,057	67,561	85,236	23,057	67,561	85,236
		177,047	**142,930**	**185,110**	**176,997**	**142,880**	**185,060**
Derivative financial instruments	13	582	1,097	1,953	582	1,097	1,953
Loans and advances to customers							
Loans fully secured on residential property	14	416,480	528,333	564,238	408,294	513,795	548,261
Loans fully secured on land	14	35,439	39,486	42,243	35,439	39,486	42,243
Other loans	14	2,128	2,721	3,807	2,128	2,721	3,807
		454,047	**570,540**	**610,288**	**445,861**	**556,002**	**594,311**
Investments							
Subsidiary undertakings	16	-	-	-	18,850	24,468	25,018
Trade investments	16	250	250	250	250	250	250
		250	**250**	**250**	**19,100**	**24,718**	**25,268**
Property, plant and equipment	17	8,358	8,477	8,696	172	153	233
Current tax assets		356	-	-	335	-	-
Deferred tax assets	18	4,257	10,193	9,968	4,031	9,976	9,991
Other assets	19	1,533	43,522	30,988	1,521	43,183	30,847
Total assets		**646,430**	**777,009**	**847,253**	**648,599**	**778,009**	**847,663**
LIABILITIES							
Due to members	20	502,586	617,009	693,522	502,586	617,009	693,522
Deposits from banks	21	5,543	22,604	25,103	5,543	22,604	25,103
Other deposits	22	91,285	58,973	49,355	91,285	58,973	49,355
Derivative financial instruments	13	620	42,101	37,875	620	42,101	37,875
Current income tax liabilities		-	196	323	-	99	265
Other liabilities	24	2,225	1,727	2,911	1,911	1,685	2,846
Provisions for liabilities and charges	31	275	331	306	275	331	306
Subordinated liabilities	23	15,700	15,700	15,700	15,700	15,700	15,700
Subscribed capital	25	5,000	5,000	5,000	5,000	5,000	5,000
Total Liabilities		**623,234**	**763,641**	**830,095**	**622,920**	**763,502**	**829,972**
Equity							
Retained earnings		(4,053)	3,580	7,370	(1,570)	4,719	7,903
Subscribed capital	25	9,788	9,788	9,788	9,788	9,788	9,788
Profit participating deferred shares	27	17,461	-	-	17,461	-	-
Total equity		**23,196**	**13,368**	**17,158**	**25,679**	**14,507**	**17,691**
Total equity and liabilities		**646,430**	**777,009**	**847,253**	**648,599**	**778,009**	**847,663**

The accounts on pages 15 to 44 were approved by the Board of Directors on 3 May 2014.

D.A. Harding
Chairman

A. Hodges
Chief Executive

C.W. Gee
Finance Director

STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	Group 2013 £000	Group Restated 2012 £000	Society 2013 £000	Society Restated 2012 £000
Cash flows from operating activities					
Interest and commission receivable		22,703	30,466	22,628	29,310
Interest expense payable		(12,547)	(15,063)	(12,547)	(15,063)
Fees and commission payable		(84)	(112)	(82)	(235)
Settlement of derivative contracts		(40,013)	(4,504)	(40,013)	(4,504)
Net trading and other income		57	23	57	950
Cash payments to employees and suppliers		(6,178)	(4,905)	(5,833)	(4,661)
Income taxes paid		-	(406)	-	(346)
Cash flows from operating activities before changes in operating assets and liabilities		**(36,062)**	**5,499**	**(35,790)**	**5,451**
Changes in operating assets and liabilities					
Net decrease/(increase) in loans and advances to credit institutions		679	(538)	679	(538)
Net decrease in loans and advances to customers		111,197	38,068	111,576	37,345
Net decrease/(increase) in other assets		41,989	(12,832)	41,662	(12,634)
Net (decrease) in deposits from banks		(17,061)	(2,499)	(17,061)	(2,499)
Net increase in other deposits		32,312	9,618	32,312	9,618
Net (decrease) in amounts due to members		(114,423)	(78,471)	(114,423)	(78,471)
Net increase/(decrease) in other liabilities		498	(1,184)	226	(1,161)
Net (decrease)/increase in liabilities and charges		(56)	25	(56)	25
Net cash from operating activities		**19,073**	**(42,314)**	**19,125**	**(42,864)**
Cash flows from investing activities					
Investments in subsidiary undertakings		-	-	(53)	550
Purchase of property and equipment	17	(99)	(56)	(98)	(56)
Sale of securities		63,127	82,956	63,127	82,956
Investment in securities		(19,757)	(64,984)	(19,757)	(64,984)
Net cash used in investing activities		**43,271**	**17,916**	**43,219**	**18,466**
Cash flows from financing activities					
Receipt of profit participating deferred shares	27	17,461	-	17,461	-
Interest paid on subscribed capital		(1,075)	(1,075)	(1,075)	(1,075)
Net cash from financing activities		**16,386**	**(1,075)**	**16,386**	**(1,075)**
Net movement in cash and cash equivalents		78,730	(25,473)	78,730	(25,473)
Cash and cash equivalents at start of year		75,229	100,702	75,179	100,652
Cash and cash equivalents at end of year	26	**153,959**	**75,229**	**153,909**	**75,179**

1. ACCOUNTING POLICIES AND FINANCIAL RISK MANAGEMENT

a. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, except for as noted in note 2.

Basis of presentation

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 directors must satisfy themselves that it is reasonable to conclude that the financial statements should be prepared on a going concern basis. The Group's business activities require it to manage carefully its liquidity and capital resources. In managing its key resources through the setting of Board policies and operating procedures, the directors are mindful of the principal risks and uncertainties that the Group faces; these are summarised on pages 7 and 8.

During the year to December 2013, and prior to the issuance of the December 2012 accounts, an accounting adjustment was identified in relation to unwinding hedge accounting previously applied in the accounts. The impact was a reduction in retained earnings of £28.7m. As a result, and concurrent with the approval of the prior year accounts, the Society issued further subscribed capital in the form of £18m of Profit Participating Deferred Shares which are incorporated in Core Equity Tier 1 capital for regulatory purposes.

The Group has continued to focus on managing the risks and uncertainties facing the business and assessing regular forecasts covering profitability, liquidity and capital assessments. Impairment losses in the year on specific books of assets and accounting restatements have impacted capital resources. The key areas of judgement in the December 2013 accounts, as reflected in the summary on pages 7 and 8, relate to the sensitivity of the lifetime mortgage insurance risk provisions to changes in key estimates, the assessment of impairment risk in relation to mortgage assets, and any further legal and regulatory risk which may be associated with the small portfolio of CCA regulated loans, over which the Society holds a beneficial interest.

The Board has performed scenario analysis to consider eventualities using more pessimistic business and economic assumptions than those used in its Corporate Plan forecasts, including stresses applied to the interest margin and the cost base. The outputs of these projections also incorporate steps to reduce interest rate risk and identifies that the Group is able to meet its regulatory capital position both now and over the Corporate Planning period. Based on the output of the Boards projections, scenario analysis and through its regular discussions with the PRA (which include dialogue relating to its regulatory capital and corporate planning forecasts), the Board has a reasonable expectation that the Group will continue to operate on a going concern basis.

In the event of a restatement, IAS1 requires that a third Statement of Financial Position is presented for comparative purposes and that this additional disclosure should also extend to cover the relevant notes to the Financial Statements. On the 27th March 2013, the EU adopted an amendment removing the requirement to show a third balance sheet position for relevant notes. The Society has adopted early the amendment to IAS1 and accordingly, comparatives within the notes to the Financial Statement show the positions at December 2012 only.

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

A number of IFRS accounting standard and pronouncements identified as being relevant to the Group, were adopted with effect from 1 January 2013:

IAS 1 – Presentation of Items of Other Comprehensive Income. The change required was that the grouping of items presented in the Statements of Other Comprehensive Income would be on the basis of whether they could be reclassified in the Income Statement in future periods.

IFRS 7 – Offsetting Disclosures. This standard had very little impact on the disclosures associated with netting arrangements on assets and liabilities.

IFRS 13 – Fair Value Measurement. This standard amended the guidance on fair value measurement in existing IFRS standards and pronouncements by incorporating it into a single accounting standard. As a result, there is more disclosure in the Group's financial statements.

IFRIC 21 – Levies. This pronouncement makes clearer the accounting cut-off date for Government imposed levies and saw the Group restating its prior year charge in relation to the FSCS.

New standards and interpretations currently in issue but not effective for accounting periods commencing on or after 1 January 2013 are:

- IFRS 9 - Financial Instruments
- IFRS 10 - Consolidated Financial Statements
- IFRS 11 - Joint Arrangements
- IFRS 12 - Disclosure of Interests in Other Entities
- IAS 27 (Revised) - Separate Financial Statements
- IAS 28 (Revised) - Investments in Associates and Joint Ventures
- IAS 32 - Offsetting Financial Assets and Financial Liabilities

From an initial assessment the adoption of IFRS 9, as currently in issue, would not be anticipated to have a material impact on the accounting of the Group. It should be noted that the EU has declined to consider the endorsement of IFRS 9 until a complete version is issued by the International Accounting Standards Board. The Group has yet to conduct a full assessment of its potential impact, pending the availability of the completed version and its endorsement from the European Union.

The Directors do not expect the other standards to have a material impact on the financial statements of the Society and Group.

Basis of consolidation

The Group's accounts include the accounts of the Society and its subsidiary undertakings, all of which have accounting periods ending on 31 December. The accounting policies of the subsidiary undertakings are materially consistent with the Group accounting policies. All internal costs and income associated with the subsidiaries are removed on consolidation. The Society's statement of financial position includes the investment in the subsidiary undertakings at cost, less any provision for impairment.

Interest income and expense

Interest income and expense are 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 is the rate that exactly discounts estimated cashflows (excluding 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 (for example early repayment charges) are taken into account.

Insurance contracts

The Society has a portfolio of Spanish Lifetime Mortgage loans secured on residential property. It has been identified that a particular clause of the mortgage contract meets the definition of an insurance contract; where a borrower dies or goes into long term care and a redemption receipt is less than the contractual sum owed the Society does not have any further ability to recover amounts from the borrower or the estate. Under IFRS 4 the Society 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 Society's other mortgage contracts; the income earned has been included in the Income Statement within the Interest and Similar Income category. Within the Statement of Financial Position the mortgage asset and any impairment which has been calculated is disclosed in line with IAS 39. The Group has a portfolio of lifetime mortgages incorporating a no-negative equity guarantee. The insurance risk liability is calculated by estimating potential shortfalls arising at redemption, discounted at the effective interest rate. 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.

Fees and commissions

Fees and commissions relating to the creating of loans and advances to members are recognised within Interest Income using the effective interest rate method.

Other operating income

The Society recognises income relating to the interest that it charges on the loans made to its subsidiary undertakings.

Financial assets

The Group classifies its financial assets in the following categories:

(i) Financial assets at fair value through profit or loss.

Derivative financial instruments. These instruments 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. The Society disposed of all of its interest rate hedges in June 2013.

Investment securities. These are deposit instruments with major high street banks, being Certificates of Deposit and Medium Term Notes used for liquidity management purposes. These instruments are carried at their market value which reflects the fair value of the asset. Changes in their fair value are recognised in profit or loss. Any gain or loss on disposal is taken through profit or loss.

Financial assets at fair value through profit or loss are subsequently carried at fair value. Fair values are obtained in line with the three tier hierarchy described in IFRS 7 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) Loans and receivables

Loans and advances to credit institutions. These are sums deposited in instantly accessible bank accounts with major high street banks, used for liquidity purposes. These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loans and advances to customers. These are sums advanced to the Group's borrowers, secured on property, land or (in a very restricted number of instances) unsecured. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

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

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

Impairment

The Group assesses at each financial position date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes accounts going in to arrears and other observable data that comes to the attention of the Group about the following loss events:

(i) the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;

(ii) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

(iii) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Group, including:

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

– national or local economic conditions that correlate with defaults on the assets in the Group.

The above assessment includes those mortgage assets which are subject to forbearance arrangements.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

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

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

Subsidiary undertakings

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

Property, plant and equipment

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

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

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

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

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each financial reporting date.

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 income tax

Deferred income 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 income 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 are recognised 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 remeasurement of monetary items at year-end exchange rates are recognised in profit or loss.

Leases

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

Financial Liabilities

All financial liabilities including shares, deposits, debt securities and subordinated liabilities are recognised initially at fair value, being the issue proceeds, net of transaction costs incurred as appropriate. Financial liabilities are subsequently measured at amortised cost using the effective interest rate method.

Offsetting

Foreign exchange derivative financial assets are subject to offsetting, enforceable, master netting agreements. The gross and net amounts of these assets on the balance sheet is £620k. Related amounts not set off are £582k financial liabilities with cash collateral received of £20k. Foreign exchange derivative financial liabilities are subject to offsetting, enforceable, master netting agreements. The gross and net amounts of these liabilities on the balance sheet is £582k. Related amounts not set off are £620k financial assets with cash collateral paid of £1,070k.

For the financial assets and liabilities subject to enforceable master netting arrangements or similar arrangements above, 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.

Financial Services Compensation Scheme ("FSCS") - Provisions for Liabilities and charges

During 2008, claims were made on the FSCS following the failure of Bradford & Bingley plc, Heritable Bank plc, Kaupthing Singer and Friedlander Limited and London Scottish Bank plc. In order to fund the claims made under its terms of operation, the FSCS has borrowed from the Bank of England and HM Treasury. The FSCS pays interest on its borrowings, it incurs operating expenses in its own right and incurs capital losses where shortfalls arise on the realisations of assets that it is managing from the failed banks listed above. The costs of the FSCS are passed on to all UK banks and building societies.

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

IFRIC 21 - Levies clarify the treatment of the levy charged by FSCS. The trigger date for recognition of a provision in respect of the FSCS levy is now 1 April. This results in the Society now being required to hold an accrual for one year's interest levy.

Permanent Interest Bearing Shares

The Society has two tranches of Permanent Interest Bearing Shares in issue. Both sets were issued with the intention of enhancing the Society's regulatory capital position. The PIBS issued in 2005 confer unconditional discretion on the Society'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 income statement. Whereas interest paid on the 2005 PIBS issue is shown in the Statement of Changes in Equity.

Profit Participating Deferred Shares

The Society has £18m of Profit Participating Deferred Shares, issued on 27 April 2013. These instruments qualify as equity within the Statement of Financial Position. Whilst no coupon was paid on the PPDS during 2013, any such cost would be recognised through the Statement of Changes in Equity when paid.

b. Financial risk management

Strategy in using financial instruments

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

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

During June 2013, the Society exited from all of its historic interest rate swaps, recording a gain at the point of exit. At 31 December 2013, the value of fixed rate mortgages had reduced by approximately one third when compared to the position a year earlier; none of the mortgages are currently hedged using interest rate derivatives.

Credit risk - exposure

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

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

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

	Group		Society	
	2013 £000	2012 £000	2013 £000	2012 £000
Financial assets				
Loans and advances to credit institutions	58,313	24,992	58,263	24,942
Investment securities	23,057	67,561	23,057	67,561
Gross loans and advances-on residential property and land	427,240	469,337	411,309	453,784
-lifetime mortgages	46,122	112,822	46,122	112,822
Loans to subsidiary undertakings	-	-	24,519	24,466
Derivatives - Interest and exchange rate swaps	582	1,097	582	1,097
	555,314	**675,809**	**563,852**	**684,672**

Impairment provisions are provided for losses that have been incurred at the financial position date.

Credit risk - forbearance

The Society'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, deferment of interest 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 2013, the Society had 52 accounts (2012: 59) with balances of £6m (2012: £7m) where conversion to interest only or an extension of term had taken place. Of these, 30 accounts (2012: 36) were neither past due or impaired, and 22 (2012: 23) were past due and/or impaired (aggregate capital balance £3.6m (2012: £3.7m); aggregate arrears £31k (2012: £51k); aggregate impairment provision of £19k (2012: 21k)).

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

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

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

Of the £472m in this class £432m (91.5%) (2012: 92.4%) is fully secured on residential property and £38m (8.0%) (2012: 9.7%) is fully secured on land. £2m (0.5%) (2012: 0.5%) is unsecured personal loans. With balances of £46m Lifetime mortgages represent 9.7% of this class (2012: 18.9%).

Secured lending – fully secured on residential property

The average loan to valuation ("LTV") of the Group's lending that is fully secured on residential property is estimated at 39% (2012: 40%), whilst the average LTV of new residential property lending was 61% (2012: 62%). Further analysis of the Group's residential property lending is detailed below.

Loan to value analysis (indexed):

	All residential Properties (Including Lifetime Mortgages)	
	2013	2012
Total book	%	%
<70%	72	74
70% - 80%	16	13
80% - 90%	6	9
>90% - 100%	3	2
>100%	3	2
Average loan to value of stock - UK mortgages	38	41
Average loan to value of stock - Spanish mortgages	59	32

Estimates of current LTV are obtained by indexing the valuation at the last physical inspection of the property, by reference to externally published data. The above encompasses those mortgage assets over which the Group holds legal title and excludes those first and second charge mortgage assets where it only holds a beneficial interest, as, for this book, LTV is not considered to be the best measure of credit risk.

At 31 December 2013, 28% of the loan book had an LTV of 70% or greater. In the event that HPIs were to increase by 5%, at 31 December 2013 this would reduce the proportion of the loan book that had an LTV of 70% or greater to 23%; in the even that HPIs decreased by 5% at 31 December 2013, the proportion of the loan book with an LTV of 70% or greater would increase to 36%.

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% (2012: 3%). There are no lifetime mortgages which are past due.

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

	2013		2012*	
	£m	%	£m	%
Not Impaired:				
Neither past due nor impaired	378.6	87	474.8	89
Past due up to 3 months	22.9	5	25.3	5
Past due 3 to 6 months	3.4	1	4.5	1
Past due 6 to 12 months	1.0	-	2.8	1
Past due over 12 months	0.5	-	1.1	-
Impaired:				
Past due up to 3 months	2.2	1	2.3	-
Past due 3 to 6 months	1.2	-	1.9	-
Past due 6 to 12 months	1.2	-	1.3	-
Past due over 12 months	2.2	1	2.2	1
Possessions**	3.4	1	2.9	-
Mortgage book where beneficial interest is held***	15.4	4	17.0	3
	432.0	**100**	**536.1**	**100**

** For properties in possession, £3.3m (2012: £4.0m) of collateral is held. In the analysis above, for all past due loans, £78.6m (2012: £83.9m) of collateral is held.

*** The mortgage book of first and second charge loans in which the Group holds a beneficial interest was initially acquired at a deep discount and is considered impaired. The net book value of this loan book after impairment provisions is £6.2m (2012: £12.5m).

In the analysis above, loans which are not impaired and are less than 3 months past due have collective impairment provisions of £13.6m (2012: £6.1m) set aside to cover losses.

At 31 December 2013 the Group held individually identified impairment provisions of £2.0m (2012: £1.6m).

Geographical Analysis

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

	2013		2012*	
	£m	%	£m	%
East Midlands	7.6	2	13.6	2
Greater London	27.2	6	36.0	7
London	64.2	15	73.5	14
North	8.7	2	12.9	2
North West	161.5	37	187.0	35
Other	14.6	3	20.1	4
South East	38.5	9	58.6	11
South West	15.1	4	24.5	5
Wales	11.5	3	15.5	3
West Midlands	14.2	3	19.5	4
Yorkshire	23.6	5	31.2	5
Total UK properties	**386.7**	**89**	**492.4**	**92**
Spain (lending is lifetime mortgages)	45.3	11	43.7	8
	432.0	**100**	**536.1**	**100**

Secured lending – fully secured on land

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

	2013		2012	
	£m	%	£m	%
Offices	10.5	28	12.0	29
Shops	9.2	24	9.9	24
Industrial	5.7	15	6.0	14
Restaurants, Hotels and other	12.6	33	13.5	33
	38.0	**100**	**41.4**	**100**

* Restated (see note 2)

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

	2013		2012	
Not Impaired:	£m	%	£m	%
Neither past due nor impaired	29.1	76	32.2	78
Past due up to 3 months	2.1	5	1.5	4
Past due 3 to 6 months	0.8	2	1.2	3
Past due 6 to 12 months	0.4	1	0.9	2
Past due over 12 months	0.6	2	0.2	1
Impaired:				
Past due up to 3 months	0.7	2	0.8	2
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	0.6	2	0.6	1
Past due over 12 months	1.4	4	1.4	3
Possessions*	2.3	6	2.6	6
	38.0	**100**	**41.4**	**100**

* For properties in possession £2.2m of collateral is held (2012: £2.4m). In the analysis above, for all past due loans, £11.0m of collateral is held (2012: £11.2m).

In the analysis above, loans which are not impaired and are less than 3 months past due have collective impairment provisions of £72k (2012: £100k) set aside to cover losses.

At 31 December 2013 the Group held individually identified impairment provisions of £2.5m (2012: £1.9m).

Unsecured lending

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

	2013		2012	
Not Impaired:	£m	%	£m	%
Neither past due nor impaired	1.8	89	2.1	75
Past due up to 3 months	0.2	8	0.4	14
Past due 3 to 6 months	0.1	3	-	-
Past due 6 to 12 months	-	-	-	-
Past due over 12 months	-	-	0.1	3
Impaired:				
Past due up to 3 months	-	-	-	-
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	-	-	0.1	4
Past due over 12 months	-	-	0.1	4
	2.1	**100**	**2.8**	**100**

In the analysis above, loans which are not impaired and are less than 3 months past due have collective impairment provisions of £nil (2012: £nil) set aside to cover losses.

At 31 December 2013 the Group held individually identified impairment provisions of £0m (2012: £0.1m).

Credit risk – loans and advances to banks and investment securities.

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

The maximum individual counterparty exposure at the financial position date was £96m which was on deposit with the Bank of England. The number of active counterparties at the financial position date was 7 (2012: 7). All counterparties are UK 'High Street' blue chip 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:

	2013		2012	
	£m	%	£m	%
Financial Institutions	176.9	100	142.8	100
Mortgage backed securities	0.1	-	0.1	-
	177.0	**100**	**142.9**	**100**

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

Geographical exposure, assessed by reference to the registered address of the counterparty and the lead regulator of the entity:

	2013		2012	
	£m	%	£m	%
UK	177.0	100	142.9	100
	177.0	**100**	**142.9**	**100**

Industry sector/asset class exposure:	2013		2012	
	£m	%	£m	%
UK financial institutions	176.9	100	142.8	100
Asset backed securities	0.1	-	0.1	-
	177.0	**100**	**142.9**	**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.

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 nominal value of derivative financial instruments are included in the "Impact of derivatives" total figures disclosed. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

Historically the Group entered into long dated interest rate swap contracts, the purpose of which was to hedge long term fixed rate lending. As it had been identified that the swaps were not effective for IAS 39 purposes, they were terminated in June 2013. From the 2012 comparative table it may be seen that the swaps had longer durations than the fixed rate assets and as a result, the Group had a much greater exposure to changes in interest rates in the longer-dated time periods.

After taking into account the derivatives entered into by the Group, the interest rate sensitivity exposure at 31 December 2013 and 31 December 2012 was:

	Effective interest rate	0-3 months	3-6 months	6-12 months	1-5 years	5-10 years	10-20 years	20-30 years	Over 30 years	Non-interest bearing	Total
31 December 2013	**%**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Assets											
Cash and central banks balances	0.50	95,645	-	-	-	-	-	-	-	32	95,677
Due from other banks	0.74	58,282	-	-	-	-	-	-	-	31	58,313
Investment securities	3.63	-	15,335	2,054	5,259	-	-	-	-	409	23,057
Loans to customers	3.93	353.802	5,163	10,209	17,162	7,880	12,294	7,476	119	-	414,105
Lifetime mortgages	6.75	370	370	739	-	2,704	15,703	18,216	1,840	-	39,942
Other assets	-	-	-	-	-	-	-	-	-	15,336	15,336
Total assets		**508,099**	**20,868**	**13,002**	**22,421**	**10,584**	**27,997**	**25,692**	**1,959**	**15,808**	**646,430**
Liabilities											
Due to other banks	1.09	4,000	1,000	500	-	-	-	-	-	43	5,543
Other deposits	1.55	60,039	9,500	11,212	10,000	-	-	-	-	534	91,285
Due to members	1.55	463,206	11,606	19,745	6,530	-	-	-	-	1,499	502,586
Subordinated liabilities	4.36	9,200	-	-	1,500	-	5,000	-	-	-	15,700
Other liabilities	-	-	-	-	-	-	-	-	-	3,120	3,120
Subscribed capital	-	-	-	-	-	-	-	-	-	14,788	14,788
Profit participating deferred shares	-	-	-	-	-	-	-	-	-	17,461	17,461
Reserves	-	-	-	-	-	-	-	-	-	(4,053)	(4,053)
Total liabilities		**536,445**	**22,106**	**31,457**	**18,030**	**-**	**5,000**	**-**	**-**	**33,392**	**646,430**
Interest rate sensitivity gap		**(28,346)**	**(1,238)**	**(18,455)**	**4,391**	**10,584**	**22,997**	**25,692**	**1,959**	**(17,584)**	**-**
31 December 2012	**%**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Assets											
Cash and central banks balances	0.50	50,359	-	-	-	-	-	-	-	18	50,377
Due from other banks	1.35	24,970	-	-	-	-	-	-	-	22	24,992
Investment securities	2.86	15,017	-	17,293	34,604	-	-	-	-	647	67,561
Loans to customers	3.71	389,238	3,426	6,145	32,556	11,980	6,232	14,345	-	-	463,922
Lifetime mortgages	6.74	427	427	853	23,524	37,051	44,336	-	-	-	106,618
Other assets	-	43,352	-	-	-	-	-	-	-	20,187	63,539
Total assets		**523,363**	**3,853**	**24,291**	**90,684**	**49,031**	**50,568**	**14,345**	**-**	**20,874**	**777,009**
Liabilities											
Due to other banks	1.43	9,500	7,000	6,000	-	-	-	-	-	104	22,604
Other deposits	1.89	37,732	9,000	12,000	-	-	-	-	-	241	58,973
Due to members	2.27	569,054	7,960	16,175	21,117	-	-	-	-	2,703	617,009
Subordinated liabilities	4.36	9,200	-	-	1,500	5,000	-	-	-	-	15,700
Other liabilities	-	-	-	-	-	-	-	-	-	44,355	44,355
Subscribed capital	-	-	-	-	-	-	-	-	-	14,788	14,788
Reserves	-	-	-	-	-	-	-	-	-	3,580	3,580
Total liabilities		**625,486**	**23,960**	**34,175**	**22,617**	**5,000**	**-**	**-**	**-**	**65,771**	**777,009**
Impact of derivatives		134,533	37,156	(4,078)	(29,000)	(29,395)	(41,482)	(14,734)	(53,000)	-	-
Interest rate sensitivity gap		**32,410**	**17,049**	**(13,962)**	**39,067**	**14,636**	**9,086**	**(389)**	**(53,000)**	**(44,897)**	**-**

The Society'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 2013 an increase of 1% in market interest rates across all maturities would reduce income and equity by £7.9m (2012: £24.9m increase). The main reasons for the change in the sensitivity results is that the Society exited from its interest rate swaps in June 2013 and disposed of its fixed interest rate UK lifetime mortgages in December 2013. These amounts are for indication only and do not represent amounts that are at risk. ALCO monitor a variety of interest rate shocks from 0.5% to 4%.

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 Society 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 2013 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 Society’s liquid assets at 31 December 2013 were greater than those of 31 December 2012 as a result of the receipt, in mid-December, of the cash consideration on the disposal of its UK Lifetime mortgage book.

The table below analyses the Group’s contractual cash flows under financial liabilities except for derivatives which are disclosed at their fair value based on maturity dates.

	On demand	0-3 months	3-12 months	1-5 years	5-10 years	10-15 years	Over 15 years	Total
At 31 December 2013	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Due to members	333,765	166,407	760	2,099	-	-	-	503,031
Due to other banks and depositors	1,448	63,092	22,684	10,294	-	-	-	97,518
Other liabilities	-	878	275	-	-	-	-	1,153
PIBS interest	-	-	400	1,600	2,000	2,000	2,000	8,000
Subordinated liabilities	-	170	513	3,821	11,953	1,675	6,340	24,472
Total outflow	**335,213**	**230,547**	**24,632**	**17,814**	**13,953**	**3,675**	**8,340**	**634,174**

	On demand	0-3 months	3-12 months	1-5 years	5-10 years	10-15 years	Over 15 years	Total
At 31 December 2012 *	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Due to members	317,256	255,229	24,528	22,806	-	-	-	619,819
Due to other banks and depositors	548	31,962	34,837	15,457	-	-	-	82,804
Other liabilities	188	1,066	638	441	-	-	-	2,333
Derivatives	-	1,924	402	937	5,402	4,885	28,551	42,101
PIBS interest	-	-	400	1,600	2,000	2,000	2,000	8,000
Subordinated liabilities	-	171	513	3,933	7,869	5,875	6,675	25,036
Total outflow	**317,992**	**290,352**	**61,318**	**45,174**	**15,271**	**12,760**	**37,226**	**780,093**

*** Restated**

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
At 31 December 2013	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Assets									
Cash and central banks balances	95,677	-	-	-	-	-	-	-	95,677
Due from other banks	58,722	15,335	2,054	5,259	-	-	-	-	81,370
Derivative financial instruments	242	48	25	267	-	-	-	-	582
Loans to customers	14,451	3,349	6,695	71,561	60,181	207,232	49,128	1,508	414,105
Lifetime mortgages	370	370	739	-	2,704	15,703	18,216	1,840	39,942
Other assets	1,888	-	426	1,703	2,129	-	-	8,608	14,754
Total assets	**171,350**	**19,102**	**9,939**	**78,790**	**65,014**	**222,935**	**67,344**	**11,956**	**646,430**
Liabilities									
Due to other banks	4,039	1,003	501	-	-	-	-	-	5,543
Other deposits	60,409	9,545	11,262	10,069	-	-	-	-	91,285
Derivative financial instruments	146	101	373	-	-	-	-	-	620
Due to members	499,830	-	751	2,005	-	-	-	-	502,586
Subordinated liabilities	-	-	-	1,500	9,200	5,000	-	-	15,700
Other liabilities	2,225	275	-	-	-	-	-	-	2,500
Total liabilities	**566,649**	**10,924**	**12,887**	**13,574**	**9,200**	**5,000**	**-**	**-**	**618,234**
Net liquidity gap	**(395,299)**	**8,178**	**(2,948)**	**65,216**	**55,814**	**217,935**	**67,344**	**11,956**	**28,196**
At 31 December 2012 *									
Total assets	96,885	2,521	25,348	113,635	131,737	309,058	84,228	16,666	780,078
Total liabilities	608,151	24,780	34,580	38,570	10,402	20,203	3,703	18,730	759,119
Net liquidity gap	**(511,266)**	**(22,259)**	**(9,232)**	**75,065**	**121,335**	**288,855**	**80,525**	**(2,064)**	**20,959**

*** Restated**

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. The Society 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 2013 the Group had a currency exposure of €58.0m (2012: €57.1m) in loans and receivables. At the balance sheet date this exposure is matched with exchange rate SWAPs. The Board sets limits on the level of exposures to foreign currency. These exposures 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.

	2013 £000	2012 £000
Effect on income with no Euro forward contracts	(3,690)	(3,512)
Effect on income with Euro forward contracts fully matching Euro denominated assets	1	6

Fair values of financial assets and liabilities

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

The following methods and assumptions have been applied in determining the fair value of the financial instruments in these reports:

(i) Trade investments are measured at cost as the fair value cannot be estimated reliably.

(ii) The fair value of derivatives and investment securities 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 loans and advances to customers at a variable rate of interest is assumed to approximate to their carrying amounts. The fair value of loans and advances at a fixed rate of interest is estimated by internal valuation models. External market data is used within these internal valuation models.

(iv) All other financial assets and liabilities are held at amortised cost.

The Group has disclosed within these financial statements all the assets and liabilities for which fair values are required. The Board does not believe it is necessary to place a fair value on the outstanding minimal amount of assets and liabilities on which a fair value has not been placed as these predominantly attract variable rates of interest and therefore their carrying value is deemed to reflect their fair value.

The accounting policies for financial instruments have been applied to the items below.

Group	2013		2012*	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets	£000	£000	£000	£000
Cash and balances with the Bank of England	95,677	95,677	50,377	50,377
Loans and advances to credit institutions	58,313	58,313	24,992	24,992
Investment securities	23,057	23,057	67,561	67,561
Derivative financial instruments	582	582	1,097	1,097
Loans and advances to customers	454,047	445,525	570,540	564,636
Investments	250	250	250	250
	631,926	623,404	714,817	708,913
Financial liabilities	£000	£000	£000	£000
Due to members	502,586	502,278	617,009	616,526
Deposits from banks	5,543	5,543	22,604	22,604
Other deposits	91,285	91,285	58,973	58,973
Derivative financial instruments	620	620	42,101	42,101
Subordinated liabilities	15,700	15,700	15,700	15,700
Subscribed capital	5,000	4,925	5,000	5,363
	620,734	620,351	761,387	761,267

Society	2013		2012*	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets	£000	£000	£000	£000
Cash and balances with the Bank of England	95,677	95,677	50,377	50,377
Loans and advances to credit institutions	58,263	58,263	24,942	24,942
Investment securities	23,057	23,057	67,561	67,561
Derivative financial instruments	582	582	1,097	1,097
Loans and advances to customers	445,861	437,339	556,002	550,098
Investments	250	250	250	250
	623,690	615,168	700,229	694,325
Financial liabilities	£000	£000	£000	£000
Due to members	502,586	502,278	617,009	616,526
Deposits from banks	5,543	5,543	22,604	22,604
Other deposits	91,285	91,285	58,973	58,973
Derivative financial instruments	620	620	42,101	42,101
Subordinated liabilities	15,700	15,700	15,700	15,700
Subscribed capital	5,000	4,925	5,000	5,363
	620,734	620,351	761,387	761,267

* Restated

a. Loans and advances to customers

The fair value of loans and advances to customers has been calculated on an individual basis taking into account the fixed interest rate attached to each mortgage.

b. Deposits and borrowings

The estimated fair value of fixed interest deposits which do not have a market value is based on the carrying value of the deposits.

c. Investment securities

The fair value of each individual investment security is calculated using a discounted cash flow model using a current yield curve appropriate for the remaining term to maturity.

Fair values of financial assets and liabilities

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

The following table summarises the carrying values of financial assets and liabilities presented on the Group or Society's balance sheet. The fair values presented in the table are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

2013 Group and Society	Level 1	Level 2	Level 3	Total
Financial assets	£000	£000	£000	£000
Investment securities	-	23,057	-	23,057
Derivative financial instruments	-	582	-	582
Financial liabilities	£000	£000	£000	£000
Derivative financial instruments	-	620	-	620

2012 Group and Society	Level 1	Level 2	Level 3	Total
Financial assets	£000	£000	£000	£000
Investment securities	-	67,561	-	67,651
Derivative financial instruments	-	1,097	-	1,097
Financial liabilities	£000	£000	£000	£000
Derivative financial instruments	-	42,101	-	42,101

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities. None of the Groups financial assets of liabilities are valued using this technique.

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 Groups financial assets of liabilities are valued using this technique.

The fair value of derivatives and investment securities 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.

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 market participants at the measurements 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 cashflow 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.

c. Critical accounting estimates and judgements in applying accounting policies

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

(i) Impairment losses on loans and advances

The Group reviews its portfolio of loans to assess potential impairment at least on a quarterly basis

Save for lifetime mortgages (discussed further below), forbearance matters, arrears positions and indexed LTVs are reviewed on all loan accounts in order to identify potential impairment indicators. For all accounts where impairment may have occurred, the recoverability of the balance due at the financial statement date is assessed by reference to the discounted cashflows associated with the loan, which includes periodic interest and capital repayments and a redemption amount, which accommodates sale disposal costs and any first charge re-payment by the borrower. Values at redemption are assessed as follows:

- loans secured on residential property (whether by first or subsequent charge) – property values are assessed by reference to regional HPI data, published by Nationwide Building Society.
- loans secured on land (a category which includes commercial property) – historic valuation data is supplemented with periodic updated desktop, drive-by or full inspection valuation information.

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

The Group holds a beneficial interest in a portfolio of mortgage assets, some of which are regulated by the CCA. The legal title of these loans remains with a third party business, to which the Group provided funding and over which it holds a debenture; owing to this beneficial interest held, these assets are consolidated in the Group balance sheet. During the year the Group identified instances of non-compliance with the CCA. Having taken legal advice, the impact on the loan book has been assessed and included in the estimate of discounted future cashflows that forms the basis of the impairment provision. This has been assessed based on the recent historic cash flow receipts, experience on redemption and using estimates of the likely future redemption dates. The value of the mortgage assets, post impairment provision, is £6.2m of which approximately one third relates to regulated mortgages.

A 5% uplift in cashflows from these mortgage assets, associated with greater levels of recoverability than currently estimated, would result in the provision being reduced from £7.7m to £7.4m whilst a reduction in cashflows would see the provision requirement increase to £8.8m.

It is not clear what regulatory position the FCA will take and there is no judicial certainty in the legal position. The actual result could therefore differ materially from this estimate.

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

(ii) Insurance risk

The Society's Spanish lifetime mortgages total £46.3m. All loans are at rates of interest that are fixed for the duration of the mortgage; at inception, LTVs are low and borrowers are 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. It has been identified that the mortgage contracts contain a clause that behaves like an insurance policy. In the event of death of the borrower (or a move into long term care), if the redemption receipt is less than the contractual sum owed by the account holder, the Society is committed not to pursue the borrower or the estate. This exposes the Society to an insurance risk that the contractual balance on the account at the point of redemption may not be recovered fully. Impairment provisions for such insurance risk eventualities are calculated using: the indexed LTV of the property at the financial statement date, projection data regarding the expected remaining term of the loan and HPI forecast data. The impairment provision is most sensitive to the value of the property at redemption; this is because the redemption date can be 25+ years in the future, where a small change in the HPI assumption in the earlier years can have a notable impact on the assumed property value in the later years. **Spain**: Projection data obtained from external UK sources indicates average long term year-on-year HPI appreciation at 2.9% over a 25 year period. If this rate of house price appreciation were to decrease to average 1.9% per annum, then the insurance provision would increase from its current level of £5.08m to £6.11m; an increase in HPI to 3.9% per annum would see the provision reduce to £2.19m. It should be noted that this is a lower rate of increase than that seen in the periods following the last two recessions, where increases in HPI were seen to average 8% per annum over the 10 years that followed recession. If the latter HPI projections were to be incorporated, the insurance risk impairment provision would reduce by £3.5m. Mortality rates are based on 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 increase by £271k. Pre-payment rates are estimated to be 5%, this is based on experience to date. A 1% decrease in the pre-payment rate would see the insurance risk provision increase to £6.3m, whilst a 1% increase in pre-payment would result in a reduction in the insurance risk provision to £4.1m. **UK**: The provision for the UK lifetime mortgage portfolio has been made on a consistent basis with the above, utilising a UK HPI forecast of 4.5% per annum, from an external source. Sensitivity analysis has not been provided as the mortgage portfolio has been sold by year end, so this is not considered to be beneficial to an understanding of the current year balance sheet.

(iii) Effective Interest Rate ("EIR")

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument, or when appropriate a shorter period, to the net carrying amount of the financial asset or financial liability. Estimates and judgements need to be applied by management in order to determine a suitable EIR. In order to calculate the effective interest rate, the Group needs to estimate cash flows that will arise; to do so, the assessment process includes the consideration of all contractual terms of the financial instrument but it excludes the potential for future credit losses. The EIR calculation includes all fees paid or received, all transaction costs and any other premia or discounts.

(iv) Deferred tax

An asset is recognised to the extent that is it probable that future taxable profits will be available to utilise its carrying value. The most critical element of judgement applied is that relating to the Society's forecast profitability and the certainty of that profitability in the medium term in order to meet the requirements of IAS 12. The profitability forecasts use a modelling application wherein assumptions relating to future interest margin and levels of other income and expense are combined to produce both balance sheet and profit and loss projection data. The assumptions regarding underlying interest margin are consistent with those of previous years and are further supported by the current levels of interest margin being reported. Further details may be found in note 18.

(v) Property, plant and equipment

The Group's land and building, being its head office, is owned by MBS (Property) Limited. The value of this property was tested for impairment by reference to IAS 36 Impairment of Assets. Value in use assessment techniques were used to ascertain the future cashflows of the business. The key assumptions in the assessment are that cashflows would include those arising from Liquid Assets, Loans and Advances, Shares and Deposits and Subordinated Debt, based on the Group's corporate planning forecast data. A discount rate of 12% was applied to these cashflows and the resulting position was compared to the adjusted carrying value of the net assets of the Group. The discount rate used was a post-tax assessment. As a building society is a mutual organisation with no shareholders there are no observable sector specific discount rates. By comparison, the Society's PIBS have a weighted rate of 7.17% and at 31 December 2013 were trading at a yield of 7.83%. The discount rate applied would need to increase to 14.15% before an impairment position would be observed.

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.

2. Restatement

IAS 32 - Financial Instruments: Presentation

Permanent Interest Bearing Shares

The Society has two tranches of Permanent Interest Bearing Shares, issued in 1999 and 2005; each tranche is governed by a separate Offering Circular document. The terms of these documents differ, with those for the 2005 PIBS conferring discretion on the Society's Board to cancel in part or in whole any interest payment due. There is much less discretion on the Board's part to be able to cancel interest on the 1999 PIBS.

In relation to IAS 32 - *Financial Instruments: Presentation*, it is the view of the Board that the 1999 PIBS should be reclassified as a liability as the Board does not have an unconditional right to cancel the interest payment. The terms of these PIBS include a clause that if the Society were to have in issue any other share or deposit account (save for deferred shares) on which the Board could cancel the interest at its discretion, then the 1999 PIBS would qualify to be treated as equity. At both the 2012 and 2013 year end there were no such accounts in issue, but if at future year end such an account type were to exist, then the 1999 PIBS would be re-classified as equity.

The impact of the restatement on the 2012 and earlier years' positions is: subscribed capital within the liabilities heading increased by £5m, subscribed capital within the equity heading reduced by £5m, interest expense increased by £400k, the profit before tax decreased by £400k. There was a credit direct to the statement of changes in equity of £302k, being the tax effected interest adjustment. This is treated as an error in accordance with IAS 8 and gives rise to a restatement of prior period comparatives. Additionally, liabilities at 31 December 2011 increased by £74k (2012: nil) to recognise the accruals basis for the interest on the PIBS as a result off their reclassification from equity. This restatement does not alter the treatment of capital for regulatory purposes, as both tranches of PIBS are treated in the same way within the Group's regulatory capital assessments.

IFRS 4 – Insurance Contracts

Lifetime Mortgage assets

The Society has a portfolio of Spanish Lifetime Mortgage loans secured on residential property. It has been identified that a particular clause of the mortgage contract meets the definition of an insurance contract; where a borrower dies or goes into long term care and a redemption receipt is less than the outstanding balance the Society does not have any further ability to recover amounts from the borrower or the estate. The recognition of a provision based on this insurance risk under IFRS 4 represents a change in accounting treatment. As the insurance provision is akin to a credit risk provision, it has been booked against loans and advances to customers.

The impact of the restatement is: An increase in provisions of £4.2m at 2012 (2011: increase of £3.1m) and an impairment loss of £0.5m in 2012 and reduction in interest and similar income of £0.2m, reflecting an adjustment to profit before tax of £0.7m, and a reduction in income tax of £0.2m and a reduction to 2012 opening retained earnings of £3.1m. This is treated as an error in accordance with IAS 8 and gives rise to a restatement of prior period comparatives.

IFRIC 21 – Levies

Financial Services Compensation Scheme Levy

IFRIC 21 – *Levies* clarifies the treatment of the levy charged by FSCS. The IFRIC indicates that the trigger point for recognising a provision in respect of the FSCS levy moves from 31 December to the following 1 April, being the start of the FSCS levy year. The impact of this is that, at the financial statement date, the Society would not have passed the trigger point for requiring accrual of the following year's levy and accordingly would only be required to hold an accrual for a single year levy; previously, the accounting policy for FSCS levies required the Society to hold the equivalent of two years of the interest levy and one year of the capital levy as prescribed by the FSCS.

Adoption under IFRIC 21 is mandatory for accounting periods beginning on or after 1 January 2014, although early adoption is permitted. The Society has chosen to adopt early the provisions of IFRIC 21, which is treated as a change in accounting policy in accordance with IAS 8 and gives rise to a restatement of prior period comparatives. The impact of the restatement was to reduce provisions for liabilities and charges by £375k for 2012 (2011: £177k), to increase profit before tax by £375k and results in a reclassification of £375k on the Statement of Cashflows between cash payments to employers and suppliers and net (decrease)/increase in liabilities and charges.

The deferred tax asset increased by £76k (2011: £698k) as a result of the combined impact of the tax affected restatements above. The financial impact of all of the above restatements may be seen overleaf.

2. Restatement (continued)

The effect of the restatement in the Income Statements and Balance Sheets is as follows:

Income statement	As Previously Reported 2012 £000	*Restatement* 2012 £000	*Reclassification* 2012 £000	Restated 2012 £000
Interest and similar income	28,775	(183)	(378)	28,214
Interest expense and similar charges	(17,021)	(400)	-	(17,421)
Net interest income	11,754	(583)	(378)	10,793
Fees and commission income	341	-	190	531
Fees and commission expense	(35)	-	-	(35)
Other operating income	23	-	26	49
Other operating charges	(77)	-	-	(77)
Loss from derivatives	(8,277)	-	-	(8,277)
Net gain on financial assets designated at fair value through profit or loss	(1)	-	-	(1)
Total net income	**3,728**	**(583)**	**(162)**	**2,983**
Administrative expenses	(4,587)	-	-	(4,587)
Depreciation	(275)	-	-	(275)
Impairment losses	(503)	(523)	162	(864)
FSCS Levy	(693)	375	-	(318)
Loss on ordinary activity before income tax	(2,330)	(731)	-	(3,061)
Income tax (expense)/credit	(393)	174	-	(219)
Profit/(loss) for this year	**(2,723)**	**(557)**	**-**	**(3,280)**

Reclassifications within the 2012 income statement relate to fees, sundry income and foreign exchange. The largest single reclassification was £289k of arrears and early redemption charges, reclassified from interest and similar income to fees and commission income.

Balance sheet	As Previously Reported 2011 £000	*Movement relating to 2011* *£000*	Restated 2011 £000	As Previously Reported 2012 £000	*Movement relating to earlier yrs* *£000*	*Movement relating to 2012* *£000*	Restated 2012 £000
Assets							
Liquid assets	185,110	-	185,110	142,930	-	-	142,930
Derivative financial instruments	1,953	-	1,953	1,097	-	-	1,097
Loans and advances to customers	613,425	(3,137)	610,288	574,383	(3,137)	(706)	570,540
Investments	250	-	250	250	-	-	250
Property, plant and equipment	8,696	-	8,696	8,477	-	-	8,477
Deferred tax assets	9,270	698	9,968	9,419	698	76	10,193
Other assets	30,988	-	30,988	43,522	-	-	43,522
	849,692	**(2,439)**	**847,253**	**780,078**	**(2,439)**	**(630)**	**777,009**
Liabilities							
Due to members	693,522	-	693,522	617,009	-	-	617,009
Deposits from banks	25,103	-	25,103	22,604	-	-	22,604
Other deposits	49,355	-	49,355	58,973	-	-	58,973
Derivative financial instruments	37,875	-	37,875	42,101	-	-	42,101
Current income tax liabilities	323	-	323	196	-	-	196
Other liabilities	2,837	74	2,911	1,653	74	-	1,727
Provisions for liabilities and charges	483	(177)	306	883	(177)	(375)	331
Subordinated liabilities	15,700	-	15,700	15,700	-	-	15,700
Subscribed capital	-	5,000	5,000	-	5,000	-	5,000
	825,198	**4,897**	**830,095**	**759,119**	**4,897**	**(375)**	**763,641**
Equity							
Retained earnings	9,706	(2,336)	7,370	6,171	(2,336)	(255)	3,580
Subscribed capital	14,788	(5,000)	9,788	14,788	(5,000)	-	9,788
Total equity	**24,494**	**(7,336)**	**17,158**	**20,959**	**(7,336)**	**(255)**	**13,368**
Total equity & liabilities	**849,692**	**(2,439)**	**847,253**	**780,078**	**(2,439)**	**(630)**	**777,009**

Adjustments direct to the statement of changes in equity, not reflected in the above, are a credit of £400k in relation to PIBS interest, a charge of £98k for tax relating to PIBS interest.

3. Interest receivable and similar income

	Group 2013 £000	Group 2012* £000	Society 2013 £000	Society 2012* £000
On loans fully secured on residential property	22,446	23,561	21,586	22,405
On other loans	1,590	1,807	1,590	1,807
On investment securities	1,120	1,993	1,120	1,993
On other liquid assets	821	758	821	758
Disposal of UK lifetime mortgage assets	1,049	-	1,049	-
Sale of investment securities	328	95	328	95
	27,354	**28,214**	**26,494**	**27,058**

The gain arising on disposal of UK lifetime mortgage assets arose in December 2013 when the Society sold these mortgage assets for a sum in excess of their carrying value at that time.

Periodically the Society reviews its investment securities portfolio and occasionally it divests of instruments if deemed appropriate. During 2012, this approach delivered a gain of £95k, the position for 2013 was higher, with a gain of £328k.

Other than £3.3m (2012: £3.1m) generated on loans originating in Spain, all interest receivable and similar income has been generated within the United Kingdom.

*** Restated (see note 2)**

4. Interest payable and similar charges

	Group 2013 £000	Group 2012* £000	Society 2013 £000	Society 2012* £000
On amounts due to members	10,220	14,972	10,220	14,972
On deposits and other borrowings				
Subordinated liabilities	683	719	683	719
Subscribed capital	400	400	400	400
Other	1,644	1,330	1,644	1,330
	12,947	**17,421**	**12,947**	**17,421**

*** Restated (see note 2)**

5. Other operating income and charges

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Income				
Rents receivable	-	23	-	-
Income from subsidiaries	-	-	868	950
Exchange gains and losses	158	26	158	26
Other	64	-	64	-
	222	**49**	**1,090**	**976**
Charges				
Rents payable	51	43	194	189
Other	74	34	11	11
	125	**77**	**205**	**200**

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

6. Loss from derivatives

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Net loss from derivatives	**(329)**	**(8,277)**	**(329)**	**(8,277)**

Included within the above are the swap costs and receipts associated with their normal operation and funding as follows:

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Interest rate swap receipts	578	3,422	578	3,422
Interest rate swap costs	(3,095)	(7,926)	(3,095)	(7,926)
Net	**(2,517)**	**(4,504)**	**(2,517)**	**(4,504)**

During June 2013, the Society exited from all of its interest rate swaps, as it had been identified that they were not effective for IAS 39 hedge accounting purposes. At the time that these breaks were enacted, the fair value of the derivative portfolio was £2.2m in excess of the fair value at 2012 year end; this gain is included within the total net loss from derivatives during the year.

7. Administrative expenses

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Employee costs				
Wages and salaries	2,110	2,188	2,110	2,188
Social security costs	218	233	218	233
Pension costs	171	201	171	201
	2,499	2,622	2,499	2,622
Other administrative expenses	3,190	1,965	2,845	1,721
	5,689	**4,587**	**5,344**	**4,343**

Exceptional re-organisational costs incurred during 2013 (2012: nil) were: £328k included within employee costs, above, and £499k of legal and professional costs included in other administrative expenses, above.

Remuneration of the auditor	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Fees payable to the auditor for the audit of the annual accounts	295	65	295	65
Fees payable to the auditor for other services				
Audit of the accounts of subsidiaries	4	4	-	-
Tax compliance services	20	22	20	18
	319	**91**	**315**	**83**

In addition to the amounts shown above a further £128k was paid to PwC in 2013 for work undertaken prior to their appointment as external auditors. This work was in relation to accountancy consultancy services and review of corporate plans.

8. Employees

The average number of persons employed during the year for continuing operations was:	Group 2013 Number	Group 2012 Number	Society 2013 Number	Society 2012 Number
Full-time	43	65	43	65
Part-time	7	5	7	5
Total	**50**	**70**	**50**	**70**

9. Directors' emoluments

Executive directors	Salary £000	Pension Contributions £000	Benefits £000	Total £000
2013				
D.E. Cowie (retired 5 June 2013)	143	43	7	193
C.W. Gee	117	14	11	142
P.A. Lynch	117	14	11	142
I.M. Richardson (resigned 28 June 2013)	208*	7	5	220
	585	**78**	**34**	**697**
2012				
D.E. Cowie	194	33	17	244
C.W. Gee	117	14	11	142
P.A. Lynch	117	14	11	142
I.M. Richardson	117	14	10	141
	545	**75**	**49**	**669**

*Includes £149k for compensation for loss of office

Following the retirement of David Cowie, the role of Chief Executive officer is held by Allan Hodges on an interim basis. Allan Hodges is not a director of the Society and his services are provided by Lamjam Ltd. The Society entered into the agreement with Lamjam Ltd on 29 April 2013 and paid £175,200 inclusive of VAT during 2013.

Non-executive directors	Fees 2013 £000	Fees 2012 £000
J.P. Allen	29	29
H.F. Baines (appointed 30 August 2013)	10	-
I.A. Dewar (appointed 30 August 2013)	10	-
R.W. Dyson	29	29
A. Finch (resigned 31 December 2013)	29	29
D.A. Harding (appointed 17 April 2013)	51	-
S.M. Molloy (resigned 12 June 2013)	13	29
M.J. Prior (resigned 17 April 2013)	17	50
J. Smith	36	35
	224	201

Non-executive directors	2013 £000	2012 £000
Executive Directors	697	669
Non-Executive Directors	224	201
Total directors' emoluments	**921**	**870**

10. Income tax expense

	Group 2013 £000	Group 2012* £000	Society 2013 £000	Society 2012* £000
Results for the year before tax	(1,576)	(3,061)	(104)	(2,313)
Tax rate	23.25%	24.5%	23.25%	24.5%
Expected tax expense	(366)	(750)	(25)	(566)
Adjustment for non-deductible items	31	43	1,319	17
Reversal of fair value adjustments	-	1,026	-	1,025
Deferred tax on derivative contracts	-	(903)	-	(903)
Current year losses for which no deferred tax asset recognised	1,269	-	-	-
Deferred tax movement closing rate/average rate difference	47	63	(181)	48
Deferred tax change in tax rates on opening balance	1,338	742	1,325	743
Adjustment in respect of prior years - current tax	(554)	(2)	(435)	(3)
- deferred tax	3,752	-	3,642	-
Actual tax expense, net	5,517	219	5,645	361
Comprising				
Current tax expense	-	446	-	349
Current tax adjustment in respect of prior periods	(554)	(2)	(435)	(3)
Deferred tax origination and reversal of timing difference	981	(967)	1,113	(728)
Effect of tax rate change on opening balance	1,338	742	1,325	743
Deferred tax adjustment in respect of prior periods	3,752	-	3,642	-
	5,517	**219**	**5,645**	**361**

*** Restated (see note 2)**

11. Loans and advances to credit institutions

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Accrued interest	31	22	31	22
Repayable on demand	58,282	25,422	58,232	25,372
Other loans and advances by residual maturity repayable:				
More than five years	-	118	-	118
Impairment	-	(570)	-	(570)
	58,313	**24,992**	**58,263**	**24,942**

In 2013 the Society disposed of its remaining impaired exposure to Icelandic banks at a net gain of £348k. Therefore no impairment adjustment is required in 2013.

12. Investment securities

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Government investment securities	-	9,995	-	9,995
Listed private sector investment securities	23,057	57,566	23,057	57,566
	23,057	**67,561**	**23,057**	**67,561**
Investment securities have remaining maturities as follows:				
In not more than three months	-	15,155	-	15,155
In more than three months but not more than one year	17,524	17,947	17,524	17,947
In more than one year but not more than 5 years	5,533	34,459	5,533	34,459
	23,057	**67,561**	**23,057**	**67,561**

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

The movement in investment securities is summarised as follows:

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
At 1 January	67,561	85,236	67,561	85,236
Additions	19,757	65,282	19,757	65,282
Fair value adjustment	(1,134)	(1)	(1,134)	(1)
Disposals	(63,127)	(82,956)	(63,127)	(82,956)
At 31 December	**23,057**	**67,561**	**23,057**	**67,561**

13. Derivative financial instruments and trading liabilities - Group and Society

The Group uses foreign exchange forward contracts and swaps for hedging purposes.

Interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of interest rates (for example, fixed rate for floating rate). 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 on an ongoing basis with reference to the current 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 interest rate yields. The Society exited from all its interest rate swaps in June 2013.

All derivative financial instruments are held for economic purposes.

	Notional Amount £000	Fair Values Assets £000	Fair Values Liabilities £000
Derivatives held as at 31 December 2013			
Interest rate swaps	-	-	-
Exchange rate swaps	48,149	582	620
	48,149	**582**	**620**
Derivatives have remaining maturities as follows:			
Up to 3 months	19,135	242	146
3 to 6 months	6,226	48	101
6 to 12 months	12,411	25	373
1 to 2 years	10,377	267	-
	48,149	**582**	**620**
Derivatives held as at 31 December 2012			
Interest rate swaps	186,189	344	41,756
Exchange rate swaps	46,526	753	345
	232,715	**1,097**	**42,101**

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

14. Loans and advances to customers

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Loans fully secured on residential property	416,480	528,333	408,294	513,795
Loans fully secured on land	35,439	39,486	35,439	39,486
Other loans	2,128	2,721	2,128	2,721
	454,047	**570,540**	**445,861**	**556,002**

At 31 December 2013 the Group had €58.0m (2012: €57.1m) of loans denominated in Euros. These were converted into £ Sterling at a rate of €1.2046 to the £.

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

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Repayable on demand	10,075	9,225	10,075	9,224
Other loans and advances secured by residual maturity repayable:				
In not more than three months	2,603	2,871	2,460	2,728
In more than three months but not more than one year	10,419	13,630	9,990	13,202
In more than one year but not more than five years	74,003	75,902	71,507	73,411
In more than five years	375,166	478,714	362,303	466,224
	472,266	580,342	456,335	564,789
Less: Impairment provisions	(18,219)	(9,802)	(10,474)	(8,787)
	454,047	**570,540**	**445,861**	**556,002**

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.

14. Loans and advances to customers (continued)

As indicated in the Directors' Report (page 6, "impairment losses") the charge for the year included £889k relating to the increase in insurance risk provisions and £6.7m relating to the book of mortgages managed by a third party in which the Society held a beneficial interest.

Impairment losses on loans and advances	Loans fully secured on residential property	Other Loans fully secured on land	Other Loans	Total
Group	**£000**	**£000**	**£000**	**£000**
At 1 January 2013				
Individually identified				
Credit risk provisions	1,387	1,708	81	3,176
Interest provisions	214	158	14	386
Total individually identified	**1,601**	**1,866**	**95**	**3,562**
Collectively identified				
Credit risk provisions	1,948	100	-	2,048
Insurance risk provisions	4,192	-	-	4,192
Total collectively identified	**6,140**	**100**	**-**	**6,240**
Total opening provisions	**7,741**	**1,966**	**95**	**9,802**
Amounts utilised during the year				
Individually identified	(543)	(297)	(35)	(875)
Collectively identified				
Credit risk provisions	-	-	-	-
Insurance risk provisions	-	-	-	-
Total collectively identified	**-**	**-**	**-**	**-**
Statement of Comprehensive Income				
Individually identified	934	960	(50)	1,844
Collectively identified				
Credit risk provisions	6,587	(28)	-	6,559
Insurance risk provisions	889	-	-	889
Total collectively identified	**7,476**	**(28)**	**-**	**7,448**
Total	**8,410**	**932**	**(50)**	**9,292**
At 31 December 2013				
Individually identified	1,992	2,529	10	4,531
Collectively identified				
Credit risk provisions	8,535	72	-	8,607
Insurance risk provisions	5,081	-	-	5,081
Total collectively identified	**13,616**	**72**	**-**	**13,688**
Total	**15,608**	**2,601**	**10**	**18,219**

14. Loans and advances to customers (continued)

Impairment losses on loans and advances	Loans fully secured on residential property	Other Loans fully secured on land	Other Loans	Total
Society	**£000**	**£000**	**£000**	**£000**
At 1 January 2013				
Individually identified				
Credit risk provisions	1,387	1,708	81	3,176
Interest provisions	214	158	14	386
Total individually identified	**1,601**	**1,866**	**95**	**3,562**
Collectively identified				
Credit risk provisions	933	100	-	1,033
Insurance risk provisions	4,192	-	-	4,192
Total collectively identified	**5,125**	**100**	**-**	**5,225**
Total opening provisions	**6,726**	**1,966**	**95**	**8,787**
Amounts utilised during the year				
Individually identified	(542)	(297)	(35)	(874)
Collectively identified				
Credit risk provisions	-	-	-	-
Insurance risk provisions	-	-	-	-
Total collectively identified	**-**	**-**	**-**	**-**
Statement of Comprehensive Income				
Individually identified	934	961	(50)	1,845
Collectively identified				
Credit risk provisions	(145)	(28)	-	(173)
Insurance risk provisions	889	-	-	889
Total collectively identified	**744**	**(28)**	**-**	**716**
Total	**1,678**	**933**	**(50)**	**2,561**
At 31 December 2013				
Individually identified	1,993	2,530	10	4,533
Collectively identified				
Credit risk provisions	788	72	-	860
Insurance risk provisions	5,081	-	-	5,081
Total collectively identified	**5,869**	**72**	**-**	**5,941**
Total	**7,862**	**2,602**	**10**	**10,474**

14. Loans and advances to customers (continued)

Impairment losses on loans and advances	Loans fully secured on residential property*	Other Loans fully secured on land*	Other Loans*	Total*
Group	**£000**	**£000**	**£000**	**£000**
At 1 January 2012				
Individually identified				
Credit risk provisions	1,860	1,589	519	3,968
Interest provisions	214	158	14	386
Total individually identified	**2,074**	**1,747**	**533**	**4,354**
Collectively identified				
Credit risk provisions	1,756	100	-	1,856
Insurance risk provisions	3,032	-	-	3,032
Total collectively identified	**4,788**	**100**	**-**	**4,888**
Total opening provisions	**6,862**	**1,847**	**533**	**9,242**
Amounts utilised during the year				
Individually identified	(455)	-	(352)	(807)
Collectively identified				
Credit risk provisions	-	-	-	-
Insurance risk provisions	-	-	-	-
Total collectively identified	**-**	**-**	**-**	**-**
Statement of Comprehensive Income				
Individually identified	(18)	119	(86)	15
Collectively identified				
Credit risk provisions	192	-	-	192
Insurance risk provisions	1,160	-	-	1,160
Total collectively identified	**1,352**	**-**	**-**	**1,352**
Total	**1,334**	**119**	**(86)**	**1,367**
At 31 December 2012				
Individually identified				
Credit risk provisions	1,387	1,708	81	3,176
Interest provisions	214	158	14	386
Total individually identified	**1,601**	**1,866**	**95**	**3,562**
Collectively identified				
Credit risk provisions	1,948	100	-	2,048
Insurance risk provisions	4,192	-	-	4,192
Total collectively identified	**6,140**	**100**	**-**	**6,240**
Total	**7,741**	**1,966**	**95**	**9,802**

Previously interest provisions have not been included in the impairment losses on loans and advances note. They are now shown in this note as they will now be incorporated within the individually identified credit risk provision.

*** Restated (see note 2)**

14. Loans and advances to customers (continued)

Impairment losses on loans and advances	Loans fully secured on residential property*	Other Loans fully secured on land*	Other Loans*	Total*
Society	£000	£000	£000	£000
At 1 January 2012				
Individually identified				
Credit risk provisions	1,562	1,589	519	3,670
Interest provisions	214	158	14	386
Total individually identified	**1,776**	**1,747**	**533**	**4,056**
Collectively identified				
Credit risk provisions	1,756	100	-	1,856
Insurance risk provisions	3,032	-	-	3,032
Total collectively identified	**4,788**	**100**	**-**	**4,888**
Total opening provisions	**6,564**	**1,847**	**533**	**8,944**
Amounts utilised during the year				
Individually identified	(455)	-	(352)	(807)
Collectively identified				
Credit risk provisions	-	-	-	-
Insurance risk provisions	-	-	-	-
Total collectively identified	**-**	**-**	**-**	**-**
Statement of Comprehensive Income				
Individually identified	280	119	(86)	313
Collectively identified				
Credit risk provisions	(823)	-	-	(823)
Insurance risk provisions	1,160	-	-	1,160
Total collectively identified	**337**	**-**	**-**	**337**
Total	**617**	**119**	**(86)**	**650**
At 31 December 2012				
Individually identified				
Credit risk provisions	1,387	1,708	81	3,176
Interest provisions	214	158	14	386
Total individually identified	**1,601**	**1,866**	**95**	**3,562**
Collectively identified				
Credit risk provisions	933	100	-	1,033
Insurance risk provisions	4,192	-	-	4,192
Total collectively identified	**5,125**	**100**	**-**	**5,225**
Total	**6,726**	**1,966**	**95**	**8,787**

*** Restated (See note 2)**

15. Impairment losses

	Group		Society	
	2013 £000	2012* £000	2013 £000	2012* £000
Impairment losses on loans and advances to customers-on residential property & land (see note 14)	8,403	207	1,672	(510)
-lifetime mortgages (see note 14)	889	1,160	889	1,160
Reversal of Impairment losses on loans and advances to credit institutions	(347)	(430)	(347)	(430)
Write back of mortgage insurance guarantee premiums	(239)	(73)	(239)	(73)
Impairment on loan to subsidiary	-	-	5,671	-
	8,706	**864**	**7,646**	**147**

The reversal of the impairment on loans and advances to credit institutions arose as a result of the Society disposing of its balances with failed Icelandic banking counterparties. The disposal occurred at a value in excess of the written down value.

The charge for 2012 has been restated and increased by £361k. See note 2 for details.

*** Restated (See note 2)**

16. Investments

	Shares	Loans	Total
Investments in subsidiary undertakings - Society	**£000**	**£000**	**£000**
At 1 January 2013	2	24,466	24,468
Impairment	-	(5,671)	(5,671)
Advances	-	53	53
At 31 December 2013	**2**	**18,848**	**18,850**

100% held subsidiary undertakings	Nature of Business	Country of Incorporation
MBS (Mortgages) Limited	Mortgage lending	England
MBS (Property) Limited	Property ownership	England

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

The Society's subsidiary undertakings are wholly funded by the Society. The Society's ability to recover its investment in these subsidiaries is based upon the cashflows that the subsidiaries can generate.

The Group holds a beneficial interest in a portfolio of mortgage assets, some of which are regulated by the CCA. The legal title of these loans remains with a third party business, to which MBS (Mortgages) Ltd provided funding. The Society holds a debenture over these assets. These assets are consolidated in the books of MBS (Mortgages) Ltd and as a result of the re-assessment of the recoverability of these assets (as noted in note 1c), an impairment provision has been booked in the financial statements of MBS (Mortgages) Ltd. This re-assessment impairs the ability of the subsidiary to repay the Society's investment in it, and therefore an impairment provision of £5.7m has been made in the Society's separate financial statements, reducing the net investment in the subsidiary to reflect the recoverability of the assets within the business.

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

Trade Investments - Group and Society	2013 £000	2012 £000
At 1 January	250	250
At 31 December	**250**	**250**

The above trade investment represents a minority share in an unquoted investment for which there is no active market. This investment has been assessed for impairment and is carried at historic cost.

17. Property, plant and equipment

Group	Land and buildings £000	Alterations, fixtures and equipment £000	Total £000
Cost			
As at 1 January 2013	8,538	1,564	10,102
Additions	1	98	99
As at 31 December 2013	**8,539**	**1,662**	**10,201**
Accumulated Depreciation			
As at 1 January 2013	650	975	1,625
Charge for the year	110	108	218
As at 31 December 2013	**760**	**1,083**	**1,843**
Carrying amount			
As at 31 December 2013	7,779	579	8,358
As at 31 December 2012	7,888	589	8,477

Society	Land and buildings £000	Alterations, fixtures and equipment £000	Total £000
Cost			
As at 1 January 2013	-	1,330	1,330
Additions	-	98	98
As at 31 December 2013	**-**	**1,428**	**1,428**
Accumulated Depreciation			
As at 1 January 2013	-	1,177	1,177
Charge for the year	-	79	79
As at 31 December 2013	-	**1,256**	**1,256**
Carrying amount			
As at 31 December 2013	-	172	172
As at 31 December 2012	-	153	153

Freehold land and buildings occupied by the Group and Society for its own activities as at 31 December 2013.	7,779

The Group's land and building, being its head office, is owned by MBS (Property) Limited. The value of this property was tested for impairment by reference to IAS 36 Impairment of Assets. Value in use assessment techniques were used to ascertain the future cashflows of the business. The key assumptions in the assessment are that cashflows would include those arising from Liquid Assets, Loans and Advances, Shares and Deposits and Subordinated Debt, based on the Group's corporate planning forecast data. A discount rate of 12% was applied to these cashflows and the resulting position was compared to the adjusted carrying value of the net assets of the Group. The discount rate used was a post-tax assessment. As a building society is a mutual organisation with no shareholders there are no observable sector specific discount rates. By comparison, the Society's PIBS have a weighted rate of 7.17% and at 31 December 2013 were trading at a yield of 7.83%. The discount rate applied would need to increase to 14.15% before an impairment position would be observed.

17. Property, plant and equipment (continued)

Group	Land and buildings £000	Alterations, fixtures and equipment £000	Total £000
Cost			
As at 1 January 2012	8,538	1,508	10,046
Additions	-	56	56
As at 31 December 2012	**8,538**	**1,564**	**10,102**
Accumulated Depreciation			
As at 1 January 2012	539	811	1,350
Charge for the year	111	164	275
As at 31 December 2012	**650**	**975**	**1,625**
Carrying amount			
As at 31 December 2012	7,888	589	8,477
As at 31 December 2011	7,999	697	8,696

Society	Land and buildings £000	Alterations, fixtures and equipment £000	Total £000
Cost			
As at 1 January 2012	-	1,274	1,274
Additions	-	56	56
As at 31 December 2012	-	**1,330**	**1,330**
Accumulated Depreciation			
As at 1 January 2012	-	1,041	1,041
Charge for the year	-	136	136
As at 31 December 2012	-	**1,177**	**1,177**
Carrying amount			
As at 31 December 2012	-	153	153
As at 31 December 2011	-	233	233

18 Deferred tax assets

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 20.0% (2012: 23.0%). The movement on the deferred income tax account is as follows:

	Group		Society	
	2013 £000	2012* £000	2013 £000	2012* £000
At 1 January	10,193	9,968	9,976	9,991
Statement of comprehensive income	(6,071)	225	(6,080)	(15)
Statement of changes in equity	135	-	135	-
At 31 December	**4,257**	**10,193**	**4,031**	**9,976**

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

	Group 2013 £000	Group 2012* £000	Society 2013 £000	Society 2012* £000
Other provisions	(14)	(26)	(14)	(26)
Provision for loan impairment	-	471	-	238
Accelerated tax depreciation	(5)	16	9	32
Tax losses	1,832	774	1,592	774
Deferred tax asset on timing differences on derivative contracts	2,444	8,958	2,444	8,958
Net deferred tax income tax assets	**4,257**	**10,193**	**4,031**	**9,976**

The movement in the deferred tax account is shown below:

	Group 2013 £000	Group 2012* £000	Society 2013 £000	Society 2012* £000
Other provisions	12	860	12	861
Tax losses	923	(774)	683	(774)
Provision for loan impairment	(471)	7	(238)	(227)
Accelerated tax depreciation	(21)	(2)	(23)	(9)
Deferred tax movement on timing differences on derivative contracts	(6,514)	134	(6,514)	134
Deferred income tax credit/(expense) in: Statement of comprehensive income	(6,071)	225	(6,080)	(15)
Statement of changes in equity	135	-	135	-
Net deferred income tax (expense)/income	**(5,936)**	**225**	**(5,945)**	**(15)**

IAS 12 - *Income Taxes*, requires that a deferred tax asset ("DTA") can only be recognised to the extent that it is probable that it will be recovered through future profitability.

In order to assess the recoverability of its deferred tax asset, the Group prepares financial forecasts over short, medium and long term time horizons so as to determine its likely future profitability. Its annual budgeting and corporate planning processes allow the Board to forecast financial performance over a 3-4 year time horizon.

*** Restated (see note 2)**

For capital planning, the corporate plan is then projected across a 10 year time period using the assumptions that underpin the 3-4 year period.

It is recognised that the further into the future it is necessary to look for sufficient taxable profits (the "look-out" period), the more subjective the projections become. The accounting standard permits the look-out period to be based on the stability and trend in past earnings and on the nature of the business or industry. The Board has been mindful of this when assessing its profitability forecasts, given that it has been a profitable and stable provider of financial services for over 90 years. It could be argued that the probability of taxable profits decreases over time; so there could be a point when taxable profits are no longer probable, however, the Board recognise that the accounting standard does not require there to be an arbitrary cut-off in the time period over which an assessment of expected taxable profits is made (for example, the recoverability test should not be limited using an arbitrary look-out period solely because budget information is not available after a certain number of years).

For 2013 more pessimistic assumptions have been made in relation to the Group's stress - tested profitability forecasts and this has seen the de-recognition of an element of the DTA. It should be noted that the de-recognised element of the DTA is still available for tax relief purposes, as tax losses can be carried forward indefinitely under UK tax rules.

In addition to the recognised deferred taxation assets and liabilities, certain deferred tax assets have not been recognised. At 31 December 2013 for the Group, these were: £3,819k arising from timing differences on derivative contracts (2012:£ nil) and £1,269k arising from losses (2012: £nil). At 31 December 2013 for the Society, these were: £3,819k arising from timing differences on derivative contracts (2012: £nil) and £nil arising from losses (2012: £nil).

19. Other assets

	Group		Society	
	2013	2012	2013	2012
Amounts due within one year	£000	£000	£000	£000
Credit support annex	1,070	42,255	1,070	42,255
Prepayments	432	1,217	420	878
Other assets	31	50	31	50
	1,533	**43,522**	**1,521**	**43,183**

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. The significant reduction in the balance is attributable to the Society exiting from all its interest rate swap derivatives in June 2013.

20. Due to members

	Group		Society	
	2013	2012	2013	2012
	£000	£000	£000	£000
Held by individuals	502,586	617,009	502,586	617,009
Shares are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	1,499	2,703	1,499	2,703
Repayable on demand	333,765	317,256	333,765	317,256
Other shares by residual maturity repayable:				
In not more than three months	164,566	251,788	164,566	251,788
In more than three months but not more than one year	751	24,130	751	24,130
In more than one year but not more than five years	2,005	21,132	2,005	21,132
	502,586	**617,009**	**502,586**	**617,009**

21. Deposits from banks

	Group		Society	
	2013	2012	2013	2012
Amounts owed to credit institutions are repayable from the financial position date in the ordinary course of business as follows:	£000	£000	£000	£000
Accrued interest	43	104	43	104
Other amounts owed to credit institutions by residual maturity repayable:				
In not more than three months	4,000	9,500	4,000	9,500
In more than three months but not more than one year	1,500	13,000	1,500	13,000
	5,543	**22,604**	**5,543**	**22,604**

22. Other deposits

	Group		Society	
	2013	2012	2013	2012
Amounts owed to other deposit customers are repayable from the financial position date in the ordinary course of business as follows:	£000	£000	£000	£000
Accrued interest	534	241	534	241
Repayable on demand	1,447	548	1,447	548
Other amounts owed to other deposit customers by residual maturity repayable:				
In not more than three months	58,592	22,184	58,592	22,184
In more than three months but not more than one year	20,712	21,000	20,712	21,000
In more than one year but not more than five years	10,000	15,000	10,000	15,000
	91,285	**58,973**	**91,285**	**58,973**

£24m nominal value of mortgages is pledged as collateral for £15m of deposits placed by other deposit customers.

23. Subordinated liabilities

		Group and Society	
		2013	2012
Subordinated loans		£000	£000
Loan repayment 2015	(Fixed interest rate of 7.362%)	1,500	1,500
Loan repayable 2022	(Variable interest rate of 3 month LIBOR plus 1.75%)	5,000	5,000
Loan repayable 2023	(Variable interest rate of 3 month LIBOR plus 2.45%)	4,200	4,200
Loan repayable 2032	(Fixed interest rate of 6.70%)	5,000	5,000
		15,700	**15,700**

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.

24. Other liabilities

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Amounts falling due within one year:				
Income tax - deducted from interest payments to customers	447	705	447	705
Taxation and social security	60	75	60	75
Creditors	718	286	445	283
Interest accrued on subordinated liabilities	159	159	159	159
Accruals	841	502	800	463
	2,225	**1,727**	**1,911**	**1,685**

Other liabilities includes interest accrued on PIBS of £75k (2012: £75k) and on subordinated liabilities of £159k (2012: £159k).

25. 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 2013 £000	Group 2012* £000	Society 2013 £000	Society 2012* £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. As such, the 8.00% PIBS are treated as a liability on the part of the Society. This has resulted in the 1999 PIBS issue being restated as debt instead of equity.

Classified as equity	Group 2013 £000	Group 2012* £000	Society 2013 £000	Society 2012* £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.

*** Restated (see note 2)**

26. Cash and cash equivalents

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £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	95,677	50,377	95,677	50,377
Loans and advances to credit institutions	58,282	24,852	58,232	24,802
	153,959	**75,229**	**153,909**	**75,179**

27. Profit Participating Deferred Shares

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Nominal value – proceeds received	18,000	-	18,000	-
less: issue costs	(539)	-	(539)	-
Book value	17,461	-	17,461	-
PPDS Reserve Account at 1 January (memo)	-	-	-	-
Share of loss for the year	(2,290)	-	(1,887)	-
PPDS Reserve Account at 31 December (memo)	(2,290)	-	(1,887)	-

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 Core 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 (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, 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 in years where the Society incurs consolidated post-tax losses or where the PPDS Reserve Account is in deficit as a result of previous years' losses. No dividend has been declared in the year.

28. Related party transactions

Key Management Personnel. The directors, the Chief Executive and the Society Secretary are considered to be the only key management personnel as defined by IAS 24. In line with the Board's continuing policy, there were no loans provided to any of these individuals or their close family members (2012: nil). None of the directors, or their close family members held any of the Society's PIBS (2012: nil).

The total remuneration of key management personnel was as follows:

	Group 2013 **£000**	Group 2012 **£000**
Executive directors (per note 9)	697*	669
Non-executive directors (per note 9)	224	201
Chief Executive (Allan Hodges - appointed 29 April 2013)	175	-
Society Secretary (Graeme Honeyborne - appointed 13 November 2013)	20	-
Total	**1,116**	**870**

*includes £149k compensation for loss of office for one executive director

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. Mrs. S. M. Molloy, who resigned on 12 June 2013 is a partner in Gateley LLP who provide legal services to the Group. In 2013 Gateley LLP have been paid £65,288 inclusive of VAT for legal services rendered.

Subsidiaries. The Group is controlled by Manchester Building Society; details of the subsidiary undertakings may be found in note 16.

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

As at 31 December	Society 2013 £000	Society 2012 £000
(i) Current loan accounts - unsecured		
As at 1 January	24,466	25,016
Loans issued during the year	1,335	1,653
Loan repayments during the year	(1,282)	(2,203)
Impairment in subsidiary	(5,671)	-
As at 31 December	**18,848**	**24,466**
(ii) Interest income charged to subsidiaries	868	950
Interest is charged at pre-agreed rates which are either fixed, track the Bank of England base rate, or track LIBOR rates.		
(iii) Society recharge to subsidiaries of head office expenses	16	18
(iv) Subsidiary recharge to Society on rent for head office	143	143

29. Financial commitments

	Group 2013 £000	Group 2012 £000	Society 2013 £000	Society 2012 £000
Capital expenditure contracted for but not provided	5	188	5	188

(ii) Lease commitments

At the financial position date, the Group had outstanding commitments as lessee under operating leases. The financial commitments are shown below.

	Lessee 2013 £000	Lessee 2012 £000
Less than 1 year	50	50
1 to 5 years	142	192
Total	**192**	**242**

(iii) Contingent liabilities

The Group does not have any other contingent liabilities.

30. 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.

	Group 2013 £000	Group 2012* £000
Tier 1 Capital		
Retained earnings	(1,374)	5,611
PPDS	17,461	-
PIBS	14,788	14,788
Total	30,875	20,399
Tier 2 Capital		
Subordinated debt	14,500	14,800
Collectively identified provisions	13,688	1,364
Total	28,188	16,164
Total Basel II regulatory capital	59,063	36,563

Since the start of 2013, notable movements in capital have arisen from:

	£000
Opening position at 1 January 2013 (as previously reported)	39,154
Reduction in reserves arising from restating 2012 and earlier years	(2,591)
Opening position at 1 January 2013 (restated)	36,563
Issuance of new PPDS	17,461
Movements in Tier 2 capital	12,024
Reduction in retained earning arising from current year trading	(6,985)
Closing position at 31 December 2013	59,063

Concurrent with the approval of the 2012 financial statements, £18m of new capital was issued in April 2013 in the form of PPDS. These instruments, issued and subscribed at par, are classified as equity within the Financial Statements and included as Core Tier 1 capital for regulatory purposes. The figure disclosed is the proceeds received less the costs of issue.

The Board is focused on further actions to reduce risk and rebuild reserves, as demonstrated by the sale of the UK lifetime mortgage portfolio. The 31 December 2013 capital position reflects the actions taken by the Board, along with the impact of the accounting adjustments and impairments booked in these 2013 accounts.

From 1 January 2014 the extent to which remunerated capital instruments may be included within regulatory capital is set to change, as a result of the implementation of Basel III. For the Group, the impact is that certain elements that are currently included within its regulatory capital, being PIBS and certain tranches of subordinated debt, will amortise over a 10 year period. Additionally, deferred tax assets arising from losses are deducted from regulatory capital; deferred tax assets arising from timing differences may continue to be classified within regulatory capital subject to certain regulatory criteria. The Society's assessment is that its regulatory capital on 1 January 2014 would be £42m. The Society has assessed the impact of this future amortisation of instruments and is satisfied that it will continue to meet its regulatory requirements without the need to issue further capital instruments.

* Restated (see note 2)

31. Provisions for liabilities and charges

Financial Services Compensation Scheme	Group 2013 £000	Group 2012* £000	Society 2013 £000	Society 2012* £000
At 1 January	331	306	331	306
Charge for the year	489	318	489	318
Provisions utilised	(545)	(293)	(545)	(293)
At 31 December	275	331	275	331

* Restated (see note 2)

The Society's provision for FSCS charges arises from its operation as a UK deposit taker. In previous years, it had been expected that repayment of the FSCS' borrowings from HM Treasury would arise from amounts recovered from the failed institutions, whilst the interest cost of such borrowings would be passed on to all deposit-taking institutions covered by the FSCS in the form of a management expenses levy. During 2013 this position changed, as the FSCS announced that there was likely to be a shortfall in their overall level of recoverability; it indicated that it would levy this shortfall on deposit-taking institutions over the next three years. The provision at the end of 2013 includes the expected management expenses levy for the FSCS scheme year 2013/2014. The shortfall capital levy for the FSCS scheme year 2012/2013, was received during 2013 and recognised as a charge in the Statement of Comprehensive Income for 2013. No provision is made for scheme years beyond these periods. The levy is paid during Q3 each year and the Society does not expect to recover any sums paid. The Society has adopted early the provisions of IFRIC 21, further details of which may be found in notes 1 and 2.

ANNUAL BUSINESS STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2013

1. Statutory limits	2013 %	Statutory % limit
Lending limit	9.84	25.0
Funding limit	16.15	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 accounts.

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.

2. Other ratios

	2013 %	2012 %
As a percentage of shares and borrowings:		
Gross capital	7.3	4.9
Free capital	8.2	4.6
Liquid assets	29.5	20.5
As a percentage of mean total assets:		
Profit after taxation	(1.00)	(0.40)
Group management expenses	0.83	0.60
Society management expenses	0.76	0.55

The above percentages have been prepared from the Group accounts 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 general 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.

'Management expenses' represent the aggregate of administrative expenses and depreciation taken from the Group/Society statement of comprehensive income.

3. Information relating to the directors and officers as at 31 December 2013

Name	Date of birth	Date of appointment	Occupation	Other directorships
Directors				
J.P. Allen	3.6.1953	Nov 2009	Consultant	Emerson Developments (Holdings) Ltd. J & JA Associates Ltd. Jones Homes Ltd. Pallet-Track Ltd.
H.F. Baines	12.3.1957	Aug 2013	Consultant	HBOS Final Salary Trust Ltd. Halifax Pension Nominees Ltd.
I.A. Dewar	14.9.1957	Aug 2013	Chartered Accountant	Brewin Dolphin Holdings plc
R.W. Dyson	10.1.1949	Jul 2008	Chartered Surveyor	Terrace Hill Group plc. Barncabin Ltd.
C.W. Gee	22.6.1968	Jan 2005	Building Society Executive	MBS (Property) Ltd. MBS (Mortgages) Ltd.
D.A. Harding	29.7.1947	Apr 2013	Company Director	The Royal Mint Ltd.
P.A. Lynch	31.8.1969	Apr 2002	Building Society Executive	MBS (Property) Ltd. MBS (Mortgages) Ltd.
J. Smith	5.12.1950	May 2006	Certified Accountant	Rubicon West plc. JJF Services Ltd. Bright Tribe Trust Ltd Bright Tribe Educational Services Ltd Adventure Learning Academy Trust.

Executive Directors	Position	Date of signing service contract
C.W. Gee	Finance Director	7.12.2004
P.A. Lynch	Operations Director	3.4.2002

Each of the executive directors have employment contracts which are terminable by the Society by giving 12 months notice. The executive directors are required to give 6 months notice to the Society to terminate their contract.

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

NOTES

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